# SECURITIES AND EXCHANGE COMMISSION

**WASHINGTON, D.C. 20549**

# Form 20 – F

**[ ] Registration Statement pursuant to Section 12 (b) or (g) of The Securities Exchange Act of 1934**

**or**

**[x] Annual report pursuant to Section 13 or 15 (d) of The Securities Exchange Act of 1934 for the fiscal year ended December 31, 2000**

**or**

**[ ] Transition report pursuant to Section 13 or 15 (d) of The Securities Exchange Act of 1934**

**Commission file number 1–15094**

# MOBILE TELESYSTEMS OJSC

**(Exact name of Registrant as specified in its charter)**

**RUSSIAN FEDERATION**

**(Jurisdiction of incorporation or organization)**

**4 Marksistskaya Street, Moscow 109147 Russian Federation**

**(Address of Principal Executive Offices)**

Securities registered or to be registered pursuant to Section 12(b) of the Act:

**NONE**

**(Title of Class)**

Securities registered or to be registered pursuant to Section 12(g) of the Act:

| Title of Each Class | Name of Each Exchange on Which Registered |
|---|---|
| AMERICAN DEPOSITARY SHARES, EACH REPRESENTING 20 ORDINARY SHARES, PAR VALUE 0.10 RUSSIAN RUBLES PER ORDINARY SHARE | NEW YORK STOCK EXCHANGE |

Securities for which there is a reporting obligation pursuant to Section 15(d) of the Act:

**NONE**

**(Title of Class)**

Indicate the number of outstanding shares of each of the issuer's classes of capital or common stock as of the close of the period covered by the annual report.

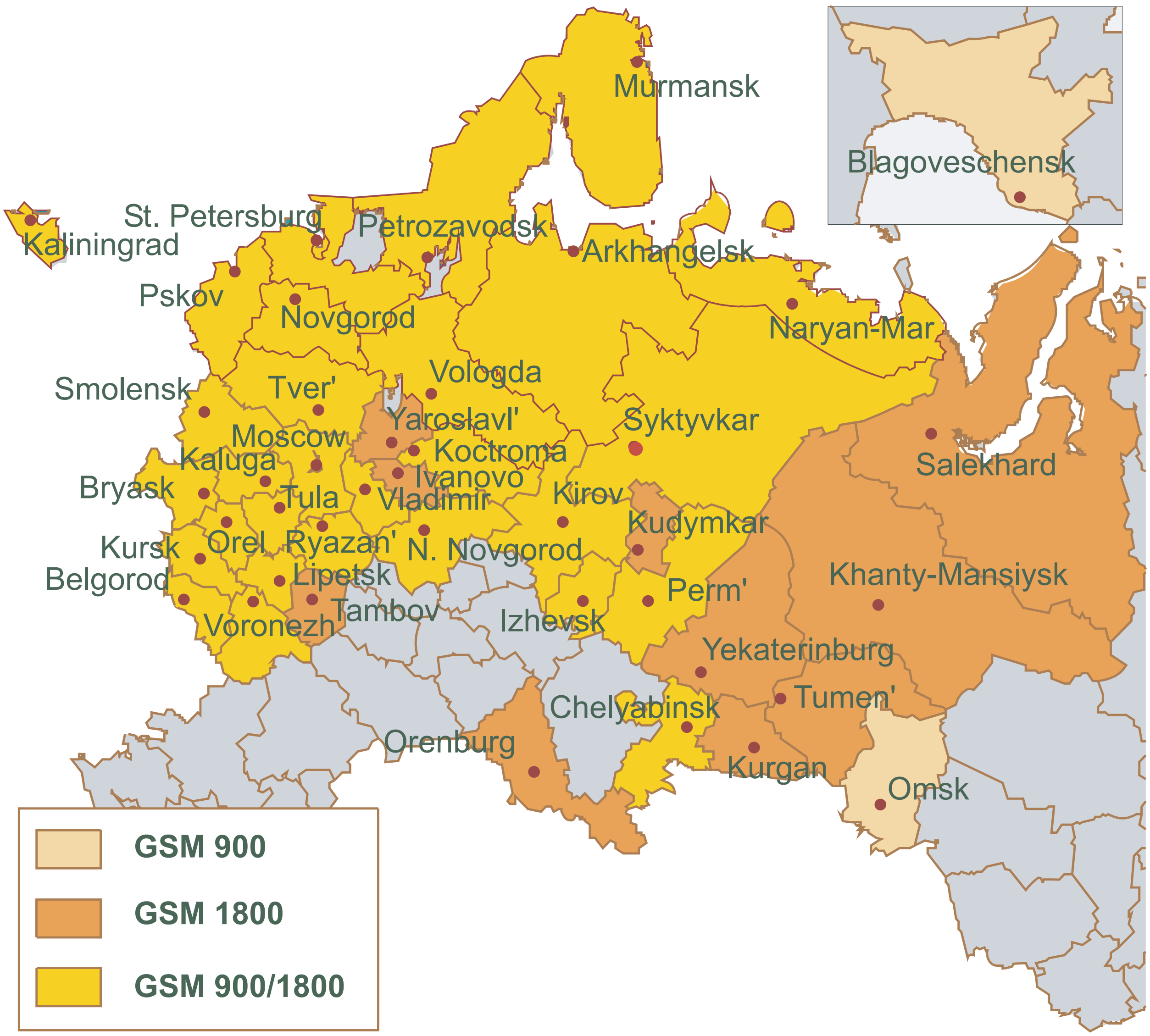
1,993,326,150 ordinary shares, par value 0.10 Russian rubles each, as of December 31, 2000

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes: [X] No.: [ ]

Indicate by check mark which financial statement item the Registrant has elected to follow:

Item 17 [ ] Item 18 [X]



Murmansk
Blagoveschensk
St. Petersburg
Kaliningrad
Petrozavodsk
Arkhangelsk
Pskov
Novgorod
Naryan-Mar
Smolensk
Tver'
Vologda
Yaroslavl'
Syktyvkar
Moscow
Koctroma
Kaluga
Salekhard
Ivanovo
Bryask
Tula
Vladimir
Kirov
Kudymkar
Kursk
Orel
Ryazan'
N. Novgorod
Khanty-Mansiysk
Belgorod
Lipetsk
Perm'
Tambov
Voronezh
Izhevsk
Yekaterinburg
Tumen'
Chelyabinsk
Orenburg
Kurgan
Omsk
GSM 900
GSM 1800
GSM 900/1800

## CAUTIONARY STATEMENT REGARDING FORWARD-LOOKING STATEMENTS

Matters discussed in this document may constitute forward-looking statements. The Private Securities Litigation Reform Act of 1995 provides safe harbor protections for forward-looking statements in order to encourage companies to provide prospective information about their businesses. Forward-looking statements include statements concerning plans, objectives, goals, strategies, future events or performance, and underlying assumptions and other statements, which are other than statements of historical facts.

Mobile TeleSystems OJSC, or MTS, desires to take advantage of the safe harbor provisions of the Private Securities Litigation Reform Act of 1995 and is including this cautionary statement in connection with this safe harbor legislation. This document and any other written or oral statements made by us or on our behalf may include forward-looking statements, which reflect our current views with respect to future events and financial performance. The words "believe," "expect," "anticipate," "intends," "estimate," "forecast", "project" and similar expressions identify forward-looking statements.

The forward-looking statements in this document are based upon various assumptions, many of which are based, in turn, upon further assumptions, including without limitation, management's examination of historical operating trends, data contained in our records and other data available from third parties. Although we believe that these assumptions were reasonable when made, because these assumptions are inherently subject to significant uncertainties and contingencies which are difficult or impossible to predict and are beyond our control, we cannot assure you that we will achieve or accomplish these expectations, beliefs or projections. In addition to these important factors and matters discussed elsewhere herein and in the documents incorporated by reference herein, important factors that, in our view, could cause actual results to differ materially from those discussed in the forward-looking statements including the achievement of the anticipated levels of profitability, growth, cost and synergy of our recent acquisitions, the timely development and acceptance of new products, the impact of competitive pricing, the ability to obtain necessary regulatory approvals, the impact of general business and global economic conditions and other important factors described from time to time in the reports filed by MTS with the Securities and Exchange Commission.

Except to the extent required by law, neither MTS, nor any of its respective agents, employees or advisors intends or has any duty or obligation to supplement, amend, update or revise any of the forward-looking statements contained or incorporated by reference in this document.

## CURRENCIES AND EXCHANGE RATES

In this annual report, references to "US dollars" or "$" are to the currency of the United States, and references to "rubles" are to the currency of the Russian Federation.

## PART I

**Item 1.** ***Identity of Directors, Senior Management and Advisors***

Not applicable.

**Item 2.** ***Offer Statistics and Expected Timetable***

Not applicable.

**Item 3.** ***Key Information***

**A. Selected Financial Data**

The selected financial data below shows our historical financial information at December 31, 1996, 1997, 1998, 1999 and 2000 and for the years then ended. This information is derived from our audited financial statements.

The selected financial data should be read in conjunction with the Consolidated Financial Statements and "Operating and financial review and prospects" included in this document.

| | Years Ended December 31, | | | | |
|---|---|---|---|---|---|
| | **1996** | **1997** | **1998** | **1999** | **2000** |
| | *(Amounts in thousands, except per share amounts)* | | | | |
| **Statement of Operations Data:** | | | | | |
| **Net revenues:** | | | | | |
| Service revenues (1) | $44,963 | $188,223 | $313,282 | $314,568 | $ 484,469 |
| Connection fees ............ | 1,449 | 4,750 | 8,697 | 12,755 | 14,885 |
| Equipment sales............. | 7,233 | 15,435 | 16,344 | 31,004 | 36,358 |
| Total net revenues ...... | 53,645 | 208,408 | 338,323 | 358,327 | 535,712 |
| **Cost of services and products** | | | | | |
| Interconnection and line rental | 9,588 | 25,864 | 43,617 | 38,958 | 41,915 |
| Roaming expenses......... | 951 | 7,542 | 13,223 | 21,725 | 41,178 |
| Cost of equipment ......... | 6,710 | 15,537 | 14,658 | 29,932 | 39,217 |
| Cost of services and products ...................... | 17,249 | 48,943 | 71,498 | 90,615 | 122,310 |
| Operating expenses (2).... | 11,639 | 28,273 | 54,641 | 66,606 | 107,839 |
| Sales and marketing expenses | 3,449 | 9,554 | 15,657 | 23,722 | 76,429 |
| Provision for doubtful accounts | 3,122 | 13,000 | 12,829 | 8,006 | 2,403 |
| Depreciation and amortization | 7,658 | 14,757 | 19,629 | 53,766 | 87,684 |
| Net operating income .... | 10,528 | 93,881 | 164,069 | 115,612 | 139,047 |

| | | | | | |
|---|---|---|---|---|---|
| Currency exchange and translation loss (gain) (3). | 515 | 1,389 | 25,125 | 3,238 | 1,066 |
| **Other expenses (income):** | | | | | |
| Interest income ............. | — | (1,086) | (2,181) | (801) | (7,626) |
| Interest expenses, net of amounts capitalized......... | 1,347 | 756 | 8,302 | 11,805 | 11,335 |
| Loss on other assets....... | — | — | 2,775 | 847 | — |
| Other expense (income) | — | 3,773 | 2,063 | (1,676) | (502) |
| Total other expenses, net | 1,347 | 3,443 | 10,959 | 10,175 | 3,207 |
| Income before provision for income taxes and minority interest | 8,666 | 89,049 | 127,985 | 102,199 | 134,774 |
| **Provision for income taxes** | 3,862 | 29,409 | 62,984 | 18,829 | 51,154 |
| **Minority interest in net income (loss)**…… | — | — | (1,027) | (2,291) | (6,428) |
| **Net income (loss)............** | $4,804 | $59,640 | $66,028 | $85,661 | $ 90,048 |
| Basic and diluted earnings (loss) per share ................ | $0.004 | $0.049 | $0.047 | $0.052 | $0.050 |
| Cash dividends per common share | — | $0.02 | $0.04 | $0.18 | $0.22 |
| Weighted average common shares outstanding........... | 1,225,896 | 1,225,896 | 1,397,946 | 1,634,527 | 1,806,968 |
| **Other Data:** | | | | | |
| EBITDA (4)(5) (unaudited) | $17,671 | $103,476 | $154,762 | $169,260 | $ 232,595 |
| EBITDA margin (6) (unaudited) | 32.9% | 49.7% | 45.7% | 47.2% | 43.42% |
| Cash provided (used) by operating activities (5) | 12,066 | 90,523 | 103,486 | 116,801 | 190,914 |
| Cash provided (used) by financing activities .......... | 25,222 | 28,253 | (9,624) | (11,557) | 298,543 |
| Cash used in investing activities | (34,422) | (71,351) | (122,051) | (115,184) | (423,349) |
| Capital expenditures........ | 34,422 | 71,351 | 103,132 | 118,338 | 224,898 |

| | As of December 31, | | | | |
|---|---|---|---|---|---|
| | **1996** | **1997** | **1998** | **1999** | **2000** |
| **Balance Sheet Data:** | | | | | |
| Cash and cash equivalents | $5,239 | $52,664 | $20,884 | $10,000 | $ 75,828 |
| Short-term investments .. | – | — | – | – | 170,000 |
| Total assets...................... | 97,419 | 252,519 | 614,165 | 682,047 | 1,101,332 |
| Total debt, including current portion (7)....................... | 15,195 | 48,061 | 110,155 | 112,123 | 47,305 |
| Total liabilities ................ | 46,815 | 139,239 | 315,674 | 312,065 | 300,248 |
| Total shareholders' equity: | 50,604 | 113,280 | 269,942 | 343,724 | 801,084 |
| including capital stock | 41,905 | 46,800 | 49,276 | 49,276 | 40,352 |

(1) Service revenues represent subscription fees, usage charges and value-added service fees, as well as roaming fees charged to other operators for their subscribers, or guest roamers, utilizing our network. Guest roaming fees were $8,675, $38,858, $56,516, $44,048, and $43,214 for each of the five years ended December 31, 2000, respectively.
(2) Operating expenses include taxes (other than Russian income taxes), primarily revenue and property-based taxes, of $3.6 million in the year ended December 31, 1996, $8.9 million in the year ended December 31, 1997, $16.5 million in the year ended December 31, 1998, and $15.6 million in the year ended December 31, 1999; and $26.9 million in the year ended December 31, 2000.
(3) On a day-to-day basis, we are exposed to exchange losses on cash balances and other monetary assets and liabilities denominated in rubles. See Note 2 to our consolidated financial statements included elsewhere in this document.
(4) EBITDA, which represents income before provision for income taxes, interest, depreciation and amortization, should not be considered in isolation as an alternative to net income, operating income or any other measure of performance under U.S. GAAP. We believe that EBITDA is a relevant measurement utilized by the cellular industry to assess performance which attempts to eliminate variances caused by the effects of differences in taxation, the amount and types of capital employed and depreciation and amortization policies.
(5) Certain debt agreements to which we are a party restrict our formation of subsidiaries and affiliates, changes to charter capital, development of regional operating licenses, and payments of dividends, among other things. Accordingly, management's utilization of funds depicted by EBITDA and cash flows from operating activities is restricted by lender approvals which may be required
(6) "EBITDA margin" represents EBITDA as a percentage of net revenues.
(7) Includes bank loans and equipment financing.

## B. Capitalization and Indebtedness

Not applicable.

## C. Reasons for the Offer and Use of Proceeds

Not applicable.

## D. Risk Factors

*An investment in our ADSs involves a high degree of risk. You should carefully consider the following information about these risks, together with the information contained in this document, before you decide to buy our ADSs. If any of the following risks actually occurs, our business, financial condition or results of operations could be adversely affected. In that case, the trading price of our ADSs could decline and you could lose all or part of your investment.*

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

### Risks Relating to the Russian Federation

#### *Political Risks*

Since 1991, Russia has sought to transform itself from a one-party state with a centrally-planned economy to a pluralist democracy with a market-oriented economy. As a result of the sweeping nature of the reforms, and the failure of some of them, the Russian political system remains vulnerable to popular dissatisfaction, as well as to unrest by particular social and ethnic groups. Significant political instability could have a material adverse effect on the value of foreign investments in Russia, including the value of our ADSs.

***Governmental instability could adversely affect the value of investments in Russia and the value of our ADSs.***

The composition of the Russian government—the prime minister and the other heads of federal ministries—has at times been highly unstable. Six different prime ministers, for example, headed governments between March 1998 and May 2000. On December 31, 1999, President Yeltsin unexpectedly resigned and Vladimir Putin was subsequently elected president on March 26, 2000. While President Putin has maintained governmental stability and the general direction of reform, he may adopt a different approach over time. The value of investments in Russia and our ADSs could be reduced and our prospects could be harmed if governmental instability recurs or if reform policies are reversed.

***Conflict between central and regional authorities and other conflicts could create an uncertain operating environment that would hinder our long-term planning ability and could negatively affect the value of investments in Russia.***

The Russian Federation is a federation of republics, territories, regions, cities of federal importance and autonomous areas, all of which are equal members of the Russian Federation. The delineation of authority among the members of the Russian Federation and the federal governmental authorities is, in many instances, uncertain and sometimes contested. Lack of consensus between the federal government and local or regional authorities often results in the enactment of conflicting legislation at various levels and may result in political instability. This lack of consensus hinders our long-term planning efforts and creates uncertainties in our operating environment, both of which may prevent us from efficiently carrying out our expansion plans.

Additionally, ethnic, religious, historical and other divisions have, on occasion, given rise to tensions, and in certain cases, to military conflict. Russian military forces have been engaged in Chechnya in the past and are currently involved in major ground and air operations there. The spread of violence, or its intensification, could have significant political consequences. These include the imposition of a state of emergency in some or all of the Russian Federation. These events could materially adversely affect the value of investments in Russia, including in the value of our ADSs.

***Economic Risks***

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

Since the dissolution of the Soviet Union, the Russian economy has experienced:

- significant declines in gross domestic product;
- hyperinflation;
- an unstable currency;
- high government debt relative to gross domestic product;
- a weak banking system providing limited liquidity to Russian enterprises;

- high levels of loss-making enterprises that continued to operate due to the lack of effective bankruptcy proceedings;
- significant use of barter transactions and illiquid promissory notes to settle commercial transactions;
- widespread tax evasion;
- growth of a black and gray market economy;
- pervasive capital flight;
- high levels of corruption and the penetration of organized crime into the economy;
- significant increases in unemployment and underemployment; and
- the impoverishment of a large portion of the Russian population.

The Russian economy has been subject to abrupt downturns. In particular, on August 17, 1998, in the face of a rapidly deteriorating economic situation, the Russian government defaulted on its ruble-denominated securities, the Central Bank stopped its support of the ruble and a temporary moratorium was imposed on certain hard currency payments. These actions resulted in an immediate and severe devaluation of the ruble and a sharp increase in the rate of inflation; a dramatic decline in the prices of Russian debt and equity securities; and an inability of Russian issuers to raise funds in the international capital markets.

There can be no assurance that recent trends in the Russian economy—such as the increase in the gross domestic product, a relatively stable ruble, and a reduced rate of inflation—will continue or will not be abruptly reversed. Moreover, the recent decline in international oil and gas prices, the strengthening of the ruble in real terms relative to the U.S. dollar and the consequences of a relaxation in monetary policy, or other factors, could adversely affect Russia's economy and our business in the future.

***Failure by the Russian government to maintain access to funding from the International Monetary Fund or to restore access to the international capital markets could have a material adverse effect on the value of our ADSs.***

Russia in the past has received substantial funding from several foreign governments and international organizations, including the International Monetary Fund or IMF. After the events of August 17, 1998, the IMF ceased lending to Russia, and we cannot assure you that any further IMF loans will be provided to Russia. Furthermore, in January 2001, the Russian government did not make when due certain payments of rescheduled Soviet debt to the Paris Club of sovereign creditors. If no IMF financing is made available or if no agreement is reached with the Paris Club, the Russian government may not receive further financial support from other international organizations and foreign governments and may not be able to repay its debts. This is forecast to be a particular concern in 2003, when a significant increase will occur in the amount due to be repaid by the Russian government. Moreover, the Russian government has not raised financing on the international capital markets since June 1998, and it may not be able to do so in the foreseeable future.

The failure of the Russian government to obtain IMF or other international funding, or to gain access to the international capital markets, could lead to direct or indirect monetary financing of any future budget deficit, putting further pressure on inflation and the value of the ruble, which in turn could materially and adversely affect our business and the value of foreign investments in Russia, including our ADSs.

***Limited liquidity in the Russian economy could materially adversely affect our operations and financial performance, our ability to withdraw our bank deposits and the ability of our customers to pay amounts due.***

Russian companies face significant liquidity problems, due to tight money supply in Russia, high taxes, limited lending by the banking sector to the commercial sector and other factors. As a result, there is a significant problem of payment arrears in the Russian economy. Many companies cannot make timely payments for goods or services and owe large amounts of overdue federal and local taxes, as well as wages to employees. Many companies have also resorted to paying their debts or accepting settlement of accounts receivable through barter arrangements or through the use of promissory notes.

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

An intensification of liquidity problems or a further deterioration of the Russian banking system could materially adversely affect our operations and financial performance, our ability to withdraw our bank deposits and the ability of our customers to pay amounts due.

***Russia's physical infrastructure is in very poor condition, which could disrupt normal business activity.***

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

The deterioration of Russia's physical infrastructure harms the national economy, disrupts the transportation of goods and supplies, adds costs to doing business in Russia and can interrupt business operations, and this could have a material adverse effect on our business and the value of our ADSs.

***Fluctuations in the global economy may adversely affect Russia's economy and our business.***

Russia's economy is vulnerable to market downturns and economic slowdowns elsewhere in the world. As has happened in the past, financial problems or an increase in the perceived risks associated with investing in emerging economies could dampen foreign investment in Russia and adversely affect the Russian economy. Additionally, because Russia produces and exports large amounts of oil, the Russian economy is especially vulnerable to the price of oil on the world market and a decline in the price of oil could slow or disrupt the Russian economy. These developments could severely limit our access to capital and could adversely affect the purchasing power of our customers and thus our business.

***Social Risks***

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

The political and economic changes in Russia in recent years have resulted in significant dislocations of authority. The local and international press have reported that significant organized criminal activity has arisen, particularly in large metropolitan centers. Property crime in large cities has increased substantially. In addition, the local press and international press have reported high levels of official corruption in the locations where we conduct our business. The depredations of organized or other crime, demands of corrupt officials or claims that we have been involved in official corruption may in the future bring negative publicity, could disrupt our ability to conduct our business effectively, and could thus materially adversely affect the value of our ADSs.

***Social instability could increase support for renewed centralized authority, nationalism or violence and thus materially adversely affect our ability to conduct our business effectively.***

The failure of the government and many private enterprises to pay full salaries on a regular basis and the failure of salaries and benefits generally to keep pace with the rapidly increasing cost of living have led in the past, and could lead in the future, to labor and social unrest. For example, in 1998, miners in several regions of Russia, demanding payment of overdue wages, resorted to strikes which included blocking major railroads. Such labor and social unrest may have political, social and economic consequences, such as increased support for a renewal of centralized authority; increased nationalism, with restrictions on foreign involvement in the economy of Russia; and increased violence. Any of these could restrict our operations and lead to the loss of revenue, materially adversely affecting us.

***Risks Relating to the Russian Legal System and Russian Legislation***

***Weaknesses relating to the Russian legal system and Russian legislation create an uncertain environment for investment and for business activity and thus could have a material adverse effect on an investment in our ADSs.***

Risks associated with the Russian legal system include:

- inconsistencies between and among laws, Presidential decrees, and Russian governmental, ministerial and local orders, decisions, resolutions and other acts;
- conflicting local, regional and federal rules and regulations;
- the lack of judicial and administrative guidance on interpreting Russian legislation;
- the relative inexperience of judges and courts in interpreting Russian legislation; and
- a high degree of discretion on the part of governmental authorities.

Additionally, several fundamental Russian laws have only recently become effective. The recent nature of much of Russian legislation, the lack of consensus about the scope, content and pace of economic and political reform and the rapid evolution of the Russian legal system in ways that may not always coincide with market developments place the enforceability and underlying constitutionality of laws in doubt and results in ambiguities, inconsistencies and anomalies. In addition, Russian legislation often contemplates implementing regulations that have not yet been promulgated, leaving substantial gaps in the regulatory infrastructure. All of these weaknesses could affect our ability to enforce our rights under our licenses and under our contracts, or to defend ourselves against claims by others.

***Lack of independence and inexperience of the judiciary and the difficulty of enforcing court decisions and governmental discretion in instigating, joining and enforcing claims could prevent us or you from obtaining effective redress in a court proceeding, materially adversely affecting an investment in our ADSs.***

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

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

***Delay in the registration of the shares of MTS CJSC could be exploited in claims against us in courts, especially those subject to political or other inappropriate influence, potentially resulting in the invalidation of corporate or shareholder actions, including the issuance and placement of the shares underlying the ADSs.***

As described in "Description of Capital Stock—Issues Relating to Shares of MTS CJSC", there was a delay in the registration of shares of MTS CJSC. While we believe we have adequate defenses if any claims or demands are made against us, the lack of independence of the judiciary and its susceptibility to political and other inappropriate influence, as discussed in the risk factor immediately above, creates an environment in which we may be prevented from defending our position on purely legal grounds. In the event that political or other inappropriate influence were successfully exerted, our corporate or shareholder actions, including the issuance and placement of the shares underlying the ADSs, could be invalidated. If the issuance and placement is declared invalid and upheld, the underlying shares would be cancelled and we would be required by Russian law to return the proceeds received from the placement.

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

The Civil Code and the Federal Law on Joint Stock Companies generally provide that shareholders in a Russian joint stock company are not liable for the obligations of the joint stock company and bear only the risk of loss of their investment. This may not be the case, however, when one company is capable of determining decisions made by another company. The company capable of determining such decisions is called an effective parent. The company whose decisions are capable of being so determined is called an effective subsidiary. The effective parent bears joint and several responsibility for transactions concluded by the effective subsidiary in carrying out these decisions if

- this decision-making capability is provided for in the charter of the effective subsidiary or in a contract between the companies, and
- the effective parent gives obligatory directions to the effective subsidiary.

In addition, an effective parent is secondarily liable for an effective subsidiary's debts if an effective subsidiary becomes insolvent or bankrupt resulting from the action or inaction of an effective parent. This is the case no matter how the effective parent's capability to determine decisions of the effective subsidiary arises. For example, this liability could arise through ownership of voting securities or by contract. In these instances, other shareholders of the effective subsidiary may claim compensation for the effective subsidiary's losses from the effective parent which caused the effective subsidiary to take action(s) or fail to take action(s) knowing that such action(s) or failure to take action(s) would result in losses. Accordingly, in our position as an effective parent, we could be liable in some cases for the debts of our effective subsidiaries. This liability could materially adversely affect us. A shareholder of an effective parent should not itself be liable for the debts of the effective parent's effective subsidiary, unless that shareholder is itself an effective parent of the effective parent. Accordingly, you will not be personally liable for our debts or those of our effective subsidiaries unless you control our business.

***Because there is little minority shareholder protection in Russia, your ability to bring or recover in an action against us will be limited.***

While Russian law provides come protections to minority shareholders, in practice corporate governance standards for many Russian companies have proven to be poor. Minority shareholders in Russian companies have suffered losses due to abusive share dilutions, asset transfers and transfer-pricing practices within corporate structures. Shareholder meetings have been irregularly conducted, and shareholder resolutions have not always been respected by management. Where controlling shareholders effectively control 75% or more of the voting shares of a company, they are in a position to approve amendments to the charter of the company, which could be prejudicial to the interests of minority shareholders. In light of these practices, it is possible that our majority shareholders and our management in the future may not run the us for the benefit of minority shareholders, and this could materially and adversely affect the value of your investment in our ADSs.

Disclosure and reporting requirements, and anti-fraud legislation, have only recently been enacted in Russia. Most Russian companies and managers are not accustomed to restrictions on their activities arising from these requirements. The concept of fiduciary duties of management or directors to their companies or shareholders is also relatively new and is not well developed. Violations of disclosure and reporting requirements or breaches of fiduciary duties to us or to our shareholders could materially adversely affect the value of your investment in our ADS.

While the Federal Law on Joint Stock Companies provides that shareholders owning not less that one percent of the company's stock may bring an action for damages on behalf of the company, Russian courts do not to date have experience with respect to such suits. Russian law does not contemplate class action litigation. Accordingly, your practical ability to pursue legal redress action against us may be limited, reducing the protections available to you as a holder of ADSs.

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

Russian legislation governing foreign investment activities does not prohibit or restrict foreign investment in the telecommunications industry. However, a lack of consensus exists over the manner and scope of government control over the telecommunications industry. While draft legislation protecting the rights of foreign investors specifically in the telecommunications industry has been considered at various times, the recently adopted Law on Foreign Investment in the Russian Federation does not provide any specific protections in this regard. Because the telecommunications industry is widely viewed as strategically important to Russia, governmental control over the telecommunications industry may increase, and foreign investment in or control over the industry may be limited. Any such increase in governmental control or limitation on foreign investment could impair the value of your investment in our ADSs and could hinder our access to additional capital.

***Anti-takeover provisions could hinder future purchases of our shares or ADSs by our majority shareholders, potentially reducing demand for, and price of, our shares or ADSs.***

Russian legislation requires that any person that intends, either alone or with affiliates, to acquire more than 30% of the common stock of a company having more than 1,000 common shareholders, must give 30 days' prior written notice to the existing shareholders. Additionally, a person acquiring 30% or more of the common stock of a company, within 30 days of acquiring 30% or more, must offer to buy all of the common stock then outstanding at a price not lower than the weighted average acquisition price of the common stock over the six months before the date of the acquisition of 30% or more of the common stock. While this requirement may be waived in a company's charter or by a resolution adopted by a majority vote at a shareholders' meeting, our charter does not contain, and our shareholders have not waived, this requirement. Russian legislation is unclear on whether this requirement applies to shareholders already owning over 30% of a company's common stock. Therefore, it is unclear whether this requirement would apply to purchases of common stock or our ADSs by Sistema and/or DeTeMobil or entities controlled by them. If this requirement would apply, or if these shareholders determined it would apply, then this could hinder further purchases of our shares or ADSs by them, potentially reducing demand for, and price of, our shares or ADSs.

***The lack of a central and rigorously regulated share registration system in Russia may result in your having difficulties in selling our ADSs.***

Ownership of shares in Russian joint stock companies is determined by entries in a share register and is evidenced by extracts from that register. Currently in Russia, there is no central registration system. Share registration is carried out by the companies themselves or, if a company has more than 500 shareholders or elects, by specialized registrars located throughout Russia. Regulations have been issued by the Federal Commission on Securities Markets regarding the licensing conditions for such registrars and the procedures to be followed by them when performing the functions of registrar. In practice, however, these regulations have not been strictly enforced. Moreover, registrars are not necessarily subject to effective governmental supervision. Due to the lack of a central and rigorously regulated share registration system in Russia, transactions in respect of a company's shares could be improperly or inaccurately recorded, and share registration could be lost through fraud, negligence or even mere oversight.

***The Russian tax system could materially adversely affect an investment in our ADSs.***

Generally, taxes payable by Russian companies are substantial and numerous. These taxes include, among others:

- income taxes;
- value-added taxes;
- excise taxes; and
- social and pension contributions.

All of these taxes are subject to frequent change. Additionally, each region may establish regional sales tax applicable to sales of goods and services to individuals at a rate of up to 5%.

The taxation system in Russia is subject to varying interpretations, frequent changes and inconsistent enforcement at the federal, regional and local levels. In some instances, new taxes have been given retroactive effect. In addition to our substantial tax burden, these conditions complicate our tax planning and related business decisions. For example, tax laws are unclear with respect to the deductibility of certain expenses and at times we have taken a position that is aggressive in this regard, but that we consider to be in compliance with current law. This uncertainty exposes us to significant fines and penalties and to enforcement measures despite our best efforts at compliance, and could result in a greater than expected tax burden. To date, the system of tax collection has been relatively ineffective, resulting in the continual imposition of new taxes in an attempt to raise government revenues. These factors, plus the existence of large government budget deficits, raise the risk of a sudden imposition of arbitrary or onerous taxes on us. This could adversely affect the value of our ADSs. The Russian government has initiated a revision of the Russian tax system. The new tax system is intended to reduce the number of taxes and the overall tax burden on businesses and to simplify the tax laws. However, the proposed tax system continues to rely heavily on the judgments of local tax officials and fails to address many existing problems. Even if further reforms to the tax code are enacted, they may not result in a reduction of the tax burden on Russian companies and the establishment of a more efficient tax system. Conversely, they may introduce additional tax collection measures such as transfer pricing. Accordingly, we may have to pay significantly higher taxes, which could have a material adverse effect on our business and on the value of our ADSs.

Moreover, financial statements of Russian companies are not consolidated for tax purposes. Therefore, each of our Russian entities pays its own Russian taxes and may not offset its profit or loss against the loss or profit, respectively, of another of our entities. Because Russian legislation contains no consolidation provisions, dividends within the entities comprising our group are subject to Russian taxes at each level. Currently, dividends are taxed at 15% to 20%, and the payor is required to withhold the tax when paying the dividend.

***You may not be able to benefit from the United States-Russia income tax treaty.***

The Russian tax rules applicable to U.S. holders of our ADSs are characterized by significant uncertainties and by an absence of interpretive guidance. Russian tax authorities have not provided any guidance regarding the treatment of ADS arrangements, and there can be no certainty as to how the Russian tax authorities will ultimately treat those arrangements. In particular, it is unclear whether Russian tax authorities will treat U.S. holders as the beneficial owners of the underlying shares for the purposes of the United States-Russia income tax treaty. If the Russian tax authorities were not to treat U.S. holders as the beneficial owners of the underlying shares, then the U.S. holders would not be able to benefit from the provisions of the United States-Russia income tax treaty.

### *By investing in Russian securities, you may be subject to registration with the Russian tax authorities and could be liable for imputed Russian income, and tax might be withheld on trades of our common shares and ADSs, reducing their value.*

The tax risks of investing in Russia can be substantial. There is a risk that trading in Russian securities will require registration with the Russian tax authorities and could subject an investor to tax liability for imputed Russian income. Moreover, a Russian Tax Service Instruction provides for a withholding tax on gains arising from the disposition of Russian shares and securities, such as shares of our common stock. The Russian tax authorities may attempt to apply withholding tax on gains derived from trading our ADSs. No procedural mechanism currently exists to withhold any capital gains or for subsequent remittance of such amounts to the Russian tax authorities with respect to sales made between non-residents.

The Russian tax authorities require a Russian resident to withhold 20% of the purchase price paid to a non-resident for the purchase of any security. A refund of all or a portion of the tax withheld may be available if an exemption or lower rate of withholding tax is provided for by an applicable tax treaty. However, obtaining the benefits of any relevant tax treaties can be difficult due to the documentary requirements imposed by the Russian tax authorities. If any such tax is assessed, the value of an ADS or a share of common stock could be materially adversely affected.

## *Risks Relating to Our Business and Industry*

### *If we are unable to obtain adequate capital, we may have to limit our operations substantially, with a resulting negative impact on our operating results and loss of market share.*

We will need to make significant capital expenditures, particularly in connection with the development, construction and maintenance of our GSM network. We spent approximately $222 million in 2000, and have included $240 million in our budget for 2001 for the fulfillment of our capital spending plans, excluding the proceeds of this offering. However, future financing may not be sufficient to meet our planned needs in the event of the following potential developments:

- changes in the terms of existing financing arrangements;
- construction of the networks at a faster rate or higher capital cost than anticipated;
- need for greater than anticipated service and customer support;
- pursuit of new business opportunities that require significant investment;
- acquisitions or development of any additional licenses;
- slower than anticipated subscriber growth;
- regulatory developments; or
- further deterioration in the Russian economy.

To meet our financing requirements, we may need to attract additional equity or debt financing. We have no specific plans or arrangements for such financing. Debt financing in Russia on commercially acceptable terms is currently difficult to obtain. If we cannot obtain adequate funds to satisfy our capital requirements, we may need to limit our operations significantly, which could negatively impact our market share and operating results.

***Because we lack full redundancy for our systems, a systems failure could prevent us from operating our business and lead to a loss of customers, damage to our reputation and violations of the terms of our licenses and contracts with customers.***

We have back-up capacity for our network management, operations and maintenance systems, but automatic transfer to back-up capacity is limited. In the event that the primary network management center were unable to function, significant disruptions to our system would occur, including our inability to provide services. Disruptions in our services due to the introduction of new technology and services to our network occurred on August 3, 2000, and December 15, 2000, and there can be no assurance that these types of disruptions will not repeat. These types of disruptions could lead to a loss of customers, damage to our reputation and violations of the terms of our licenses and contracts with customers. These failures could also lead to a decrease in value of our ADSs, significant negative publicity and litigation.

Our computer and communications hardware is protected through physical and software safeguards. However, it is still vulnerable to fire, storm, flood, loss of power, telecommunications failures, interconnection failures, physical or software break-ins and similar events. We do not carry business interruption insurance to protect us in the event of a catastrophe, even though such an event could lead to significant negative impact on our business.

***Rapid growth and expansion may cause us difficulty in obtaining adequate managerial and operational resources, restricting our ability to expand our operations.***

We have experienced rapid growth and development in a relatively short period of time. Management of this growth has required significant managerial and operational resources and is likely to continue to do so. Our future operating results depend in significant part upon the continued contributions of a small number of our key senior management and technical personnel. Management of growth will require, among other things:

- stringent control of network buildout and other costs;
- continued development of financial and management controls and information technology systems;
- increased marketing activities; and
- hiring and training of new personnel.

Our success will depend, in part, on our ability to continue to attract, retain and motivate qualified personnel. The competition in Russia for personnel with relevant expertise is intense, due to the small numbers of qualified individuals. The failure to manage our growth and development successfully would materially adversely affect us.

***If we cannot successfully develop our network, we will be unable to expand our subscriber base.***

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

- extend coverage in the Moscow license area;
- increase the capacity of our existing network in the Moscow license area;
- initiate coverage in the St. Petersburg license area;
- expand service in the regional license areas in which we currently operate; and
- introduce service in the regions in which we have licenses and have not yet commenced operations.

Our ability to increase our subscriber base depends upon the success of the network expansion. We have expended considerable amounts to enable this expansion, including the $50 million we paid to acquire Telecom XXI and its licenses for St. Petersburg and the surrounding region. Also, the buildout of the network is subject to risks and uncertainties which could delay the introduction of service in some areas and increase the cost of network construction, including difficulty in obtaining base station sites on commercially attractive terms. In addition, telecommunications equipment used in Russia is subject to governmental certification, which must be renewed at least every three years. The failure of any equipment we use to receive timely certification or re-certification could also hinder our expansion plans. To the extent we fail to expand our network on a timely basis, we could experience difficulty in expanding our subscriber base.

***If we cannot interconnect cost-effectively with other telecommunications operators, we may be unable to provide services at competitive prices and therefore lose market share and revenues.***

Our ability to provide commercially viable services depends upon our ability to continue to interconnect cost-effectively with MGTS and other local, domestic and international telecommunications operators. Fees for interconnection are established by agreements with the operators and vary, depending on the network used and the nature of the call. We have entered into interconnection agreements with several local, domestic and international telecommunications operators, including MGTS and Rostelecom. Interconnection with these operators is required to complete calls originating on our network but terminating outside it and to complete calls to our subscribers originating outside of our network.

Any difficulties or delays in interconnecting cost-effectively with other networks could hinder our ability to provide services, causing us to lose subscribers, increase our costs and decrease our revenues. Although Russian legislation requires that operators of public switched telephone networks may not refuse to provide interconnections or discriminate against one operator in comparison to another, we believe that, in practice, some public network operators charge varying interconnect rates to different mobile operators, potentially enabling our competitors to offer lower prices.

***Because we depend upon a small number of suppliers for network equipment and handsets, our costs would increase significantly if we cannot timely and cost-effectively obtain adequate supplies of equipment, and we could also lose market share.***

The construction and operation of our network depends on obtaining adequate supplies of base station, switching and other network equipment and telephone handsets on a timely basis. We purchase radio, switching and network equipment from a small number of suppliers, principally Motorola, Inc., Siemens AG and authorized dealers of Lucent Technologies, Inc. If we cannot obtain sufficient equipment supplies to continue the buildout of our network systems, we may not be able to offer coverage areas comparable to those of our competitors, negatively affecting our efforts to increase our subscriber base and potentially leading to loss of market share. Additionally, increased costs for equipment or the inability to obtain adequate supplies or equipment in a timely manner would increase our operating costs.

***We engage in transactions with related parties, which may present conflicts of interest, resulting in the conclusion of transactions on less favorable terms than could be obtained in arms'-length transactions.***

We, our principal shareholders, and their affiliates have engaged in several significant transactions among themselves and may continue to do so. We purchased interests in Rosico and ReCom from Sistema, purchased interests in Russian Telephone Company CJSC, or RTC CJSC, from DeTeMobil, and entered into arrangements with affiliates of Sistema for advertising and insurance services. In addition, we have entered into interconnection and telephone numbering capacity purchase agreements with MGTS and MTU-Inform, which are majority-owned by Sistema. We also have similar agreements with Telmos, in which Sistema has a significant, indirect, minority stake. Furthermore, we have entered into a number of arrangements with DeTeMobil and its affiliates. Although we anticipate that all future related party transactions will be on arm's-length, conflicts of interest may arise between us, our affiliates and our principal shareholders or their affiliates, resulting in the conclusion of transactions on terms not determined by market forces.

***Because our controlling shareholders are also our competitors, they may have interests that conflict with those of holders of our ADSs.***

We compete directly with affiliates of our controlling shareholder. Our shareholder, Sistema, indirectly owns, through MGTS, 23.5% of MCC. A vice president of Sistema also serves as the Chairman of MCC. Although MCC is our competitor, Rosico, our subsidiary, has leased frequencies in the 1800 MHz band to MCC to enable them to test and develop in Moscow their GSM system that uses frequencies in the 400 and 1800 MHz bands. Sistema also indirectly controls JSC Personal Communications, which holds a CDMA cellular license for the Moscow license area and began commercial operations in the region in August 1998. Ownership and involvement by our controlling shareholders in these competing businesses diverts resources that otherwise could be invested by them in our businesses and could enable these other business to compete against us more effectively.

***Failure to fulfill the terms of our licenses, including the payment of license contributions, could result in their revocation.***

Our licenses contain various requirements. These include participation in a federal communications network, adherence to technical standards, investment in network infrastructure and employment of Russian technical personnel. GSM operators are required to provide service to the federal government at the regulated tariff rates. The amount and pricing of such services are subject to change and, if they were to increase substantially, so would our operating costs.

Some of our licenses also require us to make a non-refundable contribution to finance telecommunications infrastructure improvements in the related license area. The total contributions under our licenses are approximately $41 million. We have not made any contributions under our licenses, because the authorities have not determined the terms and conditions of these contributions. If and when authorities determine the terms and conditions of these contributions, we will have to make them.

In addition, each of our licenses requires service to be started by a specific date. Although we have not commenced timely service for two of our license regions, we have obtained extensions for both regions. Each of our licenses, other than the license which covers the Moscow license area, also contains requirements as to the number of subscribers and required territorial coverage by specified dates. These requirements are subject to adjustment during the term of the license.

If the terms of a license are not fulfilled or the service provider violates legislation, the license may be suspended or terminated. Decisions of the Ministry of Communications on suspension or termination of licenses may be appealed in court. To date, there have been no legal actions seeking to suspend or terminate any of our licenses, nor have we received any notice of violation with respect to any of our licenses.

***If frequencies currently assigned to us are reassigned to other users, our network capacity will be restrained and our ability to expand limited, resulting in a loss of market share and lower revenues.***

We are dependent on access to adequate spectrum allocation in each market in which we operate in order to maintain and expand our subscriber base. While we believe that our current spectrum allocations are sufficient, a loss of assigned spectrum allocation which is not replaced by other adequate allocations could have a substantial impact our network capacity. For example, on September 5, 2000, we received a letter from the State Service for Communication Control, a department of the Ministry of Communications. The letter cancelled the approval the State Service for Communication Control had given us in May 2000 for certain frequencies within the 900 MHz band in order to install base stations with restricted emanation, which we used primarily for the development of our network in the underground stations of the Moscow subway system. While the Department of Communications Control, also under the Ministry of Communications, halted the implementation of this letter on September 14, 2000, and on November 14, 2000, the Ministry of Communications reinstated these frequency allocations to us, there can be no assurance that no future attempts will be made to remove frequency allocations from us. If this were to occur, our network capacity would be restrained and our ability to expand limited, resulting in a loss of market share and lower revenues.

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

***Inflation could increase our costs and decrease our operating margins.***

The Russian economy has been characterized by high rates of inflation, including a rate of 84.4% in 1998. As substantially all of our costs are denominated in U.S. dollars or are tightly linked to the U.S. dollar, when the rate of inflation exceeds the rate of devaluation of the ruble against the U.S. dollar, as was the case for years prior to 1998 and in 1999, we can experience inflation-driven increases in dollar terms of certain of our costs. These include salaries and rents, which are sensitive to rises in the general price level in Russia. In this situation, due to competitive pressures, we may not be able to raise our tariffs sufficiently to preserve operating margins. Accordingly, high rates of inflation relative to the rate of devaluation could increase our costs and decrease our operating margins.

***Changes in exchange rates could increase our costs, decrease our reserves or prevent us from repaying our debts.***

Over the past several years, the ruble has fluctuated dramatically against the U.S. dollar, in the great majority of instances falling in value. The Central Bank has imposed various currency-trading restrictions in attempts to support the ruble. The ability of the government and the Central Bank to maintain a stable ruble will depend on many political and economic factors. These include their ability to finance budget deficits without recourse to monetary emissions, to control inflation and to maintain sufficient foreign currency reserves to support the ruble.

Substantially all of our costs and expenditures, as well as liabilities, are either denominated in or tightly linked to the U.S. dollar. These include salaries, capital expenditures and borrowings. As a result, devaluation of the ruble against the U.S. dollar can adversely affect us by increasing our costs in ruble terms. In order to hedge against this risk, we link our tariffs, which are payable in rubles, to the U.S. dollar. The effectiveness of this hedge is limited, however, as we cannot always increase our tariffs in line with ruble devaluation due to competitive pressures, leading to a loss of revenue in U.S. dollar terms. Additionally, if the ruble declines and tariffs cannot keep pace, we could have difficulty repaying or refinancing our U.S. dollar-denominated indebtedness. The devaluation of the ruble also results in losses in the value of ruble-denominated assets, such as ruble deposits. These losses for us were approximately $3.24 million in the year ended December 31, 1999, and approximately $1.07 million in the year ended December 31, 2000. Continued devaluation of the ruble against the U.S. dollar could materially adversely affect us.

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

***Currency control regulations hinder our ability to obtain hard-currency-denominated financings on favorable terms, thus increasing our borrowing costs.***

Certain payments in foreign currency, including the following, are subject to prior permission by the Russian Central Bank:

- direct investments, except in the charter capital of a company;
- portfolio investments;
- all secured financing;
- certain financial credits for terms over 180 days;
- payments for export-import transactions with settlement over 90 days following completion; and
- payments with respect to real estate.

As of December 31, 2000, we had outstanding debt of approximately $47.31 million denominated in U.S. dollars, including our loans from Ericsson Project Finance AB and Incombank. Although we have Central Bank licenses to make payments of principal and interest on these loans, there is no assurance that we will be able to obtain similar licenses for future financings. This may prevent us from obtaining financing on favorable terms.

***Restrictions on investments outside of Russia or in hard-currency-denominated instruments in Russia expose our cash holdings to devaluation.***

Currency regulations established by the Central Bank restrict investments by Russian companies outside of Russia and in most hard-currency-denominated instruments in Russia, and there are only a limited number of ruble-denominated instruments in which we may invest our excess cash. Any balances maintained in rubles will give rise to losses if the ruble devalues against the U.S. dollar.

Additionally, Russian companies must repatriate 100% of offshore foreign currency earnings to Russia and convert 75% of such earnings into rubles. In the year ended December 31, 2000, we earned around $43 million, constituting around 8% of our total revenues, in foreign currency, primarily from roaming agreements. This requirement further increases balances in our ruble-denominated accounts and, consequently, our exposure to devaluation risk.

***Continued or increased limitations on the conversion of rubles to hard currency in Russia could increase our costs when making payments in hard currency to suppliers and creditors and could cause us to default on our obligations to them.***

Our major capital expenditures are generally denominated and payable in various foreign currencies, including U.S. dollars and Deutsche Marks. As of December 31, 2000, we had $125 million committed under contracts with foreign suppliers for the purchase of network infrastructure. To the extent such major capital expenditures involve the importation of equipment and related items, Russian legislation permits the conversion of ruble revenues into foreign currency. However, the market in Russia for the conversion of rubles into foreign currencies is limited. The scarcity of foreign currencies may tend to inflate their values relative to the ruble, and such a market may not continue to exist.

***Sistema may not be able to fulfill its obligations in connection with our loan from Ericsson.***

In December 1996, Rosico, our subsidiary, which has since been merged into us, entered into a credit agreement with Ericsson Project Finance AB for a five-year credit facility with a principal amount of $60 million. In connection with our acquisition of Rosico, Sistema agreed to indemnify Rosico for this loan and all related obligations.

Since our acquisition of Rosico, Rosico has made payments totaling $34.18 million to Ericsson Project Finance AB as of December 31, 2000. However, Sistema has only paid $27.08 million to Rosico as of December 31, 2000, violating its obligations under the acquisition agreements. During 2000, we and Sistema agreed upon a cost-efficient structure for Sistema to make the required payments. Under this method, a significant portion of payments we receive are in exchange for the issuance by us of long-term, ruble-denominated promissory notes with 0% interest and maturities in 2050. The carrying amount of these notes is negligible for our financial statements. Through December 31, 2000, Sistema had made payments to Rosico under the Rosico commitment in the amount of approximately $27.08 million, of which approximately $14.57 million in the form of long-term, ruble-denominated promissory notes with 0% interest.

The receivable from Sistema has been reflected in our financial statements as additional paid-in capital. However, because there is uncertainty as to payment, we have also reflected this receivable as a direct reduction to our shareholders' equity. As a result, we have received no credit for this receivable, and will get no credit unless and until payments are made. Accordingly, if and when payments are made, they will have a positive effect on our shareholders' equity and our cash position.

Any further failure by Sistema to meet its obligations could have an adverse effect on the anticipated increase in our shareholders' equity and on the anticipated improvement in our cash position.

**Risks Relating to Our Industry**

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

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

We face competition from several operators in the Moscow license area migrating from older analog systems to the GSM standard. In addition to VimpelCom, we compete in the Moscow license area against Moscow Cellular Communications, also known as MCC, which operates a network based on the Nordic Mobile Telephone standard, or NMT, a first-generation analog technology. MCC, in which Sistema has a stake, has also elected to pursue a license to operate a third-generation network based on the CDMA 2000 standard, which would operate in the same frequencies as MCC's current network. In March 2000, the Ministry of Communication issued an approval to MCC to construct a trial network using the CDMA 400 standard. The upgrade of MCC's network will increase its competitiveness vis-à-vis our network.

Of our competitors, VimpelCom and MCC may have significant access to capital, experience in the provision of mobile cellular services and technical, marketing, sales and distribution resources. VimpelCom is partially owned by Telenor AS, the largest telecommunications company in Norway. Alfa Group, a large Russian holding company, and VimpelCom have also recently announced Alfa Group's purchase of interests in both VimpelCom and Vimpelcom-Regions, a previously wholly-owned subsidiary of VimpelCom, in order to accelerate the development of VimpelCom's regional GSM license portfolio. This transaction, which includes Telenor, an existing shareholder in VimpelCom, could result in up to $337 million in additional financing for regional expansion for VimpelCom. Alfa Group has also recently acquired a large stake in Golden Telecom, which is the main provider of numbering capacity and interconnection services for VimpelCom. This relationship could result in lowered operating costs for VimpelCom. These resources could provide our competitors with advantages that negatively impact our business.

***The award of a third GSM license in Moscow to a company controlled by the Russian government could create a competitor which will receive preferential treatment and financial support from the federal government, creating an uneven regulatory playing field and giving it a substantial competitive advantage over us.***

In May 2000, the Ministry of Communications awarded a third license in Moscow to Sonik Duo, which is owned 35% by Sonera, the leading Finnish telecommunications operator, and 65% by TsT Mobile. TsT Mobile is a joint-venture owned 51% by Central Telegraph, which in turn is owned by Svyazinvest, and 49% by Transcontinental Mobile Investments. Both Svyazinvest and Central Telegraph are effectively controlled by the Russian federal government. The federal government's involvement in Sonik Duo could result in an uneven regulatory playing field and give Sonik Duo an advantage over us in competing for additional frequency allocations or new licenses. For instance, the temporary loss of frequency allocation we suffered in the fall of 2000 has been linked in press reports to Sonik Duo's need for frequency allocation. See "—If frequencies currently assigned to us are reassigned to other users, our network capacity will be restrained and our ability to expand limited, resulting in a loss of market share and lower revenues.." Sonik Duo may also receive significant financial assistance from the federal government. Sonik Duo has announced that it will begin commercial service in the third quarter 2001, and that the service will cover Moscow and the certain areas of the Moscow region. This would increase competition for us in the Moscow license area and could reduce our revenues.

Additionally, this GSM license may have federal status, which would allow Sonik Duo to provide GSM services throughout the Russian Federation. This could undermine our plans to expand in the regions outside of the Moscow license area and diminish the competitive advantage we hope to enjoy from the creation of a single, integrated regional network.

***Our reliance on the GSM standard may prevent us from competing effectively against other existing technologies and new technologies, causing us to lose subscribers and associated revenues.***

The adoption of a new, global standard, referred to as Universal Mobile Telecommunications System, or UMTS, may also increase the competition we face. We believe that UMTS will be based on wideband code division multiple access, or W-CDMA. In Russia, the Ministry of Communications expects to complete prepatory work for license tenders for third-generation mobile cellular standards by the second half of 2001 or first half of 2002. The UMTS standard is significantly superior to existing second-generation standards such as GSM, and given our reliance on the GSM standard, we may not be able to develop a strategy compatible with this or any other new technology. The technology we currently use may become obsolete or uncompetitive. In addition, we may not be able to acquire new technologies necessary to compete on reasonable terms.

The Ministry of Communications has granted licenses based on code division multiple access, or CDMA, technology for the provision of fixed wireless services in a number of regions throughout Russia. CDMA is a second-generation digital cellular telephony technology that can be used for the provision of both mobile and fixed services. Although CDMA technology is currently classified in Russia as a fixed telephone service, it may be used for mobile communications and there is a risk that it may be offered for use via portable handsets. If CDMA operators were able to obtain permissions to offer mobile CDMA services, they would operate in direct competition with us.

***The regulatory environment for telecommunications in Russia is uncertain and may be subject to political influence, resulting in negative regulatory decisions on other than legal grounds.***

We operate in uncertain regulatory environments. There is no comprehensive legal framework with respect to the provision of telecommunication services in Russia, although a number of laws, decrees and regulations apply to the telecommunications sector. In particular, the telecommunications system is regulated by the Ministry of Communications, largely through the issuance of licenses and instructions. As a result, officials of the Ministry of Communications have a high degree of discretion.

In this environment, political influence could be exerted to affect regulatory decisions against us. Although Sistema, one of our principal shareholders, has no formal ties with the Mayor of Moscow, Yuri Luzhkov, it has been linked in press reports to Mr. Luzhkov. We believe the likely source of such press reports is the fact that the controlling shareholder and Chairman of the Board of Sistema, Vladimir Yevtushenkov, for many years worked at the government of Moscow as Mr. Luzhkov’s advisor. Because Mr. Luzhkov has been, at times, politically adverse to President Putin, in the event of a political clash between the two politicians, some commentators in the press have suggested that President Putin could seek to exert pressure against Mr. Luzhkov through attacks on companies perceived as linked to Mr. Luzhkov, such as Sistema and us. If those commentators are correct, this could result in regulatory decisions against us on other than legal grounds, potentially increasing our costs and leading to negative impacts on our business or reducing our rights under our licenses.

***Because of limitations on the rights of license holders, our ability to integrate our networks may be restricted, thus preventing us from offering integrated network services.***

As our regional development program proceeds, we intend to integrate our various networks to create a single, unified GSM network. The Federal Law on Communications and other telecommunications regulations prohibit the transfer or assignment of licenses and require that telecommunications services must be provided by the licensee only. Further, Letter No. 1805 of March 25, 1999, issued by the Ministry of Communications, requires that agreements for the provision of telecommunications services must be concluded and performed only by the licensee. This requirement has been an important factor in our recent acquisitions, because we are unable to buy licenses, but rather must purchase the company holding the license. We also must continue to operate through such company in its license area by entering into agency, lease, services and similar agreements.

To date, the Ministry of Communications has not challenged agreements between licensees and third parties in connection with the provision of services under a license. We have entered into a series of agreements with ReCom, UDN, Rosico and other of our subsidiaries for the provision of network construction services, the lease of mobile switching centers and related services. The Ministry of Communications may change its position and view these agreements as violating the general prohibition on the transfer or assignment of licenses. This would restrict our ability to create a single, unified GSM network, reducing our ability to attract and retain subscribers and compete with a federal, country-wide licensee in the event that such a license was granted.

***Regulatory uncertainties affecting the renewal of our licenses could result in an inability to renew our licenses or in increases in our obligations and a reduction of our rights under the terms of a renewed license, increasing our costs and limiting our service area.***

Our licenses expire in various years from 2004 to 2008 and may be renewed upon application to the Ministry of Communications. For example, our GSM license with frequency allocation in the 900 MHz band covering the Moscow license area expires in 2004. Officials of the Ministry of Communications have broad discretion in deciding whether to renew a license, and we cannot assure you that our licenses will be renewed after expiration. If our licenses are renewed, they may be renewed with additional obligations, including payment obligations, or for reduced service areas. Failure to renew our licenses or receive renewed licenses with similar terms to our existing licenses could significantly diminish our service area and decrease our subscriber numbers.

***If we were categorized as a monopoly, our tariffs could be reduced and our commercial activities restricted, significantly affecting our results of operations.***

Under Russian legislation, the Russian Ministry for Antimonopoly Policy may categorize a company as a dominant force in a market. Current Russian legislation does not clearly define "market" in terms of the types of services or the geographic area. While we do not believe that there is a basis to categorize any of our entities as a dominant force, any ruling to that effect could result in the regulation of our tariffs and restrictions on our commercial activities. The imposition of government-determined tariffs could result in competitive disadvantages, a decrease in our subscriber base, and a significant decline in revenues. Additionally, restrictions on expansion or government-mandated withdrawal from regions or markets would negatively affect our plans for expansion and could reduce our subscriber base.

***The public switched telephone networks are reaching capacity limits and need modernization, which may require us to make additional capital expenditures.***

Due to the recent growth in fixed and mobile telephone use in Moscow, the city's "095" code is approaching numbering capacity limits and an additional code or codes may soon have to be introduced. This would require additional investment. In addition, continued growth in local, long-distance and international traffic, including that generated by our subscribers, may require substantial investment in public switched telephone networks.

Although the operators of public switched telephone networks are normally responsible for these investments, their weak financial condition may prevent them from making these investments. Since we are financially strong relative to these public network operators, we may be compelled to make such investments on their behalf, placing an additional burden on our financial and human resources. Additionally, assuming we do make such investments, we may not own the assets resulting from such investment. While we cannot estimate the financial and operating burdens associated with such investments, they may be substantial.

***Alleged medical risks of cellular technology may subject us to negative publicity or litigation in Russia, decrease our access to base station sites, diminish subscriber usage and hinder access to additional financing.***

The significant environmental damage suffered by Russia during the communist era has increased public sensitivity to health risks arising from technology. Electromagnetic emissions from transmitter masts and mobile handsets may harm the health of individuals exposed for long periods of time to these emissions. The actual or perceived health risks of transmitter masts and mobile handsets or press reports in Russia of any litigation relating to such risks could materially adversely affect us, including in the following ways:

- reduced subscriber growth;
- reduced usage per subscriber;
- product liability lawsuits;
- increased difficulty in obtaining sites for base stations; and/or
- reduced financing available to the wireless communications industry.

***Computer viruses may harm our network's operating ability.***

As mobile phones increase in technological capacity, they may become increasingly subject to computer viruses. These viruses can replicate and distribute themselves throughout a network system, slowing the network through the unusually high volume of messages sent across the network, in addition to affecting data stored in individual handsets. Although, to date, most computer viruses have targeted computer networks, mobile phone networks are also at risk. We cannot be sure that we will not be the target of a virus, or if we are, that we will be able to maintain the integrity of the data in individual handsets of our subscribers or that such a virus will not overload our network, causing significant harm to our operations.

**Risks Relating to our ADSs and the Trading Market**

***Because the depositary may be considered the beneficial holder of the shares underlying the ADSs, these shares may be arrested or seized in legal proceedings in Russia against the depositary.***

Because Russian law may not recognize ADS holders as beneficial owners of the underlying shares, it is possible that you could lose all your rights to those shares if the depositary's assets in Russia are seized or arrested. In that case, you would lose all the money you have invested.

Russian law might treat the depositary as the beneficial owner of the shares underlying the ADSs. This would be different from the way other jurisdictions, such as the states of the United States, treat ADSs. In those jurisdictions, although shares may be held in the depositary's name or to its order and it is therefore a "legal" owner of the shares, the ADS holders are the "beneficial," or real owners. In those jurisdictions, no action against the depositary, the legal owner, would ever result in the beneficial owners losing their shares. Because Russian law may not make the same distinction between legal and beneficial ownership, it may only recognize the rights of the depositary in whose name the shares are held, not the rights of ADS holders, to the underlying shares.

Thus, in proceedings brought against a depositary, whether or not related to shares underlying ADSs, Russian courts may treat those underlying shares as the assets of the depositary, open to seizure or arrest. We do not know yet whether the shares underlying ADSs may be seized or arrested in Russian legal proceedings against a depositary. There is a lawsuit pending in the Russian courts against a depositary bank other than Morgan Guaranty Trust Company of New York that could result in the seizure of various Russian companies' shares represented by ADSs. If this lawsuit is decided against the depositary bank involved, and if the shares are seized or arrested, the ADS holders involved will lose their rights to the underlying shares.

***Because the rights of nominee holders and depositaries are not well developed, you may be unable to exercise some of your rights or obtain some of the benefits due to you as a holder of our ADSs.***

The regulations governing nominee holders, custodians and depositaries are not yet well developed in Russia. The existing regulations could be interpreted as requiring a nominee holder or a depositary to obtain a license from the Russian authorities to act in that capacity with regard to shares of our common stock. This applies to both Russian and foreign nominee holders and depositaries. The Federal Commission on the Securities Market has also recently adopted the position that the depositary may only vote the entire amount of shares held by the depositary in one manner on a particular question put to a vote at a shareholders' meeting, and may not grant a discretionary proxy to a person designated by us if you do not give any voting instructions. This may result in your inability to exercise your rights as a holder of our ADSs, including voting. Further, in the past, nominees have reportedly experienced difficulty in convincing registrars of their right to represent the beneficial holder and to obtain the benefits for the beneficial holders available under an applicable tax treaty. This could result in your inability to obtain the benefits due to you as a holder of our ADSs.

***Because the rights of nominee holders and depositaries are not well developed, you will be unable to exercise your voting rights and may not be able to obtain some of the benefits due to you as a holder of our ADSs.***

The Federal Law on the Securities Markets provides that shares may be held by nominees entitled to receive dividends and to vote the shares on behalf of the beneficial owner upon receipt of the appropriate instructions from the beneficial owner. The nominee is required to provide information on the beneficial holder of the shares upon the demand of the registrar. However, foreign depositary banks for ADSs are not currently recognized as nominee holders under Russian law and, therefore, cannot vote the shares underlying the ADSs as a nominee. Rather, a foreign depositary bank may only vote the shares underlying the ADSs as the beneficial owner of these shares. Since Russian law prohibits a shareholder from voting in more than one way on any agenda item, a foreign depositary bank cannot vote the shares it holds on behalf of ADR holders other than as a block. While the Russian Federal Commission on Securities Markets has indicated that it intends to issue regulations allowing foreign depositary banks to vote on behalf of ADR holders, until the applicable Russian legislation is changed to allow foreign depositary banks to vote shares other than as a block, the shares underlying our ADSs may not be voted other than as a block. Further, in the past, nominees have reportedly experienced difficulty in convincing registrars of their right to represent the beneficial holder and in convincing tax authorities of the right of beneficial holders to obtain the benefits available under an applicable tax treaty. This could result in your being unable to obtain some of the benefits due to you as a holder of our ADSs.

***Even if Russian legislation is amended to allow for voting of our ADSs, your voting rights with respect to the shares represented by our ADSs are limited by the terms of the deposit agreement for our ADSs.***

Even if Russian legislation is amended to allow for voting of our ADSs, you will be able to exercise voting rights with respect to the common shares represented by ADSs only in accordance with the provisions of the deposit agreement relating to the ADSs. However, there are practical limitations upon your ability to exercise your voting rights due to the additional procedural steps involved in communicating with you. For example, our charter requires us to notify shareholders at least 30 days in advance of any meeting. Our common shareholders will receive notice directly from us and will be able to exercise their voting rights by either attending the meeting in person or voting by power of attorney.

As an ADS holder, you, by comparison, will not receive notice directly from us. Rather, in accordance with the deposit agreement, we will provide the notice to the depositary. The depositary has undertaken in turn, as soon as practicable thereafter, to mail to you the notice of such meeting, voting instruction forms and a statement as to the manner in which instructions may be given by holders. To exercise your voting rights, you must then instruct the depositary how to vote its shares. Because of this extra procedural step involving the depositary, the process for exercising voting rights may take longer for you than for holders of common shares. ADSs for which the depositary does not receive timely voting instructions will not be voted at any meeting. Except as described in this document, you will not be able to exercise voting rights with respect to the shares of common stock that will underlie the ADSs.

***You may be unable to repatriate your earnings from our ADSs.***

The Federal Law on Foreign Investments in the Russian Federation specifically guarantees foreign investors the right to repatriate their earnings from Russian investments. However, the Russian exchange control regime may materially affect your ability to do so.

Russian currency control legislation pertaining to payment of dividends provides that ruble dividends on common stock may be paid to the depositary or its nominee and converted into U.S. dollars by the depositary for distribution to owners of ADSs without restriction. Also, ADSs may be sold by non-residents of Russia for U.S. dollars outside Russia without regard to Russian currency control laws as long as the buyer is not a Russian resident.

Under the terms of the deposit agreement, there is no restriction on the sale of our ADSs in Russia to Russian residents. However, Russian currency control legislation will affect the ability of a non-resident of Russia to sell our ADSs to a Russian resident. Without a Central Bank license, Russian residents must purchase securities for rubles and may not purchase foreign-currency denominated securities, such as our ADSs. Additionally, the repatriation of proceeds from the sale of securities in Russia may be subject to costs and delays.

The ability of the depositary and other persons to convert rubles into U.S. dollars or another foreign currency is also subject to the availability of U.S. dollars or other foreign currency in Russia's currency markets. Although there is an existing market within Russia for the conversion of rubles into U.S. dollars and other foreign currencies, including the interbank currency exchange and over-the-counter and currency futures markets, the further development of this market is uncertain. At present, there is no market for the conversion of rubles into foreign currencies outside of Russia and no viable market in which to hedge ruble-currency and ruble-denominated investments.

***Future sales of common stock or ADSs may affect the market price of our common stock and ADSs.***

Sales, or the possibility of sales, of substantial numbers of shares of our common stock or ADSs in the public market following the offering could have an adverse effect on the market trading prices of the ADSs. Our subsequent equity offerings may reduce the percentage ownership of our shareholders. Newly issued preferred stock may have rights, preferences or privileges senior to those of common stock.

***Foreign judgments may not be enforceable against us.***

Judgments rendered by a court in any jurisdiction outside the Russian Federation will be recognized by courts in Russia only if an international treaty providing for the recognition and enforcement of judgments in civil cases exists between the Russian Federation and the country where the judgment is rendered. No such treaty exists between the United States and the Russian Federation for the reciprocal enforcement of foreign court judgments. The deposit agreement provides for controversies, claims and causes of action brought by any party thereto against us to be settled by arbitration in accordance with the Commercial Arbitration Rules of the American Arbitration Association; provided that any controversy, claim or cause of action relating to or based upon the provisions of the federal securities laws of the United States or the rules or regulations promulgated thereunder may, but need not, be submitted to arbitration. The Russian Federation is a party to the United Nations (New York) Convention on the Recognition and Enforcement of Foreign Arbitral Awards. However, it may be difficult to enforce arbitral awards in the Russian Federation due to a number of factors, including the inexperience of Russian courts in international commercial transactions, official and unofficial political resistance to enforcement of awards against Russian companies in favor of foreign investors, Russian courts' inability to enforce such orders, and corruption.

***Financial turmoil in emerging markets could cause the price of our ADSs to suffer.***

Financial turmoil in Russia and other emerging markets in 1997 and 1998 adversely affected market prices in the world's securities markets for companies that operate in those developing economies. Continued or increased financial downturns in these countries could cause further decreases in prices for securities of our company, even if the Russian economy remains relatively stable.

## Other Risks

***We have not independently verified information regarding our competitors.***

We have derived substantially all of the information contained in this document concerning our competitors from publicly available information, including press releases and filings under the U.S. securities laws, and we have relied on the accuracy of this information without independent verification.

***Because no standard definition of a subscriber exists in the mobile telecommunications industry, comparisons between subscriber data of different companies may be difficult to draw.***

The methodology for calculation of subscriber numbers varies substantially in the mobile telecommunications industry, resulting in variances in reported subscriber numbers from that which would result from the use of a single methodology. Therefore, comparisons of subscriber numbers between different mobile cellular communications companies may be difficult to draw.

***We have not independently verified official data from Russian government agencies.***

The official data published by Russian federal, regional and local governments are substantially less complete or researched than those of Western countries. Official statistics may also be produced on different bases than those used in Western countries. Any discussion of matters relating to Russia in this document must, therefore, be subject to uncertainty due to concerns about the completeness or reliability of available official and public information.

The veracity of some official data released by the Russian government may be questionable. In the summer of 1998, the Director of the Russian State Committee on Statistics, and a number of his subordinates were arrested and charged with manipulating economic data to hide the actual output of various companies, thereby reducing the tax liability of those companies.

## Item 4. *Information on Our Company*

## A. History and Development

Mobile TeleSystems CJSC, our predecessor, was formed in 1993. The founding shareholders included the Moscow City Telephone Network, or MGTS, and three other Russian telecommunications organizations, which collectively held 53% of our original share capital, and two German companies, Siemens AG and DeTeMobil GmbH, an affiliate of Deutsche Telekom AG, which collectively held the remaining 47%. Our two principal shareholders are currently Sistema JSFC, a Russian financial industrial group, which began to acquire MTS CJSC shares in 1995 from the founding Russian shareholders, and DeTeMobil, which increased its original ownership in MTS CJSC primarily by acquiring shares from Siemens.

Mobile TeleSystems OJSC was created on March 1, 2000, through the merger of MTS CJSC and RTC CJSC, a wholly-owned subsidiary. In accordance with Russian merger law, MTS CJSC and RTC CJSC ceased to exist and MTS OJSC was created with the assets and obligations of the predecessor companies. Our charter was registered with the State Registration Chamber on March 1, 2000, and with the Moscow Registration Chamber on March 22, 2000. Our initial share issuance was registered by the Russian Federal Commission on the Securities Market on April 28, 2000.

MTS CJSC inaugurated service in the Moscow license area in 1994, and expanded to the adjoining Tver Region, the nearby Kostroma Region and the Komi Republic after receiving licenses for these three regions in 1997. We have licenses to operate in 43 regions of the Russian Federation and are currently operating in 21 of these regions. Our licenses authorize us to provide GSM services in both the 900 and 1800 MHz frequency bands in 32 of these regions and we currently offer dual band service in 18 regions, including Moscow license area.

MTS CJSC grew, and MTS OJSC has continued to grow, by applying for GSM licenses in new regions, investing in new GSM licensees, increasing its ownership percentage in these licensees and by acquiring existing GSM license holders and operators. Since 1998, we have entered into the following transactions, which collectively have added 38 regions to our license area:

- In early 1998, MTS CJSC took a 24.8% founding stake in ReCom and acquired an additional 25.1% from Sistema later the same year. Our acquisition in 2001 of an additional 4% has increased our ownership percentage to 53.9% and given us operating control of ReCom;
- In 1998, MTS CJSC acquired 80% of Rosico from Sistema. In 2000, we acquired the remaining 20% of Rosico from Sistema's affiliates (9.5%), Siemens (10%) and DeTeMobil (0.5%);
- In 1998, MTS CJSC acquired 100% of RTC CJSC with which it subsequently merged to form MTS OJSC;
- In 1999, MTS CJSC acquired 100% of ACC;
- In 1999, MTS CJSC acquired 51% of UDN-900;
- In 2000, we acquired 51% of MSS; and
- In May 2001, we acquired 100% of Telecom XXI, which holds dual band licenses in 10 regions, including St. Petersburg, for $50 million.

On May 10, 2001, our shareholders passed a resolution pursuant to which we will merge with our wholly-owned owned subsidiaries, Rosico and ACC, in order to reduce financial, managerial, and other expenses connected with providing communication services in the territories in which Rosico and ACC currently operate. Because we are the sole shareholder of Rosico and ACC, in accordance with the Russian legislation, Rosico and ACC shares will be redeemed upon completion of the merger and no alteration in the amount of our authorized capital will occur. Following the merger, we will establish branch offices in the territories where Rosico and ACC are currently providing communication services. To reflect the results of merger and the legal succession of all rights and obligations from Rosico and ACC to us, additional amendments to our charter will be required. Subject to regulatory approval, we expect to complete the merger in the third quarter 2001.

We completed our initial public offering on July 6, 2000 and listed our shares of common stock, represented by American depositary receipts, or ADRs, on the New York Stock Exchange under the symbol "MBT." Each ADR represents 20 underlying shares of our common stock.

For a description of our principal capital expenditures and divestitures since our initial public offering, as well as those currently in progress, see "Item 5. Operating and Financial Review and Prospects—Liquidity and Capital Resources."

Our legal name is Mobile TeleSystems OJSC, and we are incorporated under the laws of the Russian Federation. We operate exclusively in the Russian Federation under the commercial names "Mobile TeleSystems" and "MTS". Our head office is located at 4, Marksistskay, Moscow 109147, and our telephone number is +7-095-766-0103. We have appointed Puglisi & Associates, 850 Library Avenue, Suite 204, Newark, Delaware 19715 as our registered agent for service of process.

## B. Business Overview

We own and operate mobile cellular telephone networks employing the Global Standard for Mobile Communications, or GSM, standard in the Russian Federation. We had approximately 1.2 million subscribers at year end 2000, of which approximately 1.1 million (92%), accounting for over 95 % of our revenues, resided in the Moscow license area. The Moscow license area, which consists of the city of Moscow and the Moscow Region, has a combined population of 15 million, accounts for more than half of all Russian mobile cellular subscribers and has a penetration rate of 13%, compared to 2.3% in Russia overall. At December 31, 2000, our market share in the Moscow license area was 55% of all mobile cellular subscribers and 71% of all GSM subscribers.

The remainder of our subscribers reside in and our revenues are generated by our operations outside the Moscow license area in 19 other regions of Russia. In addition, we hold GSM licenses, but do not currently operate, in 22 other regions of Russia. Overall, we are licensed to operate in 43 regions of Russia with an aggregate population of approximately 80 million people, or more than 55% of the country's total population. These licenses include GSM 900 and 1800 licenses for the St. Petersburg license area, which has approximately of 6.4 million inhabitants. In regions where we have not yet commenced operations, including St. Petersburg, we plan to do so in accordance with the terms of our licenses.

Telecom XXI, which we acquired in May 2001, has GSM 900 and 1800 licenses to operate in ten regions of Russia: the city of St. Petersburg, Leningrad region, Karelia Republic, Nenetsky autonomous district, Arkhangelsk region, Vologda region, Kaliningrad region, Murmansk region, Novgorod region and Pskov region. The total population of Telecom XXI's license areas is 13.4 million people, although it currently operates a network, consisting of a mobile switching center and 15 base stations, only in St. Petersburg. The St. Petersburg licence area, covering the second largest city in Russia, has a penetration rate of under 7%, as compared to Moscow's penetration rate of 17%.

We plan to create a full GSM 900 and 1800 network in St. Petersburg license area. By the end of year 2001, we intend to have a network integrating a mobile switching center with an initial capacity of 100,000 numbers and 120 base stations. The installation of these base stations will allow us to cover St. Petersburg. We also intend to provide coverage within a corridor along the entire Moscow–St. Petersburg highway by the end of year 2001, enabling us to provide continuous cellular connection along the road between the most important cities of the country. We plan to spend $80 million for network development in connection with our acquisition of Telecom XXI in 2001, and new network, integrated with our current network and marketed under our name, is sceduled to be launched in the fourth quarter of 2001.

The following table summarizes our financial and operating performance for the last four years.

| | December 31, | | | |
|---|---|---|---|---|
| | **1997** | **1998** | **1999** | **2000 (7)** |
| **Our Data:** | | | | |
| Subscribers (1) ......................... | 59,000 | 114,000 | 307,000 | 1,194,000 |
| Overall market share in the Moscow License area ............................ | 27% | 34% | 40% | 55% |
| GSM market share in the Moscow license area | 100% | 84% | 69% | 71% |
| Net revenues............................ | $208,408 | $338,323 | $358,327 | $535,712 |
| EBITDA (in thousands) (2) | $103,476 | $154,762 | $169,260 | $232,595 |
| EBITDA margin (3)................. | 50% | 46% | 47% | 43% |
| Average monthly service revenues per subscriber (4) ........................... | $409 | $302 | $124 | $54 |
| Average monthly minutes of usage per subscriber (5) ........................... | 313 | 384 | 224 | 151 |
| Subscriber churn rate (6).......... | 22.5% | 31.2% | 20.8% | 21.6% |

(1) We define a "subscriber" as an individual or organization that has a contract with us for the provision of mobile cellular telecommunication services and whose invoices are not overdue by more than two months. Our subscriber figures exclude those of ReCom, which is an unconsolidated subsidiary for the period discussed but which will be a consolidated subsidiary starting with the year ending December 31, 2001. As of December 31, 2000, ReCom had 15,000 subscribers.
(2) EBITDA, which represents income before provision for income taxes, interest, depreciation and amortization, should not be considered in isolation as an alternative to net income, operating income or any other measure of performance under U.S. GAAP. We believe that EBITDA is a relevant measurement utilized by the cellular industry to assess performance that attempts to eliminate variances caused by the effects of differences in taxation, the amount and types of capital employed and depreciation and amortization policies.
(3) "EBITDA margin" represents EBITDA as a percentage of net revenues.
(4) We calculate our average monthly service revenue per subscriber by dividing our service revenues for a given period, including guest roaming fees, by the average number of our subscribers during that period and dividing by the number of months in that period.
(5) Average monthly minutes of usage per subscriber is calculated by dividing the total number of minutes of usage during a given period by the average number of our subscribers during such period and dividing by the number of months in such period.
(6) We define our "churn rate" or "churn" as the total number of subscribers who disconnect (whether involuntarily due to non-payment or voluntarily, at such subscriber's request) from our network during the year, expressed as a percentage of the average number of our subscribers during that year.
(7) In April 2001, we acquired a controlling interest in ReCom, our previously unconsolidated subsidiary, increasing our stake to 53.9% from 49.9%. This allows us to consolidate ReCom in our financial statements beginning with the second quarter of 2001. At the time of our acqusition of majority control, ReCom had 28,000 subscribers.

## Strategy

Our strategy is to become the first truly national mobile cellular operator in Russia by integrating our regional networks into a single unified network, developing standardized tariffs and deploying integrated nationwide customer service and billing systems. To accomplish this we intend to strengthen our leading position in our key market, the Moscow license area, through a continued focus on quality service and cost control. In 2000, we more than doubled the number of integrated sales and customer service centers, increased our dealer network, and expanded our inbound and outbound call center. We intend to invest in new customer service and billing systems to help maintain customer satisfaction, reduce costs and control churn.

We also intend to continue to take advantage of the Moscow license area as a platform from which to test and launch new products and services. In 2000, we introduced several new services, including access to selected Internet-based services based on wireless application protocol, or WAP, technology and exclusive mobile cellular service in thirteen Moscow underground stations, which we plan to increase to 34 by the end of 2001. We also successfully trialled a data service based on general packet radio service, or GPRS, a high-speed transmission technology. The technical launch of GPRS services was implemented in Moscow licensed area on August 28, 2000, with 160 base stations, and the required software support for commercial GPRS service is now installed at all base stations in Moscow license area. In addition to Moscow licensed area, we have technically launched GPRS network in four other license areas: Tver, Smolensk, Yaroslavl and Kostroma. By upgrading our software, we plan to offer our customers GPRS services and applications at transmission speeds of up to 40.2 Kb per second.

We expect that our focus will now shift to a transition to third-generation, Universal Mobile Telecommunications System, or UMTS, mobile cellular systems based on W-CDMA technologies. Beginning in 2001, we began to create two UMTS test zones, one based on Siemens equipment and the other on Motorola equipment. The Siemens test zone will integrate a UMTS mobile switching center, a radio network controller and three base stations. We intend to use this test zone to evaluate technical difficulties relating to a UMTS network, including electromagnetic compatibility, subscriber handover and roaming, real data transfer rates within the test zone and connection stability and quality.

We also intend to begin a new service utilizing an enhanced SIM-card to enable subscribers to access a full range of Internet-based services. This service differs from a similar service based on WAP protocol in that a SIM-browser enables a subscriber to set up specific links on its SIM-card to allow access directly via a handset menu, without using WAP-site directories. The subscriber can also review and prepare data, such as e-mails, off-line, making this service more cost-attractive.

In addition to these new services, we plan to selectively roll out our business model and expand our network to parts of European and Asian Russia, primarily the Central, Northwestern, South and Volga regions and the Urals. Because per capita wealth and disposable income in these regions are generally well below those in the Moscow license area, we intend to focus our expansion initially on high density areas, such as regional capitals and transportation routes, based on factors such as commercial return, strategic importance, market potential, license requirements and competition. In the event we expand by acquisition of other GSM operators or license holders, we intend to consider the transparency of the business dealings of the operator or license-holder in question and, in the case of an operator, the technical compatibility of its network with ours.

## Current Operations

### *Our license areas*

The following table shows, as of June 1, 2001, information with respect to the license areas in which we provide or expect to provide GSM services:

| | | GSM-900 AND 1800<br>License Region | Licensee (1)<br>900/1800 MHz | GSM-1800 ONLY<br>License Region | Licensee (1)<br>1800 MHz |
|---|---|---|---|---|---|
| MOSCOW LICENSE AREA | | Moscow | MTS OJSC/Rosico | | |
| | | Moscow Region | MTS OJSC/Rosico | | |
| ST. PETERSBURG LICENSE AREA | | St. Petersburg (2) | Telecom XXI | | |
| | | Leningrad Region (2) | Telecom XXI | | |
| REGIONAL LICENSE AREAS | EUROPEAN RUSSIA | Pskov | MTS OJSC/ Telecom XXI | Yaroslavl | Rosico |
| | | Novgorod (2) | Telecom XXI | Ivanovo (2) | Rosico |
| | | Komi Republic (2) | MTS OJSC/Rosico | Tambov (2) | Rosico |
| | | Karelia (2) | Telecom XXI | | |
| | | Arkhangelsk (2) | Telecom XXI | | |
| | | Nenetsk (2) | Telecom XXI | | |
| | | Vologda (2) | Telecom XXI | | |
| | | Murmansk (2) | Telecom XXI | | |
| | | Kaliningrad (2) | Telecom XXI | | |
| | | Tver | MTS OJSC/Rosico | | |
| | | Kostroma | MTS OJSC/Rosico | | |
| | | Tula | MTS OJSC/Rosico | | |
| | | Vladimir | MTS OJSC/Rosico | | |
| | | Ryazan | MTS OJSC/Rosico | | |
| | | Smolensk | MTS OJSC/Rosico | | |
| | | Kaluga | MTS OJSC/Rosico | | |
| | | Voronezh | ReCom/Rosico | | |
| | | Belgorod | ReCom/Rosico | | |
| | | Bryansk | ReCom/Rosico | | |
| | | Kursk | ReCom/Rosico | | |
| | | Lipetsk | ReCom/Rosico | | |
| | | Orel | ReCom/Rosico | | |
| | | Nizhny Novgorod (2) | Rosico | | |
| | | Kirov (2) | Rosico | | |
| | | Udmurt Republic | UDN/Rosico | Sverdlovsk (2) | Rosico |
| | | Perm (2) | Rosico | Orenburg (2) | Rosico |
| | | Chelyabinsk (2) | Rosico | Kurgan (2) | Rosico |
| | | Komi | MTS/ Rosico | Komi-Permyatsk (2) | Rosico |
| | ASIAN RUSSIA | Omsk (3) | MSS | Tyumen (2) | Rosico |
| | | | | Yamalo-Nenetsk (2) | Rosico |
| | | | | Khanti-Mansiysk (2) | Rosico |
| | | Amursk (3) | ACC | | |

(1) Each of the licenses held by us, ReCom, UDN-900, MSS and ACC are specific to the Moscow license area or a single region. Rosico has licenses which cover the following:
  a) Moscow license area
  b) Central, Central-Black Earth, and Volga Regions (Tver, Kostroma, Tula, Vladimir, Ryazan, Smolensk, Kaluga, Voronezh, Bryansk, Belgorod, Lipetsk, Orel, Nizhny Novgorod, Kirov, Yaroslavl, Kursk, Tambov and Ivanovo Regions); and
  c) Urals, Northern and Western Siberia Regions (Udmurt Republic, Chelyabinsk, Sverdlovsk, Kurgan, Orenburg, Perm Regions and Komi-Permyatsk Autonomous District in the Urals, Komi Republic in the Northern Region and Tyumen Region, Khanti-Mansiysk, Yamalo-Nenetsk autonomous districts in Western Siberia Region).
  d) Telecom XXI hold licenses which cover North, North West and Kalinngrad region (St. Petersburg, Leningrad, Arkhangelsk, Vologda, Murmansk, Novgorod, Pskov, Kaliningrad regions, Karelia Republic and Nenetsk autonomous district).

(2) Our regional license areas in which the licensee has not commenced operations.
(3) 900 MHz frequency allocation only.

Each of our licenses, except that covering the Moscow license area, contains a requirement that service be commenced and that subscriber-number and territorial-coverage targets be achieved by a specified date. Neither the Ministry of Communications nor other parties have taken or attempted to take legal actions to suspend, revoke or challenge the legality of any of our licenses. We have not received any notice of violation of any of our licenses.

We have received extensions in our regional license areas in which we have not commenced operations. We believe that we are in compliance with all material terms of our licenses.

*Services Offered by Us*

Network Access

We primarily offer mobile cellular voice, data and facsimile communication services to our subscribers on the basis of various tariff plans. In general, subscribers pay a monthly subscription fee and a per-minute charge for usage. We also offer Taksphone, a prepaid service designed for business travelers, tourists and others with short term telecommunications needs who do not wish to enter into a service contract.

Automatic Roaming

Roaming allows our customers, both subscribers and guest roamers, to receive and make international, local and long-distance calls while traveling outside of their home network. Roaming is provided through individual agreements between us and other GSM operators. Unlike many other Russian cellular telecommunications providers that require additional equipment or prior notification, our roaming service is instantaneous, automatic and requires no additional equipment.

At December 31, 2000, we had roaming contracts with 173 GSM service providers in 85 countries allowing our subscribers to roam throughout Europe and parts of North America, Australia, Asia and Africa. We continually seek to expand our roaming capability and are currently in negotiations with additional operators. In Russia, as of December 31, 2000, in addition to our network coverage area in 21 regions of Russia, GSM service is available to our subscribers in parts of 40 other regions of Russia, including in most major cities, as a result of roaming agreements.

Roaming agreements regulate the relations and billing procedures between operators. The host operator sends the roamer’s home operator a bill for the roaming services provided to the roamer. The roamer's home operator pays the host operator directly for the roaming services then includes the amount due for the provision of roaming services in the roaming subscriber's monthly bill.

Value-Added Services

We offer the following value-added services to our customers these services may be included in the tariff plan selected by the subscriber or for which subscribers pay additional monthly charges and, in some cases, usage charges:

*Call Divert/Forwarding* diverts or forwards incoming calls to another telephone number. We receive revenue for the diverted part of the call, as well as for the usual incoming connection.

*Call Barring* prevents specified inbound and outbound calls from being completed and, as a result, may help to control the customer's usage rates.

*Caller I.D. Display* enables customers to identify the telephone number of calls incoming from our subscribers. This feature may be blocked by a customer who has purchased *Caller I.D. Barring* which enables customers to prevent the identification of their telephone number.

*Call Waiting* alerts customers who are using their telephone that another party is attempting to call to them; customers then have the option of ignoring the new call or answering it while placing the existing call on hold. In addition to a monthly subscription charge for call waiting, we receive revenues from the subscribers for two calls occurring simultaneously.

*Itemization of Monthly Bills* permits customers to have a record of the telephone numbers they called, the dates, time and duration of the calls they made, as well as the telephone numbers, when available, of the calls they received.

*Voice Mail* enables customers to receive and retrieve messages by executing a particular dialing sequence, whether at home or from an outside location. Such service generates additional calls. In addition to voice messages, our voice mail system permits the storage and retrieval of facsimile messages.

*Information and Directory Service* permits customers to call dedicated, short telephone numbers and receive live information regarding various subjects, including news, weather, transportation, traffic, financial, entertainment and consumer information and emergency services.

*International Access Service* permits customers to make international calls.

*Automatic Customer Care System.* This is a four-digit number which allows subscribers to get access to our Automatic Customer Care system menu. This menu allows subscribers to independently receive account statements, add or cancel current services and make various other account-related inquiries.

*Customer Care System through Internet.* Through this service, our subscribers can access to their personal accounts via the Internet, allowing them to review their accounts, change their service, arrange phone bill delivery and make bank card payments.

*Classified User Group.* Developed exclusively for our corporate customers, the Classified User Group service is offered under our corporate group tariff and allows for services only between specified telephone numbers.

Internet, Data and Facsimile Transmission

*Short Message Service (SMS)* permits customers to exchange text messages via cellular phones. It is also possible to send a message to an MTS cellular phone from a PC via the Internet.

*Mobile Office* allows customers to transmit and receive, data and facsimiles on the subscriber's voice number for no additional charge. We also offer subscribers the ability to use our network to transmit and receive data or facsimiles through dedicated numbers.

*Mobile Internet* gives our customers access to the Internet by dialing a four-digit number, paying only for usage at reduced tariffs. To use either of *Mobile Office* or *Mobile Internet*, a customer must have a handset containing a built-in modem or a separate mobile modem.

*Wireless Application Protocol, or WAP*, enables customers to access the Internet via WAP-enabled handsets. Customers may engage in mobile banking via the Telebank system, view news from leading news agencies such as Prime-TASS, Rosbizneskonsalting, France Press, weather forecasts and TV programs for major channels.

Other Services

In addition to cellular communication services, we offer corporate clients a number of telecommunication services such as design, construction and installation of local voice and data networks capable of interconnecting with fixed line operators, installation and maintenance of cellular payphones, lease of digital communication channels, access to open computer databases and data networks, including the Internet, and provision of fixed, local and long-distance telecommunication services, as well as video conferencing.

## Marketing and Sales

*Target Customers*

Our target customers historically included companies, professionals, high-income individuals, reporters, government organizations, businessmen and diplomats. However, following the economic crisis in August 1998, we launched lower tariffs and widened our cellular services market, aggressively targeting new customer segments, such as family members of businessmen, students, retirees and other mass market customers. We also offer reduced tariffs and lower payments for certain value-added services, as well as tariff plans that utilize lower-cost 11-digit numbers. Although these newer customer segments have lower average monthly usage than our traditional customer base, they have begun to represent the bulk of new demand for cellular services, at least in Moscow. At December 31, 2000, subscribers with 11-digit numbers accounted for 80% of our subscribers, an increase from 60% at the end of 1999. During this period, only 13% of our net additions were on the tariff plans with direct 7-digit Moscow numbers, although this is higher than this rate in 1999, which was only 7%. We believe that we will be able to provide the network capacity and expand our coverage area to serve these new customer segments.

*Advertising and Marketing*

Our advertising consists of

- *brand and image advertising and public relations* to position us as a leading cellular operator in Russia;
- *information advertising* to inform potential customers of the advantages of GSM technology, the high quality and variety of our services and the extensive coverage we offer; and
- *product- and tariff-related advertising* to inform customers of specific promotions, new tariffs and pricing discounts.

We use a combination of newspaper, magazine, radio, television and outdoor advertising, including billboards and signage on buses and kiosks, and exhibitions, to build brand awareness and stimulate demand. Our indirect advertising includes sponsorship of high-profile television programs, sport events , concerts and other popular events. We combine our advertising campaigns with those of telecommunication equipment manufacturers such as Sony, Ericsson, Siemens, Nokia and Panasonic. We are also coordinating the advertising policies of our dealers to capitalize on the increased volume of joint advertising and preserve the integrity and high quality image of the MTS trademark. As we expand our network, we intend to concentrate a greater part of our advertising and marketing effort on positioning us as a national brand. We plan to focus our advertising and marketing on affordable and segmented tariffs and on the wide coverage of our network and the use and availability of national roaming.

*Sales and Distribution*

As of December 31, 2000, our distribution network in the Moscow license area consisted of three integrated sales and customer service centers and 2,050 independent dealer distribution outlets. Of these independent dealer distribution outlets, 1,750 are in Moscow, with the remaining 300 in the Moscow region. In response to the demand shift to mass market subscribers, we have adjusted our distribution strategy and begun to open new dealer outlets in places of high consumer activity, such as supermarkets and malls.

In certain of our regional license areas, we intend to form joint ventures or enter into other cooperative arrangements, when prudent, to perform such tasks as marketing and sales and collection of subscriber payments. We expect that these joint ventures will have agreements with sub-dealers to better service the local markets. We already have also formed joint ventures in the Komi Republic with MTS-RK (in which we hold a 26% stake); in the Tver region with MTS-T (26%) in the Kostroma region with MTS-K (26%) and in Nizhny Novgorod with a 65% stake in MTS-NN. We have, consistent with our policy of ensuring MTS brand integrity, retained ownership of the local network elements, as well as responsibility for their construction, operation and maintenance. These joint ventures also collect subscriber payments, which they remit in full to us. We have also opened branches in 13 regions, including Syktivkar, Tula, Pskov, Smolensk, Ryazan, Vladimir, Kaluga, Kostroma, Tver, Yaroslavl, Ivanovo, Nizhny Novgorod, Kirov.

Some of our dealers purchase handsets directly from us and then sell them to the subscribers that they enroll. If a new subscriber connects to our network with equipment not purchased from us, we charge a connection fee. Under our current policy, dealers receive a commission per subscriber connected based on their monthly sales volume. The commission in Moscow licence area, currently between $50 and $60, increases with the number of new subscribers a dealer signs, regardless of whether the subscriber contracts for a 7-digit Moscow number or an 11-digit federal number. We also control the cash flow from dealers. If the new customer pays in cash, the dealer remits the full amount received to us within three days and we then pay the commission by the end of the month. If the customer chooses to pay by bank transfer or by credit card, the customer pays us directly. After the dealer activates the subscriber’s contract, the dealer’s role in marketing and selling our services to that subscriber ends.

Approximately 72% of our new subscribers are enrolled through independent dealers and we enroll the remainder directly. During 2000, in Moscow license area we increased our direct sales staff by approximately 50% and now employ approximately 150 persons. We also added eight new integrated sales and customer service centers, for a total of 13 at the and of 2000. In response to demand shifts, some of these centers are located outside the central Moscow business district in outlying suburban areas. We intend to continue expanding our distribution network, as well as our independent dealer distribution network.

As the geographical range of our network expands, we expect to increase the number of distribution points, primarily through increasing the number of dealers under contract with us and creating joint ventures with local partners to act as our dealers.

*Principal Competitors*

We compete with at least one other mobile cellular operator in each of our markets. Competition is based largely on price and secondarily on network coverage and quality, the level of customer service provided and the range of services offered.

Our principal competitors in the Moscow license area are VimpelCom, which operates both D-AMPS and dual-band GSM networks, and MCC, which operates an analog network based on the NMT standard. In addition, although CDMA operators are currently limited by regulation to providing fixed wireless services the enforceability of this regulation in not free from doubt. Consequently, we may also face future competition from Sonet, a CDMA network operator in the Moscow license area. Outside the Moscow license area, we compete against VimpelCom and MCC and their affiliates, as well as local or regional operators.

The following table illustrates the number of mobile cellular subscribers, market share and related data for each network operator in the Moscow license area at the end of 1998, 1999 and 2000:

| | **1998** | **1999** | **2000** |
|---|---|---|---|
| VimpelCom total, of which: (1) | 124,000 | 350,500 | 833,600 |
| D-AMPS | 103,000 | 218,500 | 387,300 |
| GSM | 21,000 | 132,000 | 446,300 |
| MCC (NMT) (2) | 90,000 | 95,000 | 100,500 |
| Sonet (CDMA) (3) | - | 10,000 | 20,000 |
| **Moscow total** | **328,000** | **755,500** | **2,148,100** |

1) Source: VimpelCom press-releases, dated March 26, 1998; April 14, 2000; and April 26, 2001.
2) Source: MCC public statement as reported by Bridge News, January 14, 2000; www.sotovik.ru.
3) Source: Interfax News Agency, February 8, 2000; Interview of Mikhail Susov, CEO of Sonet, to Vedomosty, 15 February 2001.

We believe that VimpelCom will continue to be our primary competitor in the Moscow license area for the foreseeable future. VimpelCom, on April 26, 2001, reported approximately 833,600 subscribers at December 31, 2000, including 780,100 in the Moscow license area, of which approximately 446,300 were GSM subscribers. In the GSM market, VimpelCom accounted for 29% of all new subscribers in 2000, while we accounted for the remaining 71%%. VimpelCom and its subsidiaries also hold licenses to operate D-AMPS networks in eight other regions of Russia and licenses to operate GSM networks in the Central Region and Central Black Earth Region, the Volga Region, the North Caucasus Region and the Siberian Region.

MCC operates an analog NMT mobile cellular network in the Moscow license area. MGTS, which is a subsidiary of one of our principal shareholders, Sistema, and two other Russian companies, control MCC. Affiliates of MediaOne International and Millicom International Cellular S.A. also own stakes in MCC. MCC commenced operations in December 1991 and, according to the telecommunications information agency www.sotovik.ru, at year-end 2000, had approximately 100,500 subscribers in the Moscow license area. MCC recently abandoned a project with Ericsson Radio Systems and Nokia to offer GSM services in Russia using the 400 MHz band when Ericsson Radio Systems declined to participate. MCC has instead elected to pursue a license to operate a third-generation network based on the CDMA 2000 standard, which would operate on the same frequencies as the current network operated by MCC. In March 2000, the Ministry of Communication issued an approval to MCC to construct a trial network using the CDMA 400 standard based on equipment developed by Lucent Technologies, Hyundai Electronic Industries and Qualcomm.

In addition to our current competitors, we expect that Sonic Duo, a new market entrant has anounced (source: Press release dated 16 May 2001) that it has concluded preparatory work on the network construction and that the commercial launch of the network is scheduled for the third quarter 2001. It is intended that, by the time of the launch, the network will cover the city of Moscow and the most populous places in Moscow Region. We believe that Sonic Duo is owned 35% by Sonera, the leading Finnish telecommunications operator, and 65% by TsT Mobile. TsT Mobile is a joint-venture owned 51% by Central Telegraph, which in turn is owned by Svyazinvest, and 49% by Transcontinental Mobile Investments, a company which is believed to have close ties with LV Finance, a Russian investment company. Both Svyazinvest and Central Telegraph are effectively controlled by the Russian federal government.

Our competitors have also developed roaming networks. In 1998, VimpelCom put into operation its dual-band GSM network and offers its GSM subscribers international roaming capability comparable to ours. However, at the end of 2000, approximately 46% of VimpelCom's subscribers still used the D-AMPS network, which we believe offers limited automatic roaming capability in Russia. Moreover, VimpelCom D-AMPS subscribers cannot roam in Europe without borrowing a GSM handset from the company. By contrast, the D-AMPS standard is prevalent in much of North America to roam in Europe allowing VimpelCom D-AMPS subscribers greater roaming flexibility than either we or VimpelCom offer GSM customers.

MCC, together with the Ministry of Communications and a Russian telecommunications company, Interregional Transit Telecom, established a unified NMT roaming network in Russia under the commercial name "Sotel," allowing automatic roaming in certain regions of Russia using the NMT standard. As of December 31, 2000, NMT roaming was available in most regions of Russia, as well as countries of the former Soviet Union.

In 1998, CDMA licenses for fixed wireless services were issued in Russia. Because, CDMA services are classified as fixed telephony, CDMA licensees are prohibited from providing mobile telephony services. In February 2000, the Moscow Commercial Court upheld a 1999 ruling by the Ministry of Communications that CDMA systems could only be used for fixed wireless services against a challenge by the Ministry of Antimonopoly Policy. However, the Ministry of Communication's ban is difficult to monitor effectively, and therefore CDMA systems may compete directly with mobile operators, including us.

JSC Personal Communications, a wholly owned subsidiary of MTU-Inform, which is indirectly controlled by one of our principal shareholders Sistema, has a CDMA license for the Moscow license area and began operations under the brand name "Sonet" in August 1998. Sonet publicly claimed to have a frequency capacity of more than 100,000 subscribers and a subscriber base of 20,000 at December 31, 2000. Sonet was also the first provider to offer unlimited local calls for a greatly reduced monthly charge, albeit at a relatively high connection charge. CDMA licenses in other regions have been issued primarily to the regional public switched telephone network operators, which are subsidiaries of Svyazinvest.

*Tariffs*

In response to the Russian economic crisis in August 1998 and consistent with our marketing strategy, we developed new tariff plans to appeal to a broader market. New subscribers can currently choose from one of thirteen tariff plans: Business, Favorite, Saver, Youth, Local, Corporate, Corporate Plus, Corporate Group, Corporate Five, Corporate Five Plus, Corporate Ten and Corporate Ten Plus and our pre-paid tariff plan, called Taksafon,. Corporate tariffplans (Corporate, Corporate Plus, Corporate Group, Corporate Five, Corporate Five Plus, Corporate Ten and Corporate Ten Plus) are available only to corporate subscribers who sign a minimum six month contract with us, have four or more telephones and pay more than $2,000 monthly, with average traffic per phone monthly of not less than $100.

These thirteen general tariff plans combine different initial connection fees, monthly network access fees, per minute usage charges and value-added service in packages designed to appeal to different market segments. In December 1999, we began billing our subscribers on a per-second basis, commencing with the second minute of use. In April 2000, we introduced a new, pre-paid tariff plan that allows subscribers to use our network by purchasing and activating a Subscriber Identity Module, or SIM, card and a pre-paid card, although we do not promote it actively. Business, Favorite, Corporate, Corporate Five and Corporate Ten use direct Moscow 7-digit numbers, whereas Saver, Youth, Local and Taksafon, our pre-paid plan, Corporate Plus, Corporate Five Plus, Corporate Ten Plus and Corporate Group assign a lower-cost, 11-digit federal telephone number using a “902” prefix. Federal 11-digit numbers require that a caller from a public switched telephone network first dial the long-distance access code “8” followed by the federal (902) number and then the seven-digit telephone number, or dial a specific Moscow number and then tone dial the seven-digit number. With a “local” number, a caller using a public switched telephone network within the Moscow “095” area code needs to dial only seven digits, without first having to access the long-distance network. For calls within Moscow’s “095” area code, 11-digit numbers are, for billing purposes, treated the same as local numbers. The Corporate, Corporate Plus, Corporate Five, Corporate Five Plus, Corporate Ten, Corporate Ten Plus and Corporate Group plans are available only to high-use corporate clients. Subscribers may change tariff plans at any time for a cost.

Our costs with respect to 11-digit numbers are significantly lower than those associated with local numbers since 11-digit numbering capacity, supplied by Rostelecom, does not incur a monthly charge and carries a lower connection fee compared to the local numbers offered to us. As a result, we are able to pass on a portion of the savings to subscribers through lower tariffs and connection fees. The disadvantages of 11-digit numbers are two-fold:

- they cannot be dialed easily from telephones that block long-distance access via the “8” code and do not have tone dialing capability; and
- incoming and outgoing calls suffer lower completion rates due to the capacity constraints of Rostelecom’s long-distance network.

To maintain our image as a provider of superior mobile cellular telecommunication services, we have maintained a pricing policy for our GSM network with limited discounts. We occasionally participate in promotional campaigns and cooperative advertising sponsored by handset manufacturers. These campaigns include promotions allowing a customer who buys the manufacturer’s handset to pay no connection fee, as well as lotteries with prizes from manufacturers. These fees are covered by pre-set payments received by us from the handset manufacturer. We set prices with reference to the market and believe that our pricing is competitive vis-à-vis alternative providers of mobile communications services. We expect that, as the mass market is penetrated and subscriber numbers increase, competition will place downward pressure on the prices we charge for our services.

Our thirteen tariff plans offer a variety of pricing schemes. The per-minute tariff for calls to Moscow from Moscow vary from $0.18 per minute to $0.34 per minute during peak periods and from $0.15 per minute to $0.19 per minute during offpeak periods, with some plans offering discounted rates at night, sometimes as low as $0.04 per minute. Higher rates apply to calls in Russia but outside Moscow. With all plans, we assess an international surcharge ranging from $1.35 per minute for calls to European countries to $2.40 per minute for African countries. Our value-added services, such as Caller ID and Call Waiting, are sometimes included in the plan at no additional charge and sometimes carry a charge between $2.00 and $6.00 per month, depending on the plan.

In addition, incoming and outgoing calls from one cellular telephone to another within the same network connected to the same mobile switching center are charged at no cost and with a discount of 20% to 50%, respectively. We also offer special tariffs for intranet calls which are considerably lower than normal roaming tariffs.

*Customer Payments and Billing*

Before 1997, subscribers were enrolled in a credit payment system under which they were billed monthly for their access, usage and value-added service fees. Since November 1997, we have enrolled new subscribers, except for certain corporate clients, in an advance payment program under which the customer prepays a specific amount to cover these fees.

We believe that customer acceptance of the advance-payment option is due to the high degree of automation of our customer care and billing system, which telephonically transmits reminders to add funds before service is discontinued, helping subscribers to monitor and control their mobile telephone expenses. Our system monitors each subscriber account and sends a ten-day advance warning on the customer's mobile telephone when the advance payment amount decreases below a certain threshold, which is approximately the average consumption by the subscriber for a ten-day period. Then the system sends a daily telephonic reminder of the decreasing account balance, including the current level of the subscriber's remaining deposit and a recommendation as to the sum that should be advanced to us based on the subscriber's historical usage. In addition, we have implemented an enhancement to the system that allows such reminders to be sent via the Short Message Service.

Under the credit payment system, customers are billed monthly in arrears for their network access and usage. If the invoice is not paid within 25 days, the customer may face an up to $20 late payment charge. We limit the amount of credit extended to customers based on the customer's payment history, type of account and past usage. Currently, subscribers using the credit system of payment have a maximum credit limit of $1,000. When the limit is reached, the subscriber receives an invoice, which must be paid within five days. If the subscriber fails to do so, we block the telephone until the invoice is settled. We actively manage our subscriber base to migrate existing credit payment customers over to the advance-payment system. However, existing credit payment customers may continue on their old tariff plan as long as their accounts remain in good standing.  As of December 31, 2000, there were approximately 96.5%  customers using the advance-payment system and 3.5% customers using the credit system.

Our tariffs are quoted in currency units equivalent to U.S. dollars.  Invoices specify the amount owed in U.S. dollar-equivalent units and require translation into rubles in order to make payments.  We currently offer our subscribers in the Moscow license area six ways to pay:

- Cash or credit card payment in our customer service centers.  Cash or credit card payment can be made at any one of our integrated sales and customer care centers in Moscow.  On payment, the official exchange rate of the Central Bank on the date of payment is used for the translation of U.S. dollar-equivalent amounts into rubles.
- Payment via wire transfer.  Payment may be made by wire transfer to our account, with U.S. dollar-equivalent amounts being translated into rubles according to the official exchange rate of the Central Bank on the date of receipt of the payment order for execution by the payer's bank.
- Payment by cash payment to a local bank.  Cash payment can be made through branches of Sberbank, the national savings bank of Russia, and Guta-Bank.  We currently have agreements covering 18 of Sberbank's branches, more than 40 Guta-Bank branches in Moscow, 15 Guta-Bank branches in the Moscow region and 6 regional Guta Bank branches. For this service, we have opened special personal accounts at Guta-Bank that allow payments to be received within one day.  In addition, subscribers may pay in any branch of Sberbank, subject to a bank surcharge.
- Payment on account.  A subscriber may, by establishing a special account at Guta-Bank, use Guta-Bank's Telebank System to pay by drawing on the account, either by sending instructions via telephone, accessing the account via WAP on the mobile phone or through the Internet.  The official exchange rate of the Central Bank on the date of the payment is used for the translation of the U.S. dollar-equivalent amounts into rubles.
- Credit card payment via telephone or Internet.  A subscriber may use a credit card to pay via telephone or the Internet by entering an access number.  A credit subscriber may arrange to have monthly invoice amounts automatically charged to a credit card.
- Pre-paid cards.  Customers on our pre-paid tariff plan, when first joining our network, need to purchase a special subscriber package that includes a Subscriber Identity Module, or SIM, card, a personal identification number and a personal unblocking key, in addition to a pre-paid card with a value equivalent to $5.  Depending on their value, which ranges from the equivalent of $10 to $90 dollars, the pre-paid cards have a time period in which a subscriber must use them fully.  After the expiration of the time limit, pre-paid cards become inactive, notwithstanding any value remaining on the card.  Subscribers can purchase additional pre-paid cards at any of our integrated sales and customer service centers.
- Express-payment cards.  This brand-named service allows our subscribers to purchase scratch cards with values ranging from $10 to $100.  The subscriber can then call a special number, enter the account number and the scratch card number, and the subscriber's account will be credited for the scratch card amount.

We continued to increase the number of customer service centers where subscribers can make payments by opening eight new offices in 2000.

*Customer Service*

We believe that to attract and retain customers, we must provide a high level of service in the key areas of customer assistance, care and billing. In 2000, we addressed capacity constraints with the opening of a 310-station call center, adding 220 new stations and reducing call waiting time to an average of 80 seconds. The call center provides customer service in Russian and in English 24 hours per day, seven days a week. Customer service representatives answer about 25,000 calls per day, including inquiries regarding disconnection due to lack of payment, handset operation, roaming capabilities, service coverage and billing. We have a special group to handle customer claims and to assist customers who wish to change their services. In addition, customer service staff follows up with customers who have discontinued service to determine the reasons for disconnection and to help us improve our services or tariff plans to accommodate subscriber needs. We also have more than 170 customer service and financial control department representatives at our eleven walk-in centers to assist customers and address their questions. Each representative serves, on average, approximately 37 customers a day.

Our customers are able to access automatically their account balance information, activate certain value-added features, and receive information regarding us and our services by dialing "0880" or "767-0880"—Automatic Customer Care System. In December 1999, we also introduced a new, Internet-based service, "Customer Care SystemThrough the Internet." This service allows subscribers to access their accounts via our Internet site and carry out, on-line, all major account activities such as payments by credit cards, viewing and delivery of itemized statements by fax or via e-mail and changes in the selection of value-added services.

**Network Technology**

We believe that geographic coverage, capacity and reliability of the network are key competitive factors in the sale of mobile cellular telecommunication services. Our network is based primarily on GSM-900 infrastructure, augmented by GSM-1800 equipment, especially in high-use areas in the Moscow license area. However there is no qualitative difference between GSM-900 and GSM-1800 services. Therefore, the higher-frequency 1800 MHz signals do not propagate as far as 900 MHz signals. More 1800 MHz base stations are typically required to achieve the same geographic coverage, but are more efficient in relieving capacity constraints in high traffic areas. In regions where geographic coverage, rather than capacity, is a limiting factor, networks based on GSM-900 infrastructure are typically superior to those based on GSM-1800 because they require fewer base stations to achieve coverage and, therefore, cost less. In most markets, including in Russia, the most efficient application of GSM technology is to combine GSM-900 and GSM-1800 infrastructure in a unified network, which is commonly referred to as a dual-band GSM network.

*Network Infrastructure*

We use switching and other network equipment supplied by Motorola, Siemens and an authorized dealer of Lucent Technologies. The radio frequencies allocated to us for the operation of GSM-900 service in Moscow span 11.4 MHz of spectrum in the city of Moscow and 10.2 MHz of spectrum in the Moscow Region. The frequencies allocated to us in the city of Moscow include 1.2 MHz of limited capacity spectrum with restricted emanation that we may only use in the Moscow underground or in a microcell to enhance coverage and capacity within buildings. As the certificates to use these 1.2 MHz of frequencies expired at the end of May 2001, we have applied for and are awaiting the extension of these permissions. During 2001 we also returned 3.2 MHz of limited capacity spectrum with restricted emanation to the Ministry of Communications to allow research into the joint use of frequency spectrum by cellular operators. In addition, we have been granted frequencies spanning 19.4 MHz of spectrum in the Moscow license area for operation of GSM-1800 base stations. We believe that these allocations in the Moscow license area are adequate and that we have also been allocated adequate spectrum in our regional license areas.

In September 2000, we technically launched general package radio systems (GPRS) equipment on 160 base stations in Moscow. Currently installed commercial version of the software support all base stations in Moscow license area to operate in GPRS mode. In addition to Moscow licensed area we have technically launched GPRS network in 4 of its licensed areas: Tver, Smolensk, Yaroslavl and Kostroma. The new software installed allow transmission speeds upto 40.2 Kb per second. By the end of the year due to the GPRS technology development, we would be able to allow our customers GPRS services and applications at the speed of 40.2 Kb per second. Several corporate clients participated in trials using Motorola Timeport handsets. We plan to roll our GPRS network out as soon as enough GPRS-enabled handsets are available from our suppliers.

*Base Station Site Procurement and Maintenance*

The process of obtaining appropriate sites requires that our personnel coordinate, among other things, site-specific requirements for engineering and design, leasing of the required space, obtaining all necessary governmental permits, construction of the facility and equipment installation. We use site development software supplied by Lucent Technologies to assess new sites so that the network design and site development are coordinated. Our own software can create a digital cellular coverage map of Moscow, taking into account the peculiarities of the Moscow urban landscape, including the reflection of radio waves from buildings and moving automobiles. Used together, these software tools enable us to plan base station sites without the need for numerous field trips and on-site testing, saving us considerable time and money in our network buildout.

Base station site contracts are essentially cooperation agreements that allow us to use space for our base stations and other network equipment. These agreements range from one to 49 years, with the term of a majority of agreements being three to five years. Under these agreements, we have the right to use premises located in attics or on top floors of buildings for base stations and space on roofs for antennas. We pay the lessor in cash or with telephones that provide a specified amount of free usage or a combination of both, which is accounted for on the basis of standard rates. In areas where a suitable base station site is unavailable, we construct towers to accommodate base station antennae. We anticipate that we will be able to continue to use our existing GSM-900 base station sites and to co-locate GSM-1800 base stations at some of the same sites.

To provide quality service to subscribers, our maintenance department, staffed 24 hours per day, performs daily network integrity checks and response to reported problems. Our technicians inspect base stations and carry out preventative maintenance at least once every six months.

*Interconnect Arrangements and Telephone Numbering Capacity*

Cellular operators must interconnect with local, inter-city and international telephony operators to obtain access to their networks and, via these operators, to the networks of other operators around the world. We have local interconnection agreements, including agreements for the provision of telephone numbering capacity, with several telecommunications operators in Moscow, including the principal public switched telephone network operator, MGTS, as well as MTU-Inform, majority owned by MGTS, and Telmos, a joint venture of MGTS with AT&T and Rostelecom. For use of 11-digit telephone numbering capacity and the associated interconnection, we have agreements with Rostelecom. Local interconnection typically entails payment of a one-time connection fee, a monthly fee per subscriber connected and a usage charge based on minutes of traffic, or some combination thereof.

To provide our subscribers with domestic long-distance services, we have interconnection agreements with Rostelecom and Interregional Transit Telecom and, to provide international services, with Rostelecom and Sovintel, a joint venture of Rostelecom and Golden Telecom, Inc. MTU-Inform and Telmos also provide domestic long-distance and international services through interconnection with the Rostelecom network. Most interconnection fees are based on usage by minute and vary depending on the destination called.

Russian legislation requires that public switched telephone networks may not refuse to provide interconnection or discriminate against one operator in comparison to another. Certain interconnection fees are subject to government regulations, such as those set by Rostelecom, but, in general, the fees charged by one commercial operator to another for interconnection may not exceed three times the cost of providing that interconnection. In practice, there is no mechanism for determining interconnection cost and, therefore, interconnection fees are set by agreement between the operators concerned.

A combination of regulatory, technological and financial factors has led to the limited availability of local telephone numbering capacity in Moscow and the Moscow Region. To meet subscriber demand and provide for an adequate inventory of numbering capacity, we have purchased numbering capacity from various vendors for cash. Our right to use this numbering capacity ranges from five years to an unlimited period of time. See Note 10 to our Consolidated Financial Statements. We amortize the acquisition costs of numbering capacity over a period of five to ten years. See Note 3 to our Consolidated Financial Statements.

To foster the growth of telecommunications in Russia and to increase the telephone numbers available to GSM operators in Russia, the Russian government has devised a plan to link all GSM operators in Russia by means of a national network. As envisioned, this network would be based around eight hubs to be linked together through fiber-optic cable connections. In accordance with a Ministry of Communications decree, we were appointed a coordinating operator in the Central Region of Russia, which includes 16 operators. We expect that we and other GSM operators in Russia will, if and when this national network is implemented, be able to decrease reliance on current interconnection arrangements.

*Network Monitoring Equipment*

We use our network management center to control and monitor the performance of our network and our call completion rate. We use our monitoring systems to optimize our network and to locate and identify the cause of failures or problems. We have agreements with our suppliers for technical support services that allow us to obtain their assistance in trouble-shooting and correcting problems with our network within the warranty period.

*Handsets*

To receive service from us, subscribers must have a handset that can be used on our network. New subscribers who do not own a GSM handset must buy one, either directly from us or from an independent dealer. We and our dealers also offer an array of mobile telephone accessories, with the typical new subscriber spending $29 to $49 on such items in addition to the handset.

Since July 1998, we have offered subscribers dual-band GSM-900/GSM-1800 handsets. These dual-band handsets are currently in widespread use on networks in Western Europe and, because they send and receive communications on both GSM-900 and GSM-1800 frequencies, they can relieve possible congestion on our network and increase the ability of our customers to roam. The share of dual-band handsets has consistently increased from approximately 1% of the total our handset sales in 1998 approximately 97% in 2000. To take full advantage of our integrated GSM-900 and GSM-1800 network, we expect that a substantial majority of the handsets we sell in the future will be dual-band. We also offer dual-band GSM-900/PCS-1900 handsets, which permit the holder to roam in the United States and other areas on PCS-1900 networks. We estimate that, as of December 31, 2000, approximately 85% of our subscribers had dual-band handsets. We also offer our subscribers tri-band handsets. These handsets, which function in the GSM-900, GSM-1800 and PCS-1900 standards, provide users with greater automatic roaming possibilities in Russia, Europe, the United States and Canada. In the second part of 2000, we responded to competitive pressure by introducing limited handset subsidies. At present, the amount of these subsidies, which we only offer in our own integrated sales and customer care offices, are up to $20 per handset on the less expensive models. However, considering the experience of mobile cellular service providers in more mature markets and VimpelCom's continued program of handset subsidies, increased competition may compel us to subsidize handsets more heavily.

We have entered into arrangements with Ericsson, Nokia, Motorola, Philips, Panasonic, Samsung, Siemens, Sony, Benefon and Alcatel to purchase GSM-900 handsets and dual-band handsets. We offer approximately five GSM-900 and more than 40 GSM-900/GSM-1800 handset models, the majority of which are manufactured by Ericsson, Nokia, Siemens and Motorola. We are not dependent on any particular supplier for handsets. The handset manufacturers provide training to our sales force, customer service personnel, dealers and engineering staff and cooperate with us on marketing and promotion. To ensure quality control and to maintain the MTS brand image, we encourage our dealers to purchase handsets for use on our network directly from us. We expect that typical dual-band handset will range in cost from approximately $40 to $200 and that subscribers' purchase and use of such handsets will increase due to the development of our dual-band network and the introduction and development of GSM-1800 networks around the world.

Around 30% of our new customers choose to be connected to MTS network with equipment purchased from us (including the equipment resold to them that our dealers previously purchased from us).

**Government Regulation**

In the Russian Federation, the federal government controls the regulation of the telecommunication services. The principal legal act regulating telecommunications in the Russian Federation is the Federal Law on Communications, dated February 16, 1995, as amended. The Federal Law on Communications provides for, among other elements, the following:

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

The Federal Law on Communications is a framework law which refers to regulations to be enacted by government bodies. Although a number of these regulations have been promulgated, regulations enacted under the legislative framework in place prior to the Federal Law on Communications continue to be applied to the extent that they do not contradict the Federal Law on Communications.

**Regulatory Authorities**

The Ministry of Communications regulates the telecommunications industry, largely through the issuance of all licenses for the provision of mobile telephone services in Russia, regardless of the standard or technology, and the issuance of instructions. The Ministry of Communications also allocates federal funding for the telecommunications industry and oversees the technical condition and development of telecommunications, including the licensing and supervision of the GSM, AMPS, NMT and CDMA networks.

Regulatory agencies under the Ministry of Communications include the State Radio Frequencies Service and the Department for Supervision over Communications and Informatization. The State Radio Frequencies Service , as part of its primary responsibility of developing and implementing a long-term policy for frequency allocation, issues frequency permits. As part of issuance process, the State Radio Frequencies Service obtains consents from other federal authorities for a particular frequency allocation, including consents from the

Ministry of Defense and civil aviation authorities. The Department for Supervision over Communications and Informatization is responsible for the technical supervision of networks and equipment throughout Russia, including the monitoring of the compliance of network operators with applicable regulations, terms of their licenses and terms of the use of frequencies allocated to them. The Department for Supervision over Communications and Informatization is also responsible for equipment certification.

The Ministry of Antimonopoly Policy of the Russian Federation supervises competition and pricing regulations. The Federal Agency on Government Communications and Information, an executive agency whose role in telecommunications regulation is not clearly defined in the Federal Law on Communications, is primarily responsible for the development and maintenance of networks for the government of Russia. Additionally, the Ministry of Health Protection has some authority over the location of telecommunications equipment.

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

The Ministry of Communications issues telecommunications licenses based on the Regulations on Licensing in the Field of Telecommunications in the Russian Federation, enacted by Decree No. 642 of the Russian government on June 5, 1994, and Decree No. 578 of June 10, 1998, on Approval of Regulations for Holding a Contest for Receipt of Licenses Associated with the Provision of Cellular Radiotelephonic Services. Under these regulations, licenses for telecommunication services may be issued and renewed for periods ranging from three to ten years. Our licenses expire in various years from 2004 to 2008 and may be renewed upon application to the Ministry of Communications. For example, the GSM license with frequency allocation in the 900 MHz band covering the Moscow license area expires in 2004. Officials of the Ministry of Communications have fairly broad discretion with respect to both issuance and renewal procedures.

A company must complete a three-stage process before commercial launch of a communications network:

- receipt of a license from the Ministry of Communications to provide mobile telephony services using a specific standard and band of radio frequency spectrum;
- approval to use specific frequencies within the specified band from the State Radio Frequencies Service ; and
- issuance by the Department for Supervision over Communications and Informatization of a permission for network operations To receive this permission, a licensee must develop a frequency allocation and site plan, which is then reviewed and certified by the Department for Supervision over Communications and Informatization for electromagnetic compatibility of the proposed cellular network with other radio equipment operating in the license area. The Department for Supervision over Communications and Informatization has discretion to modify this plan, if necessary.

Both the Federal Law on Communications and related licensing regulations prohibit the transfer of a license, including assignment or pledge of a license as collateral, except for licenses awarded through a competitive tender, which may be transferred throughout their term. Additionally, Letter No. 1805 of March 25, 1999, of the Ministry of Communications stipulates that agreements on the provision of telecommunications services must be concluded and performed by the actual licensee.

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

- failure to comply with the terms and conditions of the license;
- failure to provide services within three months from the start-of-service date set forth in the license;
- provision of inaccurate information about the communication services rendered to consumers; and
- refusal to provide documents requested by the Ministry of Communications.

Licenses may be terminated for the various reasons, including:

- failure to remedy timely the circumstances which resulted in a suspension of the license;
- unfair competition by the license holder in providing the licensed services; and
- other grounds set forth by Russian legislation or international treaties.

Decisions of the Ministry of Communications on suspension or termination of licenses may be appealed in court. To date, there have been no legal actions seeking to suspend or terminate any of our licenses nor have we received any notice of violation with respect to any of our licenses.

Licensing fees are calculated as multiples of the monthly minimum wage, currently 200 rubles, or approximately $6.90 and are 30 times the monthly minimum wage, or approximately $207, for mobile radio-communication services and 40 times the monthly minimum wage, or approximately $276, for mobile radiotelephone and cellular communication services.

Licenses also generally contain a number of other detailed conditions, including a date by which service must begin, technical standards, and a schedule of the number of subscribers and percentage coverage of the licensed territory which must be achieved by specified dates. We have commenced service by the applicable deadline in accordance with our licenses. In the areas in which we have not yet commenced operations, we have received an extension of the deadlines.

In addition to the licensing fees and contributions, Decree No. 552 of the Russian government of June 2, 1998, requires a payment of fees for use of radio frequency for cellular telephone services. Decree of the Russian government No. 895, dated August 6, 1998, further requires that all operators pay an annual fee set by the State Radio Frequencies Service and approved by the Ministry of Antimonopoly Policy, for the use of their frequency spectrums. According to Government Decree No. 380 communications operators must also make monthly payments to fund the operations of the Department for Supervision over Communications and Informatization. These payments are fixed by the Ministry of Communications and approved by the Ministry of Economy and the Ministry for Antimonopoly Policy in the amount of 0.3% of revenues generated by rendering communications services.

### Equipment Certification

Certain telecommunications equipment must be certified to be used in the Russian Federation. The Ministry of Communications issues certificates of compliance with technical requirements to equipment suppliers based on a review by the Department of Certification. In addition, a Presidential Decree requires a license and equipment certification from Federal Agency on Government Communications and Information to design, produce, sell, use or import encryption devices. Some commonly used digital cellular telephones are designed with encryption capabilities and must be certified by the Federal Agency on Government Communications and Information.

Further, all high-frequency equipment, defined as involving frequencies in excess of 9 kHz, manufactured or used in the Russian Federation requires special permission from the Department for Supervision over Communications and Informatization. These permissions are specific to the entity that receives it, and does not allow the use of the equipment by other parties.

The Ministry of Communications Decree No. 8 of January 14, 1997, also directs public switched telephone network operators to give preference to Russian producers when purchasing switching equipment. Public switched telephone networks must receive the Ministry of Communications permission in order to purchase foreign-produced equipment. Also, Decree No. 903 of the Russian government on Regulation of Use of Equipment in the Interconnected Telecommunications Network, dated August 5, 1999, gives the Ministry of Communications and the Ministry of Antimonopoly Policy the right to restrict the use of certain equipment, including the equipment manufactured outside Russia.

### Competition and Pricing

The Federal Law on Communications requires federal regulatory agencies to encourage competition in the provision of communication services and prohibits the abuse of a dominant position to limit competition. The Federal Law on Communications provides that telecommunications tariffs may be regulated if necessary. Presidential Decree No. 221, dated February 28, 1995, on Measures for Streamlining State Regulation of Prices (Tariffs) and Decree No. 239 of the Russian government, dated March 7, 1995, as amended, allow for regulation of tariffs and other commercial activities of telecommunications companies which are “natural monopolies.” In accordance with the Decree of the Ministry of Antimonopoly Policy of 13.10.2000 No. 61 the basis for inclusion into the register is the existence of a license for provision of communications services stated in Section 2 of the provision and existence of data confirming the factual provision of services. At present, neither we nor our affiliates is included in the register of subjects of natural monopolies and therefore neither we nor our affiliates are subject to these regulations.

### Interconnection and Pricing

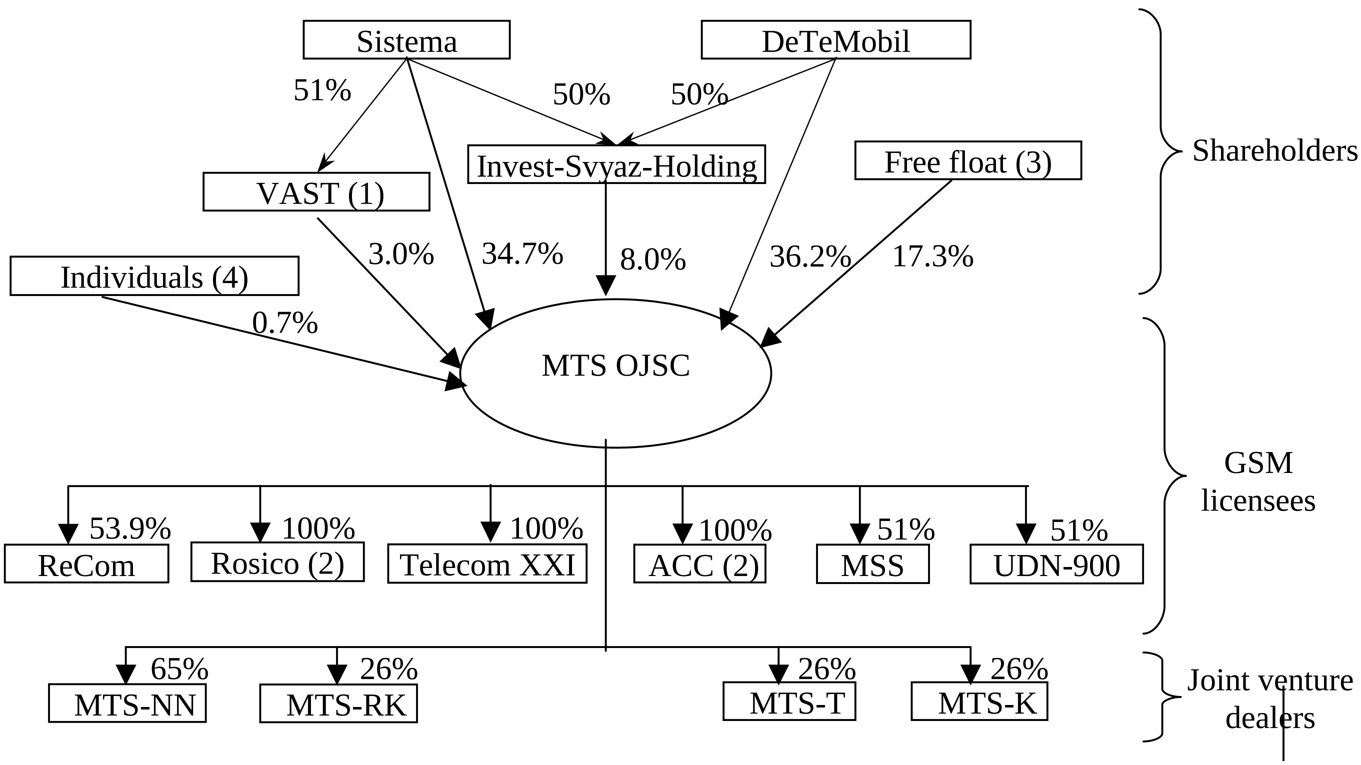
Mobile operators are free to set their own tariffs, in contrast to fixed line telephony tariffs, which have to be approved by the Ministry of Antimonopoly Policy. The Ministry of Antimonopoly Policy also has certain oversight authority with regard to rates between certain regional telephone operators, long-distance provider Rostelecom and mobile operators. In addition, Russian legislation requires that operators of public switched telephone networks, may not refuse to provide connections or discriminate against one operator in comparison to another. However, a regional fixed-line operator may charge different interconnect rates to different mobile operators, subject only to the requirement that the rates do not exceed three times the public switched telephone network operator's costs.

**Seasonality**

Our business is not materially affected by seasonal factors.

## C. Organizational Structure

The following chart illustrates our current ownership structure and ownership percentages of our subsidiaries and affiliates:




1. VAST is a limited partnership formed under the laws of Russia. ASVT OJSC, a Russian company engaged in the Russian telecommunications business, owns the remaining 49% interest in VAST.
2. At an extraordinary general meeting on May 10, 2001, our shareholders passed a resolution pursuant to which our wholly-owned subsidiaries Rosico and ACC will be merged into us. The merger is expected to be completed in the third quarter of 2001.
3. As part of our initial public offering completed on July 6, 2000, we have deposited 345,244,080 shares of our common stock in an ADR program with Morgan Guaranty Trust.
4. Upon completion of our initial public offering, selected directors, key advisors and executives of the company received 3,587,987 shares of our common stock representing 0.18% of our issued and outstanding shares. See "Item 7.B—Related Party Transactions—Key Advisors for Initial Public Offering." The terms of our stock option plan will allow our directors and executives, together with management, to receive up to an additional 9,966,631 shares of our common stock, representing 0.5% of our issued and outstanding shares. These 9,966,631 shares, which were issued to Rosico in our initial public offering, will be held either as treasury shares or will be transferred to a wholly-owned subsidiary following completion of our merger with Rosico. Please refer to note 19 of our financial statements.

All of our subsidiaries are organized and operate under the laws of the Russian Federation. Our ownership interest and voting power in each subsidiary shown above are identical. Our strategic shareholders are telecommunications companies with significant telecommunication assets and experience.

## D. Property, Plant and Equipment

We occupy premises in Moscow at 4 Marksistskaya Street and 10 Teterinsky Pereulok, which we use for administration as well as operation of mobile switching centers. The rights to use the premises were contributed to our charter capital by a founding shareholder. We also own nine buildings in Moscow, located at 2/10 and 4 First Golutvinsky Pereulok, 5 Vorontsovskaya Street, 24/2 Malaya Dmitrovka Street, 12/12 Pankratevskiy Per., 4/1 Ermolova Street, 103 Prospect Mira and 9, Sokolnitcheskay Square for use by our sales and customer service departments, as well as billing, financial control and technical services departments. We also lease other buildings in Moscow for similar purposes, including marketing and sales and other service centers. We intend to build new technical and administrative offices over the course of the next two years. We also own office buildings in some our regional license areas outside the Moscow license area, including Vladimir, Pskov, Ryazan, Kaluga, Tula and Kirov, and lease office space on an as-needed basis. We plan to acquire more buildings in St. Petersburg, Nizhny Novgorod, Yaroslavl and Ivanovo as well. Our use of these premises is not affected by environmental factors.

The primary elements of our network are base stations, base station controllers, transcoders and mobile switching centers. Base stations, each situated at a fixed site and constituting a cell or a sector of a cell, provide the radio link between the mobile station, that is, the user’s handset and the broader network. These base stations, supplied by Motorola, Siemens or an authorized dealer of Lucent Technologies, house radio transmission and reception equipment, and are linked via microwave or fiber-optic cable to base station controllers, also supplied by these manufacturers. Each base station controller manages a group of base stations, allocating radio channels among them and managing handovers from one base station to another as the mobile user moves from cell to cell. These base station controllers are, in turn, linked, in most cases via fiber-optic cable, to mobile switching centers, supplied by Siemens and an authorized dealer of Lucent Technologies, that effect handovers from one base station to another whenever the two base stations involved are managed by different base station controllers. In addition, mobile switching centers provide interconnection with the public switched telephone network and with the networks of other operators, including other mobile cellular operators. GSM technology is based on an “open architecture,” which means that equipment from one supplier can be combined with that of another supplier to expand the network. Thus, there are no technical limitations to using equipment from other suppliers. Several major suppliers currently offer GSM-900/1800 mobile cellular equipment and the market for suppliers is competitive.

At the end of 1999, we had put into operation a 180 kilometer-long, fiber-optic loop in the Moscow license area, with data transmission equipment supplied by Bosch Telekom GmbH. This fiber-optic loop enables us to improve the reliability and quality of our Moscow network, as well as reduce cost of operation. During the course of 2000, we expanded this network to a length of 400 kilometers.

To connect base stations with their respective base station controllers, we currently lease fiber-optic links from MTU-Inform, Sovintel, Rostelecom and GlobalOne, as well as use our own microwave connections. Wherever practical and cost-effective, we intend to replace microwave links with more reliable connections using fiber-optic cable. The following table sets forth the infrastructure installed by us as of December 31 of each year.

| | **1997** | **1998** | **1999** | **2000** |
|---|---|---|---|---|
| Base Stations | 163 | 349 | 709 | 1123 |
| Moscow license area | 158 | 268 | 497 | 766 |
| Regional license areas | 5 | 79 | 212 | 357 |
| Base station controllers | 11 | 22 | 31 | 35 |
| Mobile switching centers | 2 | 6 | 8 | 13 |

Of the 766 base stations in the Moscow license area at December 31, 2000, 638 operated in the 900 MHz band and the remainder in the 1800 MHz band. The initial buildout of GSM-1800 infrastructure is concentrated in the center of Moscow and in the parts of the Moscow region close to Moscow along transport routes, as well as in the main cities of the regional licensed areas.

Currently we have seven mobile switching centers in Moscow license area, compared with five mobile switching centers at the beginning of the year. At the end of 2001 the number of mobile switching centers in Moscow license area will reach ten. For more information regarding our capital expenditure plans for our networks, see "Item 5B—Liquidity and Capital Resources—Future Capital Expenditure."

## Item 5. *Operating and Financial Review and Prospects*

### A. Operating Results

The following is a discussion of our financial condition and results of operations for the years ended December 31, 1998, 1999 and 2000, and of the material factors that we believe are likely to affect our consolidated prospective financial condition. You should read this section together with our consolidated financial statements for the years ended December 31, 1998, 1999 and 2000, and the notes to those financial statements, which have been audited by the independent public accounting firm of Arthur Andersen and appear elsewhere in this document. Our consolidated financial statements have been prepared in accordance with U.S. GAAP.

### Basis of Presentation of Financial Results

We maintain our records and prepare our statutory financial statements in accordance with Russian accounting principles and tax legislation. The financial statements presented in this document have been prepared from Russian accounting records for presentation in accordance with U.S. GAAP. These financial statements and results differ from the financial statements issued for statutory purposes in Russia in that they reflect adjustments not recorded in our Russian books, which are required to present the financial position, results of operations and cash flows in accordance with U.S. GAAP.

We report to the Russian tax authorities in rubles, and our accounting records are maintained in that currency. The financial statements in this document have been prepared in accordance with U.S. GAAP and are stated in U.S. dollars. Accordingly, transactions and balances not already measured in U.S. dollars, mainly rubles and Deutsche Marks, have been translated into U.S. dollars in accordance with the relevant provision of FAS No. 52, “Foreign Currency Translation” as applied to entities in highly inflationary economies. Under FAS No. 52, revenues, costs, capital and non-monetary assets and liabilities are translated at historical exchange rates prevailing on the transaction date. Monetary assets and liabilities are translated at exchange rates prevailing on the balance sheet date. Exchange gains and losses arising from remeasurement on monetary assets and liabilities that are not denominated in U.S. dollars are credited or charged to operations.

For the purposes of the following discussion, all references to us include only MTS OJSC and our consolidated subsidiaries, and exclude ReCom.

***Overview***

We are a leading provider of cellular telecommunications services in Russia. In the operation of our networks, we employ technology based exclusively on the Global System for Mobile Communications (GSM); the most widely used mobile cellular telephone standard in the world.

Since 1994, we have been providing GSM-standard mobile cellular communications services in the Moscow license area, and, in 1997, we expanded our license area when we obtained licenses in Tver Region, Kostroma Region and the Komi Republic. In early 1998, we participated in the founding of ReCom and acquired 24.8% of its share capital upon formation. In the latter half of 1998, we further enlarged our license area through the acquisition of interests in Rosico and RTC CJSC and the acquisition of an additional interest in ReCom. In 1999, we acquired a majority interest in Udmurt Digital Network-900, or UDN-900, a company licensed to operate a GSM-900 network in the Udmurt Region, Amur Cellular Communications, or ACC, a company licensed to operate a GSM-900 network in the Amursk Region, and Mobilnye Sistemy Svyazi OJSC, or MSS, a company which is licensed to operate a GSM-900 network in the Omsk Region with a frequency allocation in the 900 MHz band. In May 2001, we acquired 100% of Telecom XXI, which holds dual band licenses in 10 regions, including St. Petersburg, for $50 million. We have licenses to operate in 43 regions of the Russian Federation and are currently operating in 21 of these regions. Our licenses authorize us to provide GSM services in both the 900 and 1800 MHz frequency bands in 32 of these regions and we currently offer dual band service in 18 regions, including the Moscow license area.

To date, we have increased our sales primarily by increasing the number of subscribers.

| | At December 31, | | |
|---|---|---|---|
| | **1998** | **1999** | **2000** |
| Subscribers | 114,000 | 307,000 | 1,194,000 |

We assess the number of subscribers who disconnect from our network in any given year in relation to our average subscribers in that year as a measure of market competition and customer dynamics. The following table shows this subscriber churn rate for 1998, 1999 and 2000.

| | Year Ended December 31, | | |
|---|---|---|---|
| | **1998** | **1999** | **2000** |
| Subscriber churn rate | 31.2% | 20.8% | 21.6% |

We believe that our subscriber churn rate increased in 1998 due to heightened competition and broadening of the subscriber base, but also as an effect of the 1998 economic crisis. Our subscriber churn rate for the year ended December 31, 1999 decreased to 20.8% compared to 1998 as the macroeconomic situation stabilized. The churn rate for the year ended December 31, 2000 increased to 21.6% as competition in the Moscow license area intensified.

In the months following August 17, 1998, Russia experienced acute financial and economic distress. The Russian government's default on its short-term ruble-denominated treasury bills and other ruble-denominated securities, the Central Bank's abandonment of its policy to support the ruble exchange rate within a predefined range and the temporary moratorium on certain hard currency payments led to:

- a large devaluation of the ruble;
- a sharp increase in the rate of inflation;
- the near collapse of Russia's banking system;
- defaults on hard currency obligations;
- a dramatic decline in the prices of Russian debt and equity securities; and
- an inability to raise funds in the international capital markets.
- 

Following the onset of the economic crisis, we experienced:

- a slowdown of our revenue growth;
- an increase in our subscriber churn rate;
- a need to introduce lower tariffs to retain existing subscribers and attract new subscribers; and
- significant currency losses on cash balances denominated in rubles.

We expect that we will continue to be affected for the foreseeable future by Russia's unstable economy.

All of our non-current assets are in the Russian Federation. No impairment of these assets, including licenses, has occurred as of December 31, 2000. However, we do believe it is reasonably possible that our carrying value for non-current assets, in particular the carrying value for Rosico licenses, could be significantly affected by a continuation of the economic crisis in Russia.

## Revenues

Our principal sources of revenue are:

- service revenues, including monthly subscription fees;
- usage fees and fees received by us pursuant to roaming agreements;
- value-added service fees;
- connection fees; and
- revenues from sales of handsets and accessories.

We set our fees and prices with reference to the competitive environment and we expect price competition to increase in the future. In December 1999, we introduced per-second billing for local calls, starting from the second minute. Our fees are not currently regulated by any organization or governmental authority.

*Tariff Structure*

We offer new subscribers thirteen tariff plans, introduced in 1999, 2000 and 2001. Seven of these plans, Corporate, Corporate Plus, Corporate Five, Corporate Five Plus, Corporate Ten, Corporate Ten Plus and Corporate Group, are available only to corporate subscribers who have a contract with MTS for a minimum of six months, have four or more telephones and pay more than $2,000 monthly. All other new subscribers can choose from one of six tariff plans: Saver, Local, Youth, Business, Favorite and Taksafon, our prepay plan. Tariffs under the thirteen plans combine different initial connection fees, monthly subscription fees, per minute usage charges and value-added service in packages designed to appeal to different market segments. In addition to the thirteen tariff plans on offer, a number of subscribers continue to pay for services under plans that are no longer offered to new subscribers.

Since 1997, we have enrolled new subscribers, except for certain corporate clients, in an advance payment program under which the customer prepays a specific amount of monthly subscription fees, usage charges and value-added service fees. Before November 1997, new subscribers were enrolled in a credit payment system under which they were billed monthly for their subscription, usage and value-added services. These payment systems are described in greater detail under the headings "Item 4.B—Business Overview—Customer Payments and Billings" and "—Tariffs."

In order to reduce our exposure to ruble fluctuations, all of our tariffs are quoted in units equivalent to U.S. dollars. Subscribers pay their bills in rubles, however, as required by Russian law. The U.S. dollar equivalent amounts are generally translated into rubles at the exchange rate quoted by the Central Bank on the date of payment.

*Service Revenues*

Monthly subscription fees consist of fixed monthly charges for network access. Included in this category is a monthly charge to subscribers who purchase international and domestic long-distance access. Monthly subscription fees represented 21.6% of our revenues in 1998, 20.7% in

1999 and 17.0% in 2000. We expect monthly subscription fees to decrease gradually as a percentage of revenues as competitive pressures force us to decrease the fixed element of the customer's monthly fee.

Usage fees include amounts charged directly to our subscribers, both for their usage of our network, as well as their usage of other operators' GSM networks when roaming outside of our service area. We bill our subscribers for all incoming and outgoing calls except for incoming local calls originated by other of our subscribers. Outgoing calls to another one of our subscribers receive a discount. We bill our subscribers for their usage of other operators' networks, plus a margin. The usage fees charged for a call originating on our network depend on a number of factors, including the subscriber's tariff plan, call duration, the time of day when the call was placed, call destination and whether the call was incoming or outgoing. Usage fees represented 54.3% of our revenues in 1998, 54.8% in 1999 and 72.8% in 2000. We expect usage fees to continue to grow as a percentage of revenue as the fixed element of the customer's monthly fee decreases.

We offer our subscribers an array of value-added services, including call forwarding, call waiting, call barring, call identification, voice mail and itemized billing. These services have historically comprised a small proportion of total sales, but we expect this proportion to increase slightly with subscriber growth. We expect that revenue from additional services will vary based upon penetration rates, customer usage, pricing and advertising and promotional programs. We expect roaming fees as a percentage of revenues to increase gradually in the future. To achieve that, we are concentrating our network development efforts in the areas where foreign and domestic visitors first connect to our networks, such as airports.

Roaming fees include amounts charged to other GSM operators for their subscribers, i.e., guest roamers, utilizing our network while traveling in our service area. We bill other GSM operators for calls of guest roamers carried on our network. Roaming fees represented 16.7% of our revenues in 1998, 12.3% in 1999 and 8.1% in 2000.

*Connection Fees*

Connection fees consist of charges paid to us by subscribers for initial connection to our network. We defer connection fees and recognize them as revenues over the estimated average subscriber life. Connection fees represented 2.6% of our revenues in 1998, 3.6% in 1999 and 2.8% in 2000. We expect connection fee revenues to decline as a percentage of total sales as:

- the ratio of new subscribers to existing subscribers continues to fall;
- expansion of service to a broader market base requires reductions in the initial subscription price; and
- competition in the Moscow and regional license areas continues to increase.

*Handsets and Accessories*

A substantial portion of our subscribers purchase their handsets and accessories directly from us and indirectly from dealers who purchase such handsets and accessories from us. Since

1998, we have offered subscribers handsets that operate in both the 900 and 1800 MHz bands, referred to as dual-band handsets. Our average selling price of handsets fell from a high of approximately $586 in 1997 to approximately $125 in 2000.

| | **1998** | **1999** | **2000** |
|---|---|---|---|
| Revenues from sale of handsets and accessories | 4.8% | 8.6% | 6.8% |
| Gross margin on sale of handsets and accessories | 10.3% | 3.5% | (7.9%) |

We had a positive gross margin from sales of handsets and accessories in 1998 and 1999. In 2000 we had a negative gross margin. For competitive reasons, we sold handsets for minimal profit. Included in the cost of sales handsets are the production costs of SIM cards; these costs amounted to $7 million in 2000. We expect that as subscribers are added to our network and prices of handsets decrease, the sales of handsets and accessories will continue to decline as a percentage of total sales.

**Expenses**

Our principal expenses are:

- cost of services and products, including interconnection and line rental, cost of equipment, and roaming expenses;
- operating expenses, including salaries, rent and other general and administrative expenses;
- sales and marketing expenses;
- provisions for doubtful accounts;
- depreciation of network equipment and amortization of telephone numbering capacity, license costs, goodwill and other intangible assets; and
- provisions for income taxes.

*Cost of Services and Products*

*Interconnection and line rental*. Interconnection and line rental charges include charges payable to other operators for access to, and use of their networks, which is necessary in the course of providing service to our subscribers as described under “Item 4.B—Business Overview—Interconnect Arrangements and Telephone Numbering Capacity.”

We expect unit interconnect costs to decline, although the aggregate amount payable by us will increase as our subscriber base and traffic volumes increase. We expect the cost of leasing telecommunication lines to vary based on the number of base stations, base station controllers, the number and capacity of leased lines utilized and competition among providers of leased lines as well as availability and usability of substitutes such as microwave links owned by us. We expect that expenses relating to leased lines will decrease as we expand the use of our own fiber-optic network in the Moscow license area.

*Roaming Expenses*. Roaming expenses consist of amounts charged by other GSM operators under agreements for roaming services provided to our subscribers while outside our service area.

*Costs of Handsets and Accessories Sold to Dealers and Subscribers.* We have entered into supply agreements with various producers and suppliers of handsets and accessories to satisfy our requirements at what we believe to be competitive prices. We expect the demand for handsets and accessories to decrease, due to the availability of "gray" handsets on the Moscow market, as well as the fact that many new subscribers already own a handset, either purchased on the gray market or because they are churn clients from other operators. We expect the cost per handset to decline due to our ability to work directly with suppliers to secure volume discounts, technology advances and competitive pressures in the market for handsets.

*Operating Expenses*

Operating expenses consist primarily of:

- salaries of employees;
- social contributions payable to the Russian government;
- taxes other than income, e.g., taxes based on sales and property taxes;
- general and administrative expenses; and
- rent.

Rent expenses include lease payments for base station sites and office space. General administrative expenses include costs relating to the technical support group for network development, the finance and accounting group and the billing department. Total operating expenses are expected to increase over time to reflect the increasing costs and staff required to service our growing subscriber base, but should decline as a percentage of total sales and per subscriber.

*Sales and Marketing*

Sales and marketing expenses consist of:

- amortization of subscriber acquisition costs, comprised of dealer commissions on new connections, over the estimated average subscriber life; and
- expenses for advertising and promotion.

These expenses also reflect advertising, promotions and other costs associated with the expansion of services into our regional license areas and are expected to increase as subscriber numbers increase there. We expect these costs to increase as a percentage of total expenses as we implement our strategy to further develop our brand and introduce value-added services. We also expect these expenses to increase in the second half of 2001 due to aggressive promotion campaigns related to the start up of operations in large markets such as St. Petersburg and Nizhny Novgorod.

*Provision for Doubtful Accounts*

We expect our required provision for doubtful accounts to remain stable as a percentage of net revenues as a result of the advance payment system.

*Depreciation of Property, Plant and Equipment and Amortization Expenses*

We expect depreciation expense, which is principally associated with the acquisition of network equipment, to increase significantly in line with our planned network development program and the buildout associated with our regional license area. Correspondingly, we also expect amortization of telephone numbering capacity and license costs to increase in line with our planned development programs and the expansion of our subscriber base, including subscribers in our regional license areas.

*Provision for Income Taxes*

The income tax base for Russian companies is gross profit computed for accounting purposes, reduced or increased in accordance with tax regulations. For this purpose, gross profit is defined as profit from sales of goods, works and services, fixed assets and other property and income from non-sale operations, less the amount of certain expenses incurred in such operations. Under the Russian income tax regulations the cost of sales is computed according to special deductibility regulations. These regulations combine very detailed guidance as to what can be deducted for statutory accounting purposes with specified limitations and restrictions on deductibility. For example, there are ceilings on deductibility of advertising or entertainment expenses. Deductions are limited or denied for a number of items commonly seen as fully deductible expenses under Western accounting rules. Examples include:

- interest on loans;
- advertising and business travel expenses above a stated limit;
- non-mandatory insurance expenses;
- research and development expenses; and
- training costs.

An applicable tax treaty, which overrides national legislation, may establish different deductibility rules. In this regard, the tax treaty, as interpreted by the Ministry of Finance, between Russia and Germany stipulates that advertising costs incurred by a Russian company are fully deductible so long as German ownership exceeds 25%. Through ownership by DeTeMobil GmbH and Siemens AG, German participation has exceeded this amount since our formation in 1993. Direct German participation was 36.2% as of December 31, 2000. Therefore, we can deduct substantially all advertising costs that we incur on our many advertising campaigns.

Generally, tax declarations remain open and subject to inspection for a period of three years following the tax year. While most of our tax declarations have been inspected without significant penalties, these inspections do not eliminate the possibility of re-inspections. Accordingly, as of December 31, 2000, substantially all of our tax declarations are open for further review.

The existing tax legislation established certain benefits and concessions for companies engaged in the production and service industry. Notably, taxable income may be reduced by amounts reinvested for specific purposes. However, the total reduction from this form of incentive together with certain other reductions may not exceed 50% of the taxable income for the period. The most significant reinvestment purposes are technical re-equipment, reconstruction, expansion and development of production facilities, and the installation of new facilities. Given that we are considering expansion involving significant capital construction, this concession is of particular importance.

In addition to the preceding factors, the decline in the value of the ruble against the U.S. dollar reduces the value to us of tax savings arising from capital investment tax incentives and the depreciation of our property, plant and equipment since their basis for tax purposes is denominated in rubles at the time of the investment or acquisition. While government regulations had historically been enacted to provide for the revaluation of the taxation basis to mitigate a portion of the loss arising from high rates of inflation, no such upward revaluation has been allowed since January 1, 1998. Continued reduction in the value to us of the tax benefits attributable to our investments in property, plant and equipment could materially adversely affect our results of operations and financial condition.

We do not expect our provision for income taxes as a percent of revenues to change significantly subject to the above factors.

**Recent Acquisitions**

We completed three acquisitions during 1998, two during 1999, one in 2000 and one in the current year to date to increase our potential subscriber base, enhance our roaming capability within Russia and strengthen our competitive position.

In August 1998, we acquired 80% of the outstanding common stock of Rosico in exchange for 408,631,860 shares of our common stock, representing approximately 25% of our common stock. During 2000, we completed 20% acquisition of Rosico stock and currently we own 100% interest of Rosico. Rosico holds three licenses with frequency allocations in the 1800 MHz band covering the Moscow license area, 18 regions of Central Russia, and 11 regions in the Urals, Northern, and Western Siberia Regions, respectively, which collectively encompass an aggregate population of approximately 61 million people. We believe that our purchase of an equity interest in Rosico primarily provides us with increased radio frequency spectrum, especially in the Moscow license area, which will enable us to increase our GSM network capacity cost-effectively by expanding the dual-band service potential. At the time of the acquisition, Rosico had obtained the frequencies and had begun design and other preparatory work. Rosico commenced its commercial operations using its allocated frequency in July 1999. As of December 31, 1999 these services are provided in dual-band mode, operating seamlessly with our services provided using frequencies in the 900 MHz band. At December 31, 2000, Rosico had operating revenues of approximately $13,000 and a net loss of approximately $2.9 million.

In September 1998, we acquired 100% of the issued and outstanding capital stock of RTC CJSC, substantially all from DeTeMobil, for approximately $13 million. RTC CJSC held GSM licenses with frequency allocations in the 900 MHz band covering six regions surrounding the Moscow license area: Ryazan, Kaluga, Smolensk, Pskov, Vladimir and Tula, as well as the Tver Region. These regions encompass an aggregate population of approximately eight million people. In March 2000, we merged with RTK to create MTS OJSC. This corporate reorganization has been accounted for at historical cost in a manner similar to that in pooling of interest accounting. Shares, earnings per share and other per share information have been restated to give retroactive effect to MTS OJSC's share structure.

In October 1998 we acquired 25.1% of the outstanding capital stock of ReCom from Sistema for cash and in April 2001 we acquired 4% of the outstanding capital stock of ReCom from an independent off-shore company for $1 million, increasing our aggregate equity interest in ReCom to 53.9%. The remaining interest in ReCom is held by two offshore entities, Eulobay Holding Limited and Halden Management Limited, and one local entity, LLC Atlant. If we fund any network development by ReCom, we intend that it be on the basis of a separate agreement between ReCom and us. ReCom was founded in February 1998 and currently holds GSM licenses with frequency allocations in the 900 MHz band in six regions: Belgorod, Voronezh, Kursk, Lipetsk, Orel and Bryansk. These regions encompass an aggregate population of approximately nine million people. As of December 31, 2000, ReCom had approximately 15,000 subscribers, operating revenues of approximately $7.4 million, and net income of approximately $0.6 million calculated in accordance with Russian accounting regulations.

In August 1999, we acquired 51% of UDN-900 for approximately $180,000. UDN-900 holds a GSM license with 900 MHz frequency allocation for the Udmurt Republic, which complements the GSM license with the 1800 MHz allocation for the republic held by Rosico. The area covered by the UDN-900 license encompasses an aggregate population of approximately one-and-a-half million people. As of December 31, 2000, UDN-900 had approximately 1,600 subscribers, operating revenues of approximately $247,000, and net loss of approximately $80,000, calculated in accordance with Russian accounting regulations.

In 1999, we acquired 100% of ACC for approximately $131,000. ACC holds a GSM license with 900 MHz allocation for the Amursk Region, an area with a population of approximately one million people. As of December 31, 2000, ACC had approximately 1,000 subscribers, operating revenues of approximately $268,000, and net loss of approximately $240,000 calculated in accordance with Russian accounting regulations.

In March 2000, we acquired for approximately $15,000 a 51% interest in Mobilnye Sistemy Svyazi OJSC, or MSS, a Russian open joint stock company that is licensed to operate a GSM network in the Omsk Region with frequency allocation in the 900 MHz band. The area covered by the MSS license encompasses an aggregate population of approximately two million people. At the time of acquisition, MSS had approximately 3,000 subscribers. As of December 31, 2000, MSS had operating revenues of approximately $1.3 million and a net loss of approximately $1.4 million received according to Russian accounting regulation and adjusted to comply with accounting principles generally accepted in the United States.

Telecom XXI, which we acquired in May 2001, has GSM 900 and 1800 licenses to operate in ten regions of Russia: the city of St. Petersburg, Leningrad region, Karelia Republic, Nenetsky autonomous district, Arkhangelsk region, Vologda region, Kaliningrad region, Murmansk region, Novgorod region and Pskov region. The total population of Telecom XXI's license areas is 13.4 million people, although it currently operates a network, consisting of a mobile switching center and 15 base stations, only in St. Petersburg . We plan to invest approximately $80 million the end of 2001 in the North West region.

We expect that our consolidated results of operations for the years following to December 31, 2000, will be adversely affected by the operating losses expected to be incurred in connection with the operations of ReCom and Telecom XXI.

**Recent Developments**

As of December 31, 1999 our share capital amounted to the equivalent of $49,276 divided into 1,634,527,440 registered shares with par value of 0.1 ruble each.

During July 2000, we issued additional shares in an initial public offering on the New York Stock Exchange. Our shares are traded in the form of American depositary shares (ADS). Each ADS represents 20 shares of our common stock. We issued a total of 17,262,204 ADSs, representing 345,244,080 common shares in the offering. Proceeds from the offering, net of underwriting discount, were $353 million.

On August 11, 2000, we registered our shares issuance report with the Federal Securities Commission of the Russian Federation and, accordingly, officially completed our initial public offering.

**Results of Operations**

The following table sets forth, for the periods indicated, the percentages that certain operations contribute to revenues.

| | Year Ended December 31, | | |
|---|---|---|---|
| | 1998 | 1999 | 2000 |
| **Statement of Operations Data:** | | | |
| Net revenues: | | | |
| Service revenues, net (1) | 92.6% | 87.8% | 90.4% |
| Connection fees | 2.6 | 3.6 | 2.8 |
| Equipment sales | | 8.7 | 6.8 |
| Total net revenues | 100.0% | 100.0% | 100% |
| Cost of services and products: | | | |
| Interconnection and line rental | 12.9% | 10.9% | 7.8% |
| Roaming expenses | 3.9 | 6.1 | 7.7 |
| Cost of equipment | 4.3 | 8.4 | 7.3 |
| Cost of services and products | 21.1 | 25.3 | 22.8 |
| Operating expenses (2) | 16.2 | 18.6 | 20.1 |
| Sales and marketing expenses | 4.6 | 6.6 | 14.3 |
| Provision for doubtful accounts | 3.8 | 2.2 | 0.4 |
| Depreciation and amortization | 5.8 | 15.0 | 16.4 |
| Net operating income | 48.5 | 32.3 | 26.0 |
| Currency exchange and translation losses (gain) (3) | 7.4 | 0.9 | 0.2 |
| Other expenses (income): | | | |
| Interest income | (0.6) | (0.2) | (1.4) |
| Interest expenses, net of amounts capitalized | 2.5 | 3.3 | 2.1 |
| Loss on other assets | 0.8 | 0.2 | 0.0 |
| Other expenses (income) | 0.6 | (0.5) | (0.1) |
| Total other expenses, net | 3.3 | 2.8 | 0.6 |
| Income before provision for income taxes and minority interest | 37. | 28.5 | 25.2 |
| Provision for income taxes | 18. | 5.3 | 9.5 |
| Minority interest in net income | (0.3) | (0.6) | (1.2) |
| Net income | 19.5% | 23.9% | 16.8% |
| Basic and diluted earnings per share | $0.047 | $0.052 | $0.050 |

(1) Service revenues represent subscription fees, usage charges and value-added service fees, as well as roaming fees charged to other operators for guest roamers utilizing our network. Guest roaming fees represented 16.7% of our revenues in 1998, 12.3% in 1999 and 8.1% in 2000.

(2) Operating expenses, including taxes (other than Russian income taxes) and primarily revenue and property-based taxes, represented 4.9% of our revenues in 1998, 4.4% in 1999 and 5.0% in 2000.

(3) On a day-to-day basis, we are exposed to exchange losses on cash balances denominated in rubles and other monetary assets and liabilities. See Note 2 to our consolidated financial statements included elsewhere in this document.

***Year Ended December 31, 2000, Compared to Year Ended December 31, 1999***

*Revenues* for the year ended December 31, 2000 increased to $535.7 million compared to $358.3 million for the year ended December 31, 1999, primarily due to significantly increased subscribers (see "Overview" above in this section), minutes of use and equipment sales, slightly offset by a decrease in certain tariffs and connection fee level. For 2000 service revenues increased by $169.9 million, connection fees increased by $2.1 million and equipment revenues increased by $5.4 million compared to 1999 due to growth in the number of subscribers.

*Cost of services and products* for 2000 increased to $122.3 million from $90.6 million for 1999. Increases in the cost of services and products were primarily due to an increase of $22.4 million in payments to other operators for interconnection, line rental and roaming, as a result of volume increases, while cost of equipment increased by $9.3 million due to higher equipment sales. Cost of services and products as a percentage of revenues decreased by 2.5%, as subscriber growth was not materially offset by a decrease in tariffs and we exploited our own optic-fiber network more intensively in 2000 that decreased interconnection and line rental expenses per revenue unit.

*Operating expenses* for 2000 increased to $107.8 million compared to $66.6 million for 1999. Increases in operating expenses were primarily due to an increase of $16.7 million in salaries and related social contributions for additional personnel including $5.3 expenses associated with management stock bonus plan, an increase of $11.2 in taxes other than income (e.g. taxes based on revenue and property taxes), an increase of $8.7 million in general and administrative expenses, increase of $3.2 in rent of technical premises for network equipment location. Operating expenses as a percentage of revenues increased to 20.1% in 2000 from 18.6% in 1999 as personnel cost and costs related to expansion of the network increased to support our growing subscriber base.

*Sales and marketing expenses* for 2000 increased to $76.4 million compared to $23.7 million for 1999, primarily as a result of the significant increase in the level of business activity and the expansion of sales and marketing support infrastructure. Based on our accounting policy, we capitalize subscriber acquisition costs only to the extent of any revenues that have been deferred from the acquisition of a subscriber, such as connection fees charged to a subscriber to initiate call service. During 2000, as a result of additions of new subscribers, we incurred approximately $30 million of direct subscriber acquisition costs in excess of related connection fees. To comply with our accounting policy, we have expensed approximately $30 million of subscriber acquisition costs in addition to regular amortization of this expense included as a component of sales and marketing expense. Additionally, during 1999, we increased our expenditures on advertising, marketing and other customer-related activities in response to increased competition to accelerate subscriber growth and to increase market penetration. Sales and marketing expenses as a percentage of revenues increased from 6.6% in 1999 to 14.3% in 2000.

*Provision for doubtful accounts receivable* of $2.4 million was recorded for 2000, compared to a provision for doubtful accounts receivable of $8.0 million for 1999. Provision for doubtful accounts receivable represented 0.4% of revenues for the year ended December 31,2000 compared to 2.2% for the year ended December 31, 1999.  The decrease in the level of doubtful accounts reflects the overall improvement in bad debt occurrences, which have stabilized with the introduction of the advance payment system.

*Depreciation and amortization* of network equipment, telephone numbering capacity, license costs and goodwill for 2000 increased to $87.7 million, compared to $53.8 million for 1999.  This increase was attributable to the increased asset base resulting from our continuing expansion of our network, increased numbering capacity to support our growing subscriber base and the amortization of license costs and goodwill recognized in the acquisitions of Rosico and RTC.  Accordingly, as a percentage of total revenues, depreciation and amortization for 2000 increased to 16.4% from 15.0% for 1999.

*Operating income* for 2000 increased  to $139.0 million, compared to $115.6 million for 1999, and operating income as a percentage of revenues for 2000 decreased to 26.0% from 32.3% for 1999, as a result of the foregoing factors.

*Loss on foreign currency exchange* for 2000 decreased to $1.1 million, compared to $3.2 million for 1999, primarily as a result of stabilization of the ruble in terms of the U.S. dollar. As we conduct our basic operations in rubles and are required to comply with Russian currency law restrictions, we expect that we will continue to sustain losses in line with the devaluation of the ruble in the foreseeable future.

*Net interest expense* for 2000 was $3.7 million, compared to net interest expense of $11.0 million for 1999.  In addition, we capitalized interest expenses totaling $0.9 million for 2000 and $1.3 million for 1999 related to borrowings to construct our network.

*Provisions for income taxes* for 2000 increased to $51.1 million, compared to $18.8.0 million for 1999.  These provisions comprised a current income tax charge of $52.1 million for 2000 and $36.5 million for 1999, and deferred taxes of $(932) million for 2000 and $1.0 million for 1999, which arise due to the temporary differences between the basis of computing income under Russian accounting principles and U.S. GAAP.  Provisions for income taxes increased to 9.5% of revenues for 2000, compared to 5.3% in 1999. Provision for income taxes increased to 38.8% as a percentage of income before provision for income taxes and minority interest for 2000, compared to 18.4% for 1999, partly as a result of the increase in the income tax rate starting January 1, 2001 from 30% to 35% that effected deferred tax amount in 2000 year and the increase in expenses not deductible for Russian statutory purposes as the overall level of activity decreased.  See Note 17 to our consolidated financial statements included elsewhere in this document.

*Net income* for the year ended December 31, 2000 increased 5.0% to $90.0 million, compared to $85.7 million for the year ended December 31, 1999, as a result of the foregoing factors.

***Year Ended December 31, 1999, Compared to Year Ended December 31, 1998***

*Revenues* for the year ended December 31, 1999 increased to $358.3 million compared to $338.3 million for the year ended December 31, 1998, primarily due to increased subscribers, minutes of use and equipment sales, offset by a decrease in tariffs. For 1999 service revenues increased $1.3 million, connection fees increased by $4.1 million and equipment revenues increased $14.7 million compared to 1998 due to growth in the number of subscribers.

*Cost of services and products* for 1999 increased to $90.6 million from $71.5 million for 1998. Increases in the cost of services and products were primarily due to an increase of $3.8 million in payments to other operators for interconnection, line rental and roaming, as a result of volume increases, while cost of equipment increased by $15.3 million due to higher equipment sales. Cost of services and products as a percentage of revenues increased to 25.3% in 1999 from 21.1% in 1998 as tariff decreases were initiated without a proportionate reduction in the cost of services.

*Operating expenses* for 1999 increased to $66.6 million compared to $54.6 million for 1998. Increases in operating expenses were primarily due to an increase of $4.8 million in salaries and related pension benefits for additional personnel, an increase of $3.0 million in general and administrative expenses, an increase of $2.3 million in repair and maintenance expenses, and an increase of $2.5 million in insurance expenses. Operating expenses as a percentage of revenues increased to 18.6% in 1999 from 16.2% in 1998 as the adverse effects of tariff decreases were compounded by increases in personnel and other costs needed to support our growing subscriber base.

*Sales and marketing expenses* for 1999 increased to $23.7 million compared to $15.7 million for 1998, primarily as a result of the overall increase in the level of business activity and the expansion of sales and marketing support infrastructure. This increase also reflects an increase in dealer commissions directly associated with the connection of new subscribers. Additionally, during 1999, we increased our expenditures on advertising, marketing and other customer-related activities in response to increased competition to accelerate subscriber growth and to increase market penetration. Sales and marketing expenses as a percentage of revenues increased from 4.6% in 1998 to 6.6% in 1999.

*Provision for doubtful accounts receivable* of $8.0 million was recorded for 1999, compared to a provision for doubtful accounts receivable of $12.8 million for 1998. Provision for doubtful accounts receivable represented 2.2% of revenues for the year ended December 31,1999 compared to 3.8% for the year ended December 31, 1998. The decrease in the level of doubtful accounts reflects the overall improvement in bad debt occurrences, which have stabilized with the introduction of the advance payment system.

*Depreciation and amortization* of network equipment, telephone numbering capacity, license costs and goodwill for 1999 increased to $53.8 million, compared to $19.6 million for 1998. This increase was attributable to the increased asset base resulting from our continuing expansion of our network, increased numbering capacity to support our growing subscriber base and the amortization of license costs and goodwill recognized in the acquisitions of Rosico and RTC. Accordingly, as a percentage of total revenues, depreciation and amortization for 1999 increased to 15.0% from 5.8% for 1998.

*Operating income* for 1999 decreased 29.5% to $115.6 million, compared to $164.1 million for 1998, and operating income as a percentage of revenues for 1999 decreased to 32.3% from 48.5% for 1998, as a result of the foregoing factors.

*Loss on foreign currency exchange* for 1999 decreased to $3.2 million, compared to $25.1 million for 1998, primarily as a result of stabilization of the ruble in terms of the U.S. dollar following the sharp decline in the value of the ruble in the wake of the events of August 17, 1998. As we conduct our basic operations in rubles and are required to comply with Russian currency law restrictions, we expect that we will continue to sustain losses in line with the devaluation of the ruble in the foreseeable future.

*Net interest expense* for 1999 was $11.0 million, compared to net interest expense of $6.1 million for 1998. In addition, we capitalized interest expenses totaling $1.3 million for 1999 and $1.2 million for 1998, related to borrowings to construct our network.

*Loss on other assets* was $0.8 million for 1999, compared to $2.8 for 1998. These losses reflect impairments reflected on real property received in settlement of cash deposits frozen in connection with the failure of AO Inkombank, a Russian financial institution. See Notes 2 and 10 to our consolidated financial statements included in this document.

*Provisions for income taxes* for 1999 decreased to $18.8 million, compared to $63.0 million for 1998. These provisions comprised a current income tax charge of $36.5 million for 1999 and $62.0 million for 1998, and deferred taxes of $(17.6) million for 1999 and $1.0 million for 1998, which arise due to the temporary differences between the basis of computing income under Russian accounting principles and U.S. GAAP. Provisions for income taxes decreased to 5.3% of revenues for 1999, compared to 18.6% in 1998. Provision for income taxes decreased to 18.4% as a percentage of income before provision for income taxes and minority interest for 1999, compared to 49.2% for 1998, partly as a result of the reduction in the income tax rate in 1999 from 35% to 30% and a benefit on bad debts expensed for tax purposes during 1999. See Note 17 to our consolidated financial statements included elsewhere in this document.

*Net income* for the year ended December 31, 1999 increased 29.7% to $85.7 million, compared to $66.0 million for the year ended December 31, 1998, as a result of the foregoing factors.

**B. Liquidity and Capital Resources**

On July 2000, we completed our initial public offering on the New York Stock Exchange, the proceeds from the offering, net of underwriting discount, were $353 million and were used (i) to fund investments in network infrastructure in the Moscow license area and regional license areas, (ii) to acquire 100% of Rosico, our consolidated subsidiary since August 1998, who is GSM-1800 license holder, to acquire 100% of Telecom XXI who is GSM-900/1800 license holder in North-West region, to acquire controlling interest in ReCom, our affiliated company since February 1998, who is license holder in six regions of Russia, (iv) to fund investments in new mobile data services such as higher-speed data transmission, Internet access and other advanced 3-G telecommunications technologies, (v) to repay certain indebtedness, such as EBRD long-term borrowings and payables to suppliers of the network equipment, (ii) purchase equipment,(iv) to finance working capital needs.

During 1998, 1999 and 2000, our operating activities generated positive cash flows. During 1998 and 1999, we have had negative cash flows from financing activities. We have also had negative cash flows from investing activities during the three years ended December 31, 2000. We expect for the foreseeable future to continue to have negative cash flows from investing activities as we continue our network expansion.

| | **Year Ended December 31,** | | |
|---|---|---|---|
| | **1998** | **1999** | **2000** |
| **Liquidity and capital resources data:** | | | |
| Cash flows from operating activities | $103,486 | $116,801 | $190,914 |
| Cash flows from financing activities | ($ 9,624) | ($ 11,557) | $298,543 |
| Cash flows from investing activities | ($122,051) | ($115,184) | ($423,349) |
| Capital expenditures............................ | $103,132 | $118,338 | $224,898 |

During 2000, net cash provided by operating activities was $190.9 million, an increase of 63.5% from 1999. The increase is primarily attributable to increases in net income, noncash depreciation and amortization charges, noncash expenses associated with management stock bonus plan, income tax payable and subscriber prepayments and deposits and deferred connection fees offset by a decrease in trade accounts payables, inventory and increase in subscriber acquisition costs. Net cash used in investing activities was $423.3 million, of which $194.9 million related to expansion of the network infrastructure. Net cash used in financing activities was $298.5 million. The increase is primarily attributable to proceeds from issuance of capital stock and payments on receivable from AFK Sistema in the amounts of $353 and $27 million, respectively offset by repayment of short-term and long-term loan and dividends paid in the amounts of $62.7 and $14.4 million, respectively.

During 1999, net cash provided by operating activities was $116.8 million, an increase of 12.9% from 1998. The increase is primarily attributable to increases in net income, noncash depreciation and amortization charges, trade receivables, trade accounts payable and subscriber deposits and deferred income offset by a decrease in deferred taxes, , and a slowing in the growth of accrued liabilities. Net cash used in investing activities was $115.2 million, of which approximately $109.0 million related to purchase of network infrastructure. Net cash used in financing activities was $11.6 million. Net cash used in financing activities primarily reflects $18.3 million related to repayment of loans, $11.2 million related to dividends paid and $18.0 million of loan proceeds.

During 1998, net cash provided by operating activities was $103.5 million, an increase of 14.3% from 1997. The increase in net cash provided by operating activities primarily reflects an increase in our net income of $6.4 million generated by the growth in business operations. The remaining increase is primarily attributable to increases in accrued liabilities and other payables and noncash depreciation and amortization charges. Net cash used in investing activities was $122.1 million, of which approximately $79.2 million related to purchase of network infrastructure and $22.0 million related to the purchase of telephone numbering capacity within the local and federal network structures. Net cash used in financing activities was $9.6 million, represented entirely by dividends paid.

Working capital is defined as current assets less current liabilities. As of December 31, 2000, we had working capital benefit of $147.2 compared with our working capital deficit of $65.9 at December 31, 1999. This $213.1 increase in our working capital benefit from December 31, 1999 is primarily attributable to obtaining of cash by completion of our initial public offering which provide of $170 million of new short-term investments, $50.6 million of new deposit, an increase of $6.9 of inventory, a decreases of $14.3 million and $3.9 million of short-term debt which was repaid and trade accounts payables, respectively, offset by an increases of $19.8 million, $21.6 million and $8.9 million of income tax payable, subscriber prepayments and deposits and trade receivables, respectively.

As of December 31, 1999, we had a working capital deficit of $65.9 million compared with our working capital deficit of $30.3 million at December 31, 1998. This $35.6 million increase in our working capital deficit from December 31, 1998, is primarily attributable to $18.0 million of long-term debt which has become current, $10.0 million of new short-term borrowings, an increase of $29.1 million in trade payables, an increase of $5.5 million in the current portion of deferred income, a decrease of $10.9 million in cash and cash equivalents and a decrease of $11.4 million in trade receivables, offset by a decrease of $11.9 million in accounts payable to related parties, a decrease of $14.5 million in subscriber deposits, and an increase of $7.5 million in inventories.

At December 31, 1998, we had a working capital deficit of $30.3 million, compared to working capital of $34.8 million at December 31, 1997. The decrease in working capital at December 31, 1998, was primarily attributable to the increase in capital spending from existing cash resources, and the reduction of $3.6 million in cash resulting from the devaluation of ruble cash balances.

As of December 31, 2000, we had indebtedness of approximately $47 million and current interest payable of approximately $2 million.

| **Amount of debt** | **Currency** | **Total** | **Interest Rates at December 31, 2000** |
|---|---|---|---|
| | | (in thousands of U.S. dollars) | |
| Ericsson loan | USD | 42,000 | LIBOR + 4% |
| Inkombank Loan | USD | 5,305 | 16% |
| Total debt: | | $47,305 | |

In December 1996, Rosico entered into a credit agreement with Ericsson Project Finance AB ("Ericsson") that provides for a credit facility with an aggregate principal amount of $60,000 and has a maximum term of five years. The Ericsson credit agreement contains covenants restricting Rosico's ability to encumber its present and future assets and revenues without the lender's express consent. The loan is repayable in ten equal consecutive quarterly payments of $6,000 commencing on the date falling 33 months after the date of first advance but not later than five years from disbursement of the first advance. The amounts advanced under the agreement bear interest of LIBOR plus 4%. If Rosico fails to pay any amount payable under the credit facility, the overdue amount bears interest at a rate of an additional 6% per annum.

The Ericsson Loan is secured by a pledge of MGTS (a related party) shares held by an affiliate of Sistema. Subject to the satisfaction of certain conditions, advances under the agreement may be made exclusively for the purposes of financing Rosico's further contribution to the affiliate of Sistema, which has been awarded the task of partially reconstructing and capitalizing MGTS.

Concurrent with the Rosico Agreement, Sistema (our 34.8% shareholder) agreed to fund the full and timely repayment of the Ericsson Loan and to indemnify Rosico and MTS for any costs incurred by either of Rosico or MTS in connection with the repayment of the Ericsson Loan.

In August 1995, we entered into a loan agreement with the European Bank for Reconstruction and Development, also known as the EBRD, for the purpose of financing the development of our telecommunication network. The $45 million loan facility comprised a $14 million participant loan received in 1996 and a $31 million bank loan received in 1997. The participant loan matures in 2003, while the bank loan matures in 2001.

In September 2000 we agreed with EBRD to fully prepay the remaining amount of bank loan and participant loan and appropriate outstanding interest in October 2000. Therefore, on October 16, 2000 we prepaid the remaining principal balance of $26,916 and accrued interest of $10,012.

In July 1999, we entered into a rollover credit facility with "BNP – Dresdner Bank" ("Dresdner Bank") for the purpose of financing working capital. The credit facility in the amount up to $10 million was granted to MTS with the final repayment date no later than July 2, 2002. The amount advanced under the agreement bears interest of LIBOR plus 2.5% per annum. Default interest is 12% per annum. An advance of $10 million was fully repaid in September 2000. In this regard, as of December 31, 2000 the outstanding amount under the credit facility was $ nil.

In August 1997, MSS, our subsidiary, entered into a rollover credit facility with OJSC "AB Inkombank" ("Inkombank") for the purposes of financing GSM-900 network development. The credit facility in the amount up to $12 million was granted to MSS with the final repayment date no later than March 31, 2002. The amount advanced under the agreement bears interest of 16% per annum. Default interest is 32% per annum. Under the term of agreement the amount of assets pledged is $4 million.

**Future Capital Expenditure**

We estimate our total capital expenditures will continue to be substantial because of our acquisitions and intensified investments in the regions, Telecom XXI and ReCom. The table below is set forth our plans for capital expenditures for the five-year period through 2005:

We estimate our total capital expenditures will continue to be substantial because of our acquisitions and intensified investments in the regions. The table below is set forth our plans for capital expenditures for the five-year period through 2005:

| | Year Ended December 31, (in millions of US dollars) | | | | | |
|---|---|---|---|---|---|---|
| Estimated capital expenditures in: | 2001 | 2002 | 2003 | 2004 | 2005 | Total |
| Moscow license area | $220 | $100 | $82 | $80 | $74 | $556 |
| St. Petersburg license area | $50 | $20 | $20 | $20 | $24 | $134 |
| Regional license area | $60 | $88 | $75 | $74 | $67 | $364 |
| Total | $330 | $208 | $177 | $174 | $165 | $1054 |

These are estimates and our actual capital expenditures may vary significantly from our estimates.

As of December 31, 2000 approximately $43 million of these planned capital expenditures had been contractually committed under our contract with Siemens AG for the supply of equipment for the continued expansion of our GSM network in the Moscow license area and regional license area, which total $18 million and $25 million, respectively. As of May 31, 2001, outstanding commitments under these contracts were approximately $88 million.

Although capital spending will limit the availability of cash, we believe that no additional financing will be required in 2001.

**Future Implementation of New Accounting Standards**

In the year 2001, we will adopt SFAS No. 133, “Accounting for Derivative Instruments and Hedging Activities,” as amended by SFAS No. 137. This statement establishes accounting and reporting standards for derivative instruments and for hedging activities. Among other things, the statement requires that an entity recognize all derivative instruments on the balance sheet as either assets or liabilities, and to account for those instruments at fair value. We do not expect the impact of this new accounting standard on our consolidated balance sheet or results of operations to be material.

**C. Research and Development, Patents and Licenses, Etc.**

Our research and development activities were not significant for the last three years and primarily included activities such as the search for knowledge in new telecommunication technologies, evaluation of alternatives of new or improved services and systems. Expenditures on research and development were recognized as expenses when they occurred. We did not spend any amounts during the last three financial years on company-sponsored research and development activities.

## D. Trend Information

### Sales

After the strong sales increase in the fourth quarter of 2000, during which we added 305,000 new subscribers, the traditionally slower first quarter of 2001 brought in 227,000 new clients, and we finished the first quarter of this year with a subscriber base of 1,421,000. Of this total, 119,000 were regional subscribers.

Average montly service revenue per subscriber $50 in the fourth quarter of 2000, and we expect to see a further decrease this year due to tariff changes and the increasing ratio of mass-market subscribers to our total subscriber base.

### Regional expansion

We will continue this year our efforts to expand in the regions outside the Moscow license area. In addition to the acquisition of Telecom XXI, we are working to develop networks in six regions: Nizhny Novgorod, Ivanovo, Kirov, Chelyabinsk, Tumen, and Perm. Additionally, by the end of the year we plan to have commenced operations or started studies for the commencement of operations in all of our 43 current license area.

### Capital expenditures

We expect that capital expenditures will increase this year as a result of additional acquisitions and investment in our St. Petersburg and regional networks, which we believe can be financed from remaining proceeds from our offering and cash flow.

# Item 6. *Directors, Senior Management and Employees*

## A. Directors and Senior Management

Our directors, executive officers and key employees, and their respective ages and positions as of June 15, 2001, were as follows:

| Name | Year of Birth | Position |
|---|---|---|
| Directors and Executive Officers: | | |
| Alexei N. Buyanov ...................... | 1969 | Vice President – Investments and Securities |
| Dr. Yury A. Gromakov ................ | 1946 | Vice President – Technology |
| Michael Guenther ........................ | 1944 | Director |
| Rainer Hennicke .......................... | 1954 | Chairman |
| Valeriy A. Kozlov........................ | 1956 | Vice President – Administrative Affairs |
| Alexander L. Leiviman ................ | 1949 | Director |
| Evgeniy G. Novitsky.................... | 1957 | Director |
| Mikhail A. Smirnov..................... | 1950 | Director and President |
| Gernot Taufmann......................... | 1957 | Director |
| Anatoly V. Tchekhvan ................. | 1948 | Vice President – Operations |
| Wim van Bommel........................ | 1948 | Vice President – Finance |
| Alexander P. Vronetz................... | 1943 | Deputy Chairman |

**Alexei N. Buyanov** has served as our Vice President of Investments and Securities since March 1998. From 1996 through March of 1998, Mr. Buyanov served as first vice president of JSC Sistema Invest, a parent of Sistema. From 1994 through 1996, Mr. Buyanov was an executive manager at Sistema. He is also President of our subsidiary Rosico CJSC, and a director of our subsidiaries Rosico, ReCom, ACC, UDN-900, MSS and MTS-NN.

**Dr. Yury A. Gromakov** has served as our Vice President of Technology since 1994. He has been involved in the design of mobile communication systems for more than 25 years and holds a degree of Doctor of Technical Sciences, the highest scientific degree in Russia. Mr. Gromakov has published numerous works, including two monographs in the area of mobile communications.

**Michael Guenther** has served as one of our Directors since October 2000. His current term expires on June 29, 2001. Mr. Guenther is a financial director of T-Mobil International. He is also a member of the board of directors or supervisory board of each of the following companies affiliated with T-Mobil: T-Mobil GmbH, One2One, max.mobil, Niedermeyer GmbH, Polska Telefonica Cyfrowa Sp., RadioMobil a.s., C-Mobil B.V., WESTEL Mobil Tavkoezlesi Rt., BEN B.V., Eurotel Bratislava a.s.

**Rainer Hennicke** has served as Chairman of our Board of Directors since January 2001. His current term expires on June 29, 2001 . He also acted as our Chairman from January through December 1999 and from July 1995 until December 1997. He was our Deputy Chairman in 1998 and 2000. Mr. Hennicke has been head of the representative office of DeTeMobil in Russia since 1995. Mr. Hennicke has also served as a Director of our subsidiary, Rosico CJSC, since 1999 and director of ReCom OJSC since 2001. In addition to his service at the Company, he has been a director of ZETA Telekommunikationsdienste GmbH since 1999.

**Valeriy A. Kozlov** has served as our Vice President of Administrative Affairs since 1994. Before joining us, Mr. Kozlov served as an administrative director for VAST, a joint Russian-Canadian venture formerly called M-Bell.

**Alexander L. Leiviman** has served as one of our Directors since 1997. His current term expires on June 29, 2001. Since 1993, he has been a director of Sistema and since 1999 he has been first vice president and a director of Sistema. From March of 1994 through May of 1997, Mr. Leiviman served as a director of VimpelCom. Mr. Leiviman also serves on the boards of 11 other companies, all of which are affiliated with Sistema.

**Evgeniy G. Novitsky** has served as one of our Directors since 1996. His current term expires on June 29, 2001. Mr. Novitsky has also been a director of the Moscow City Telephone Network OJSC since 1998. Since 1995, he has served as president and a director of Sistema and, since 1998, as a director of MGTS. Mr. Novitsky also serves on the boards of 21 other companies, all of which are affiliated with Sistema.

**Mikhail A. Smirnov** has served as our President and Director since 1995. His term as Directors expires on June 29, 2001 and his term as President expires in March 2003. Mr. Smirnov has also served as Chairman of the Board of Directors of our subsidiary ReCom since 1998 and as chairman of the Association of GSM Operators of Russia since 1996. He is also Chairman of the Board of Directors of our subsidiaries Rosico CJSC, ACC,UDN-900, MSS, ReCom OJSC, MTS-NN and member of the Board of Directors of MTS-RK.

**Gernot Taufmann** has served as one of our Directors since 1998. His current term expires on June 29, 2001. He is president of the Moscow Office of Deutsche Telekom AG and has overseen Deutsche Telekom’s responsibilities in the Commonwealth of Independent States since 1995. Mr. Taufmann also a deputy chairman of Moscow Teleport, Chairman of Board of Directors of Ukrainian Mobile Communications, and a member of Board of Directors of Rosico. He has also served as the chief executive officer of ZETA Telekommunikationsdienste GmbH since 1999.

**Anatoly V. Tchekhvan** has served as our Vice President of Operations since March 2001. From February 1996 through March 2001, Mr. Tchekhvan served as the chief of our operational department. Before joining us, Mr. Tchekhvan served as chief engineer of Rostelecom.

**Wim van Bommel** has served as our Vice President of Finance since August 1999. From May 1996 through August 1999, he worked in Russia for Millicom International Cellular S.A. as finance director for Millicom’s joint ventures in Smolensk and Kemerovo. From August 1991 through May 1996, Mr. van Bommel worked as chief financial officer for the Dutch subsidiary of a U.S.-based chemical trading company.

**Alexander P. Vronetz** has served as Deputy Chairman of our Board of Directors since January 2001. His current term expires on June 29, 2001. Mr. Vronetz served as our Chairman in 2000 and also acted as Deputy Chairman from June through December of 1999. Mr. Vronetz has also been deputy general director of Sistema-Telecom JSC, an affiliate of Sistema, since December 1998. From November 1994 through December 1998, he headed Giprosvyaz, a Russian research organization. He has been a director of the Moscow City Telephone Network OJSC since 1999 and of PTT Teleport Moscow CJSC from 1999 to 2000.

## B. Compensation of Directors and Senior Management

Our senior management together with directors were paid during 2000 an aggregate amount of approximately $2.8 million for services in all capacities provided to us.

### Management Stock Bonus and Stock Option Plans

On April 27, 2000, contingent on the closing of our initial public offering, we established a stock bonus plan and stock option plan for selected officers, key employees and key advisors. Under the plans, directors, key employees and key advisors received 3,587,987 of our common shares and will participate in a stock option plan under which they may receive up to 9,966,631 of our common shares. At the time of the initial public offering, we issued 13,554,618 shares of common stock to our subsidiary Rosico pursuant to these plans at a price of $1.024 per share for the total amount of $13.9 million. See "Item 7.B—Related Party Transactions—Key Advisors for Initial Public Offering."

Under the stock bonus plan, during the period from September 12, 2000 through September 22, 2000, 3,587,987 common shares were purchased from Rosico at nominal price of 0.1 rubles per share as follows:

| | Number of shares purchased | Percentage of total shares outstanding |
|---|---|---|
| Directors | 3,049,786 | 0.153 |
| Key Advisors | 538,201 | 0.027 |
| Total | 3,587,987 | 0.180 |

Directors, key employees and key advisors will be restricted from selling these shares for 180 days from the date of purchase. However, if an employee should leave the company before the end of the two year restricted period, such employee will retain the rights to the shares purchased. Accordingly, on the date the shares were granted, we recognized aggregate expenses under this plan as compensation expenses amounting to $5.3 million, based on the intrinsic value of the shares on the date they were granted.

Under the stock option plan, officers and key employees will have the right to convert portions of their annual cash bonuses into options to purchase up to 9,966,631 common shares of MTS. On the second anniversary of entering the option agreement, officers and key employees must either take their bonus in cash or forfeit their bonus in exchange for common shares of MTS at the 100-day average sales price of the shares at the date of entering into the option agreement. The option agreement has not been formally agreed and approved with individual employees at December 31, 2000 and, accordingly, an exercise price for the option agreements has not yet been determined. Should the 100-day average sales price of the shares at the exercise date be lower than that at the date of entering into the option agreement, we will provide officers and key employees with an option to receive additional shares at the 100-day average sales price of the shares at the date of entering the original option agreement.

We are accounting for the management stock option plan in accordance with FASB Interpretation No. 44 and EITF No. 00-23. Accordingly, we will record compensation related to this award in a manner akin to a combined variable award. Specifically, any estimate of compensation expense under this arrangement will be made at the time that the option is granted to the officers and key employees. This expense generally will be based on the fair value of the cash bonus that the employee is entitled to receive and will be updated each reporting period based on changes in facts or circumstances. To the extent that officers or key employees elect to convert their bonus into options to purchase shares, it is likely that the compensation expense to be recorded by us would differ from expense based on the fair value of the cash bonus, as we would need to employ variable plan accounting under the provisions of Accounting Principles Board Opinion No. 25. Under variable plan accounting, we would record compensation expense based on the difference between the fair market value of our common stock at the end of a reporting period and the exercise price of the underlying options. Such expense would be recorded ratably over the vesting period of the options. At December 31, 2000, employees under this plan are not contractually obligated to receive any cash bonus under this plan. Accordingly, no compensation expense has been recorded during the year ended December 31, 2000.

## C. Board Practices

### Board of Directors

Members of our Board of Directors are elected by a majority vote of shareholders at the annual General Meeting using a cumulative voting system. Directors are elected for one year terms and may be re-elected an unlimited number of times. Our Board of Directors currently consists of seven members, although this may be increased to nine members by shareholder resolution. The Board of Directors has the authority to make overall management decisions for the Company, except those matters reserved to the shareholders. See Item 10—Additional Information—General Meetings of Shareholders“ for more information regarding the competence of our shareholders’ meetings. The members of our Board of Directors do not serve pursuant to a contract.

### President

The General Meeting of Shareholders, at the recommendation of the Board of Directors, appoints our President for a term of three years. The rights, obligations and the times and amounts of payment for the President’s services are determined by a contract concluded with him by the Company, which is represented by the Chairman of the Board of Directors or by a person authorized by the Board of Directors. This contract may be terminated without cause with two months’ prior written notice, following which the President is entitled to five months’ salary. The President is responsible for day-to-day management of our activities, except for matters reserved to our shareholders or the Board of Directors. See Item 10—Additional Information—General Meetings of Shareholders“ for more information regarding the competence of our shareholders’ meetings. For details about our president, Mikhail A. Smirnov, see “—Directors and Senior Management.”

**Audit Commission**

Members of the Audit Commission are nominated and elected by our shareholders for a term of one year. A Director may not simultaneously be a member of the Audit Commission. Our Audit Commission currently has three members:

- Nickolai S. Zhmurenko holds the position of Financial Director within Sistema Telecom CJSC, has served on the Audit Commission since June 1998 and was re-elected to the Audit Commission in February 2001. His current term expires on 29 June 2001.
- Sergey N. Kushakov holds the position of Chief Accountant at Sistema, has served on the Audit Commission since June 1999 and was re-elected to the Audit Commission ion February 2001. His current term expires on 29 June 2001.
- Elena Soldan is employed at the Financial Department of Deutsche Telecom AG, has served on the Audit Commission since June 1999 and was re-elected to the Audit Commission in February 2001. Her current term expires on 29 June 2001.

The members of our Audit Commission do not serve pursuant to a contract.

## D. Employees

At the end of 2000, we had 2,340 employees, representing growth of approximately 98.9% from year-end 1999. This includes 5 executives; 515 in technical and maintenance; 1,299 in sales, marketing and customer service; and 521 in administration and finance. Over 76% of these employees work in Moscow. The substantial growth in the number of our employees is attributable primarily to the continued expansion of our network in the Moscow license area and other regions of Russia and our increased focus on customer care. The following chart sets forth the number of our employees for the last three financial years:

| As of December 31, | Moscow License Area | Other Regions | Total | Percent Increase over Prior Year |
|---|---|---|---|---|
| 2000 | 1,782 | 558 | 2,340 | 98.9% |
| 1999 | 963 | 214 | 1,177 | 43.7% |
| 1998 | 618 | 201 | 819 | n.a. |

Our future success will depend in significant part on the continued service of our key technical, sales and senior management personnel. To date, we have experienced a low level of departures, voluntary or otherwise. Our employees are not unionized, we have not experienced any work stoppages and we consider our relations with employees to be strong.

## E. Share Ownership

In reviewing the share information in this document, holders of our ADSs should note that each ADS is the economic equivalent of twenty shares of our common stock.

Each of our directors, senior management and employees individually beneficially owns less than one percent of our common stock.

The aggregate beneficial interest of our directors, senior management and employees as of December 31, 2000, was as follows:

| Number of Shares of common stock | % of common stock outstanding |
|---|---|
| 3,049,786 | 0.153% |

## Item 7. *Major Shareholders and Related Party Transactions*

### A. Major Shareholders

The following table sets forth, as of June 1, 2001, information regarding beneficial ownership of our common stock by each person known by us to own beneficially any of our voting securities and all our directors and executive officers as a group. All shares of common stock have the same voting rights. Since the date of our incorporation, March 1, 2000, there have not been any sigifnicant changes in the percentage ownership held by any major shareholders, other than the dilution each experienced during our initial public offering, completed July 6, 2000.

| | Beneficial ownership as of June 1, 2001 | |
|---|---|---|
| **Name** | **Number** | **Percentage** |
| Sistema (1) | 692,523,468 | 35% |
| DeTeMobil (2) | 721,536,738 | 36% |
| Invest-Svyaz-Holding (3) | 160,247,802 | 8% |
| VAST (4) | 60,219,432 | 3% |
| American Depositary Share holders (5) | 345,244,080 | 17% |
| All executive officers and directors, and shares issued for ESOP as a group | * | * |
| Total | 1,993,326,138 | 100% |

* Less than 1%.

(1) Sistema has pledged 156,078,936 shares of common stock to AO Deutsche Bank Luxembourg S.A. The total number of shares pledged by Sistema to AO Deutsche Bank Luxembourg S.A. represents 7.8% of the issued and outstanding shares. Vladimir P. Yevtushenkov has a controlling interest in Sistema Invest, and would be considered under U.S. securities laws as the beneficial owner of our shares held by Sistema and VAST, as further discussed in note 4 below. Mr. Yevtushenkov is also chairman of the board of Sistema.

(2) DeTeMobil is a wholly owned subsidiary of Deutsche Telekom AG, the largest telecommunications provider in Germany.

(3) Invest-Svyaz-Holding is a Russian closed joint stock company owned 50% by Sistema and 50% by DeTeMobil. Invest-Svyaz Holding has pledged 81,728,372 shares of common stock to Zeta Telekommunikationsdienste GmbH, a company 51% owned by DeTeMobil and 49% owned by Disantis S.A., an entity affiliated with Sistema. The total number of shares pledged by Invest-Svyaz-Holding to Zeta Telekommunikationsdienste GmbH constitute 4.1% of the issued and outstanding shares.

(4) VAST is a limited partnership formed under the laws of Russia. Sistema owns a 51% interest in VAST. ASVT OJSC, a Russian company engaged in telecommunications, owns the other 49% of VAST.

As of June 15, 2001, we had 1,993,326,150 shares of common stock outstanding. The total number of MTS ADSs outstanding was 17,262,204, representing underlying ownership of 345,244,080 shares, approximately 17.3% of our outstanding share capital. The share underlying the ADSs are deposited with Morgan Guaranty Trust Company of New York and the local custodian is ING Eurasia.

Based on our share register, we believe we are not directly or indirectly owned or controlled by another corporation or government, and that there are no arrangements that may result in a change of control.

## B. Related Party Transactions

### *ReCom Convertible Bonds*

During 1999 and 2000, we acted as the general contractor for the construction of ReCom's network. During these years, we delivered to ReCom network equipment in the amount of $15 million. In connection with this, in November 2000, ReCom issued to us bonds in the amount of $12 million, convertible under certain circumstances into common stock of ReCom. These bonds have maturities varying from 2003 to 2005. If we were to exercise these conversion options in full, we would become holder of up to 75% of the outstanding common stock of ReCom.

### *Rosico Purchase*

In August 1998, MTS CJSC purchased from Sistema 13,680 shares of common stock of Rosico, representing 80% of the issued and outstanding capital stock of Rosico, in exchange for 408,631,860 newly issued shares of MTS CJSC's common stock, which represented approximately 25% of its issued and outstanding capital stock immediately after that exchange. MTS CJSC recorded the purchase price at $118 million, based on the estimated fair value of the Rosico businesses acquired.

Under this purchase agreement, Sistema agreed to fund all payment and other obligations arising under the Ericsson loan and to indemnify us and Rosico for any costs we or Rosico incur in connection with the repayment of the Ericsson loan.

### *Moscow Bank for Reconstruction and Development*

Beginning in August 2000, we have maintained accounts with the Moscow Bank of Reconstruction and Development, whose major shareholder is Sistema. As of December 31, 2000, we had deposited with the Moscow Bank of Reconstruction and Development $51 million, including a time deposit and a current account in the amount of $50 million and $1 million, respectively. During 2000, the related interest accrued and collected on the deposits amounted to $952,000, which has been reflected in our financial statements as a component of interest income.

### *Rosno OJSC*

We have entered into insurance contracts with Rosno OJSC and its affiliates, whose major shareholder is Sistema, for which we made payments totaling approximately $6.4 million in 1998 for our 1999 policy. We insured our property for approximately $193 million and $274 million in 1999 and 2000, respectively, with Rosno OJSC. Insurance premiums paid to Rosno amounted to $4.7 million and $6.5 million in 1999 and 2000, respectively, including premiums paid for medical insurance that amounted to $682,000 and $1,583,000 in 1999 and 2000, respectively. We believe that that all of the insurance contracts with Rosno have been entered on market terms. Rosno has entered into reinsurance contracts with leading global reinsurers, with the exception of medical risks.

***Maxima Advertising Agency***

In 1999 and 2000, we entered into contracts for advertising services with Maxima Advertising Agency. Maxima is related to us through certain members of our board of directors, which are also members of Maxima's board of directors. Advertising fees paid to Maxima amounted to $6.4 million in 2000.

***MTU-Inform***

We have interconnection arrangements with, and receive domestic and international long-distance services from, MTU-Inform. We believe that these arrangements are on market terms. MTU-Inform is owned 51% by MGTS, which is majority-owned by Sistema and its affiliates.

***Telmos***

We have interconnection arrangements with, and receive domestic and international long-distance services from, Telmos. We believe that these arrangements are on market terms. Telmos is 40% owned by MGTS, which is majority-owned by Sistema and its affiliates.

***Moscow City Telephone Network***

Our primary interconnection arrangement is with MGTS, and we purchased a building from MGTS for the amount of approximately $2.9 million in 2000. We believe that this purchase was made on market terms. MGTS is related to us through certain members of our board of directors, which are also members of MGTS' board of directors

***DeTeMobil***

We currently have a non-exclusive roaming agreement with DeTeMobil that is comparable to roaming agreements between us and other cellular mobile operators.

***Key Advisors for Initial Public Offering***

Officers of two of our shareholders, Sistema and DeTeMobil, advised us as part of our initial public offering. In return for their assistance, these key advisors purchased a total of 538,201 of our shares during the period from September 12, 2000, through September 22, 2000, from Rosico at nominal price of 0.1 rubles per share, for total compensation of approximately $797,000. See "Item 6.B—Compensation of Directors and Senior Management."

## C. Interests of Experts and Counsel

Not applicable.

## Item 8. *Financial Information*

### A. Consolidated Statements and Other Financial Information

**8.A.1. See Item 18.**

**8.A.2. See Item 18.**

**8.A.3. See Report of Independent Accountants, page F-1.**

**8.A.4. We have complied with this requirement.**

**8.A.5. Not applicable.**

**8.A.6. Not applicable/See Item 18.**

#### 8.A.7. Litigation

We are not involved in any legal proceedings that we believe are material to us.

#### 8.A.8. Dividend Distribution Policy

We declared cash dividends in the ruble equivalent of $0.003 per share in 1997, $0.007 per share in 1998, and $0.007 per share in 1999, each in respect of the prior year. In addition, an interim dividend of 0.24 rubles, or $0.008, per share was declared by our board of directors on April 4, 2000, and paid prior to June 5, 2000. Because MTS CJSC will not hold an annual shareholders' meeting in 2000 due to the merger of MTS CJSC and RTC CJSC on March 1, 2000, and their subsequent liquidation, it is not possible for shareholders of MTS CJSC to declare an annual dividend in respect of the year ended December 31, 1999. Therefore, our directors declared an interim dividend that, while based on the net income earned by MTS CJSC in the year ended December 31, 1999, will be paid, due to requirements of Russian legislation, as an interim dividend in respect of the year ended December 31, 2000. Under Russian legislation, the annual dividend declared for a year cannot be less than the total of the interim dividends declared for that year. Therefore, while we do not expect to declare any additional dividends in respect of the year ended December 31, 2000, the annual dividend in respect of that year will be at least 0.24 rubles per share, assuming we are able to pay a dividend at all under Russian legislation. As our existing shareholders have already received payment of the interim dividend, only shareholders of record for the purposes of an annual shareholders' meeting who have not already been paid this dividend will receive a dividend payment.

Except for these dividends, we have not, since our inception, declared or paid any dividends on our common stock. We expect that any dividend declared or paid in respect of the year ended December 31, 2001, or in respect of subsequent years would be no more than 15% of net income, calculated according to generally accepted accounting principles used in the United States. Annual dividend payments, if any, must be recommended by our board of directors and approved by our shareholders.

We anticipate that any dividends we may pay in the future on the common shares represented by the ADSs will be declared and paid to the depositary in rubles and will be converted into U.S. dollars by the depositary and distributed to holders of ADSs, net of the depositary's fees and expenses. Accordingly, the value of dividends received by holders of ADSs will be subject to fluctuations in the exchange rate between the ruble and the dollar.

**B. Significant Changes**

On April 24, 2001, we increased our ownership in ReCom from 49.9% to 53.9%. We acquired the additional 4% of shares from a third party for $1 million. In May 2001, we acquired 100% of the shares of Telecom XXI, the GSM 900/1800 cellular license holder for operations in the North-West Region of Russia in which St. Petersburg is located. We plan to invest approximately $80 million in capital expenditures in the North West Region by the end of 2001. We plan to account for both acquisitions during the second quarter of 2001 using the purchase method.

On May 10, 2001, our shareholders passed a resolution approving our merger with two of our wholly-owned subsidiaries, Rosico and ACC. Because we are the sole shareholder of Rosico and ACC, the merger will not alter our share capital. Rosico and ACC shares will be redeemed upon completion of the merger, which is expected to occur in the third quarter of 2001.

**Item 9. *The Offer and Listing***

(Items 9A 1-3, 9A 5-7, B, D, E and F are not applicable.)

**A.4. Market Price Information**

The following table sets forth the annual high and low market prices per ADS on the New York Stock Exchange for the fiscal year ended December 31, 2000; the high and low market prices for each full financial quarter since the completion of our initial public offering on July 6, 2000; and the high and low market prices for each of the most recent sixth months. Our ordinary shares are not currently listed in Russia, although they are admitted for listing on the RTS.

| | High | Low |
|---|---|---|
| 2000 | $32.0000 | $21.2500 |
| Third Quarter, 2000 | $32.0000 | $21.2500 |
| Fourth Quarter, 2000 | $29.7500 | $22.0000 |
| First Quarter, 2001 | $31.0000 | $22.8750 |
| May 2001 | $29.5000 | $25,8000 |
| April 2001 | $28.7000 | $23.5500 |
| March 2001 | $30.2600 | $24.7500 |
| February 2001 | $31.0000 | $24.3000 |
| January 2001 | $30.4375 | $22.8750 |
| December 2000 | $25.5625 | $22.0000 |

## C. Markets

Our ordinary shares are not currently listed in Russia, although they are admitted for listing on the RTS. American Depositary Receipts, each representing twenty of our ordinary shares, have been listed on the New York Stock Exchange under the sumbol “MBT” since June 30, 2000.

## Item 10. *Additional Information*

## A. Share Capital

Not applicable.

## B. Charter and Certain Requirements of Russian Legislation

We describe below material provisions of our charter in effect on the date of this annual report and certain requirements of Russian legislation. In addition to this description, we urge you to review our charter to learn its complete terms.

### Purpose of the Company

Article 2.1 of our charter provides that our principal purpose is to obtain profits through the planning, marketing, and operation of a radiotelephone mobile cellular network in the Russian Federation.

### Rights Attaching to Shares

Pursuant to our charter, we have the right to issue registered common shares, preferred shares, and other securities provided for by legal acts of the Russian Federation with respect to securities. Preferred shares may be issued only after corresponding amendments have been made to the charter of the Company pursuant to a resolution of the general meeting of shareholders.

We have issued only common shares. Holders of our common shares have the right to vote at all general meetings of shareholders. As required by the Federal Law on Joint Stock Companies and our charter, all common shares of the Company shall have the same par value and grant to the shareholders who own them an identical amount of rights. Each fully paid share of common stock, except for treasury shares, gives its holder the right to:

- freely transfer the shares without consent of other shareholders;
- receive dividends;
- participate in shareholders meetings;
- transfer voting rights to its representative on the basis of a power of attorney;
- elect candidates for the board of directors and audit commission;
- make proposals to the board of directors;
- if holding, alone or with other holders, over 10% of the outstanding common stock, demand the calling of an extraordinary shareholders meeting or an unscheduled audit by the audit commission or an independent auditor;

- demand, under the following circumstances, repurchase by us of all or some of the shares owned by them, as long as the holder voted against the decision approving the action:
  - reorganization;
  - conclusion of a transaction exceeding 50% of our balance sheet value;
  - amendment of our charter that restricts the holder's rights; and
  - closed issuance of shares or convertible securities;
- upon liquidation, receive a proportionate amount of our property after its obligations are fulfilled;
- have free access to company documents and receive copies for a reasonable fee; and
- exercise other rights of a shareholder given in our charter, under Russian legislation, and by decisions of shareholders meeting approved in accordance with its competence.

**Preemptive Rights and Anti-Takeover Protections**

Our charter provides existing shareholders with a preemptive right to purchase shares or convertible securities during an open subscription for cash. A shareholders meeting decision by a majority vote can waive this preemptive right and establish a time period for which the waiver is effective.

Russian legislation requires that any person that intends, either alone or with affiliates, to acquire more then 30% of the common stock of a company having more than 1,000 common shareholders, any person intending, individually or jointly with affiliates, must give 30 days' prior written notice to the existing shareholders.

Additionally, a person acquiring 30% or more of the common stock of a company, within 30 days of acquiring 30% or more, must offer to buy all of common stock at a price not lower than the weighted average acquisition price of the common stock over the six months before the date of acquisition of 30% or more of the common stock. Failure to observe this requirement results in the limitation of the acquirer to voting only 30% of the common stock. This requirement may be waived in a company's charter or by a resolution adopted by a majority vote at a shareholders meeting, excluding the votes of the person acquiring shares. Our charter does not contain, and our shareholders have not waived, this requirement. Russian legislation is unclear on whether this requirement applies to shareholders already owning over 30% of a company's common stock. Therefore, it is unclear whether this requirement would apply to purchases of common stock by Sistema and/or DeTeMobil or entities controlled by them.

**Dividends and Dividend Rights**

The Federal Law on Joint Stock Companies and our charter set forth the procedure for determining the annual dividends that we distribute to our shareholders. The board of directors determines the payment of quarterly or semi-annual dividends by a majority vote. According to our charter, annual dividends are recommended to a shareholders meeting by a majority vote of the board of directors, and approved by an annual shareholders meeting by a majority vote. The annual dividend approved at an annual shareholders meeting may not be more than the amount recommended by the board of directors or less than the aggregate amount of interim dividends paid for the year. Dividends are distributed to shareholders registered as holding the company's shares at least ten days prior to the date of the board of directors' or annual shareholders meeting declaring the dividend. Dividends are not paid on treasury shares.

The Federal Law on Joint Stock Companies allows dividends to be paid only out of net profits for the current year and as long as the following conditions have been met:

- the charter capital of the company has been paid in full;
- the value of the company's net assets, minus the proposed dividend payment, is greater than the total of the company's charter capital and the company's reserve fund;
- the company has repurchased all shares from shareholders having the right to demand repurchase; and
- the company is not, and would not become as the result of payment of dividends, insolvent.

MTS CJSC paid annual dividends in 1997 before shareholders had paid the charter capital in full, which was a violation of the above restriction on dividend payments. The only potential result of this violation would be the return of these dividend payments to us, as the successor to MTS CJSC.

**Distributions on Liquidation to Shareholders**

Under Russian legislation, liquidation of a company results in its termination without the transfer of rights and obligations to other persons as legal successors. Our charter allows us to be liquidated

- by a three-quarters shareholders meeting vote; or
- by a court order.

Following a decision to liquidate us, the right to manage its affairs would pass to the liquidation commission which, in the case of voluntary liquidation, is appointed a shareholders meeting and, in an involuntary liquidation, is appointed by the court. Creditors may file claims within a period to be determined by the liquidation commission, but which is at least two months from the date of publication of notice of liquidation by the liquidation commission.

The Civil Code gives creditors the following order of priority during liquidation:

- individuals owed compensation for injuries or deaths caused by a company;
- employees;
- secured creditors;
- federal and local governmental entities; and
- other creditors in accordance with Russian legislation.

The remaining assets of a company are distributed among shareholders in the following order of priority:

- payments to repurchase shares from shareholders having the right to demand repurchase;
- payments of declared but unpaid dividends on preferred stock and the liquidation value of the preferred stock, if any; and
- payments to holders of common stock on a pro rata basis.

**Risks Regarding Exercise of Rights Associated with ADSs**

The regulations governing nominee holders, custodians and depositaries are not yet well developed in Russia. The existing regulations could be interpreted as requiring a nominee holder or a depositary to obtain a license from the Russian authorities to act in that capacity with regard to shares of our common stock. This applies to both Russian and foreign nominee holders and depositaries. This could result in your inability to exercise your rights as a holder of our ADSs, including voting. The same problem may also affect the ability of the depositary to grant a discretionary proxy to a person designated by us if you do not give any voting instructions. Further, in the past, nominees have reportedly experienced difficulty in convincing registrars of their right to represent the beneficial holder and to obtain the benefits for the beneficial holders available under an applicable tax treaty. This could result in your inability to obtain the benefits due to you as a holder of our ADSs. However, the Federal Law on the Securities Markets provides that shares may be held by nominees entitled to receive dividends and to vote the shares on behalf of the beneficial owner upon receipt of the appropriate instructions from the beneficial owner. The nominee is required to provide information on the beneficial holder of the shares upon the demand of the registrar. Some of the difficulties initially experienced by investors appear to have been abated by the Federal Law on the Securities Markets and by the regulations on registrars that govern issues concerning nominees.

**Approval of the Ministry of AntimonopolyPolicy of the Russian Federation**

Pursuant to Russian antimonopoly legislation, any transaction that would result in a shareholder's shareholdings in the Company equaling or exceeding 20% of the total shareholdings in the Company must be approved in advance by the Ministry of Antimonopoly Policy of the Russian Federation.

**Notification of Foreign Ownership**

Pursuant to Russian securities legislation, any foreign person or company acquiring shares in a Russian joint stock company must notify the Russian Federal Commission on Securities Markets of such acquisition on the date of such acquisition in the form and substance required by Russian securities legislation. Other than this notification requirement, there are no requirements or restrictions with respect to foreign ownership of shares in the Company.

## Liability of Shareholders

The Civil Code and the Federal Law on Joint Stock Companies generally provide that shareholders in a Russian joint stock company are not liable for the obligations of the joint stock company and bear only the risk of loss of their investment. This may not be the case, however, when one company is capable of determining decisions made by another company. The company capable of determining such decisions is called an effective parent. The company whose decisions are capable of being so determined is called an effective subsidiary. The effective parent bears joint and several responsibility for transactions concluded by the effective subsidiary in carrying out these decisions if

- this decision-making capability is provided for in the charter of the effective subsidiary or in a contract between the companies, and
- the effective parent gives obligatory directions to the effective subsidiary.

Thus, a shareholder of an effective parent is not itself liable for the debts of the effective parent's effective subsidiary, unless that shareholder is itself an effective parent of the effective parent. Accordingly, you will not be personally liable for our debts or those of our effective subsidiaries unless you control our business.

In addition, an effective parent is secondarily liable for an effective subsidiary's debts if an effective subsidiary becomes insolvent or bankrupt resulting from the action or inaction of an effective parent. This is the case no matter how the effective parent's capability to determine decisions of the effective subsidiary arises, such as through ownership of voting securities or by contract. In these instances, other shareholders of the effective subsidiary may claim compensation for the effective subsidiary's losses from the effective parent that caused the effective subsidiary to take any action or fail to take any action knowing that such action or failure to take action would result in losses.

## Alteration of Capital

*Share Capital Increase*

We may increase our charter capital by

- issuing new shares, or
- increasing the nominal value of already issued shares using the company's net income.

A decision to increase the charter capital by issuing additional shares or increasing the nominal value of issued shares requires a majority vote of a shareholders meeting. In addition, the issuance of shares above the number provided in our charter necessitates a charter amendment, which requires a three-quarters affirmative vote of a shareholders meeting.

The Federal Law on Joint Stock Companies requires that newly issued shares be sold at market value, except in limited circumstances where existing shareholders exercise a preemptive right to purchase shares at 90% of their market value or fees are paid to intermediaries, in which case the fees paid may be deducted from the price. The market value may not be set at less than the nominal value of the shares. Either the board of directors or, if the nominal value of the shares exceeds a specified amount, an independent appraiser, values any in-kind payments for the new shares.

The Federal Commission on the Securities Market, under the power given to it by the Federal Law on the Securities Market, has issued detailed procedures for the registration and issue of shares of a joint stock company. These procedures require

- prior registration of a share issuance with the Federal Commission on the Securities Market;
- public disclosure of information relating to the share issuance;
- following the placement of the shares, registration and public disclosure of the results of the placement of shares.

*Capital Decrease; Share Buy-Backs*

The Federal Law on Joint-Stock Companies does not allow a company to reduce its charter capital below the minimum charter capital required by law. As of January 1, 2001, the charter capital minimum for an open joint stock company was approximately $7,000. Our charter requires that any decision to reduce our charter capital, whether through the repurchase and cancellation of shares or a reduction in the nominal value of the shares, is by a three-fourths affirmative vote of a shareholders meeting. Additionally, within 30 days of a decision to reduce our charter capital, we must issue written notice to our creditors. Our creditors would then have the right to demand, within 30 days of receipt of our notice, repayment of all amounts due to them, as well as compensation for damages.

The Federal Law on Joint Stock Companies allows the board of directors to authorize the repurchase of up to 10% of our shares in exchange for cash. The repurchased shares either must be resold within one year of their repurchase or the shareholders must decide to cancel such shares and then either decrease the charter capital or increase the nominal value of the remaining shares to preserve the total amount of the charter capital.

The Federal Law on Joint Stock Companies allows us to repurchase our shares only if, at the time of repurchase:

- our charter capital is paid in full;
- we are not and would not become, as a result of the repurchase, insolvent;
- the value of our net assets, taking account of the proposed repurchase, is not less than the sum of our charter capital our the reserve fund; and
- we have repurchased all shares from shareholders having a right to demand repurchase of their shares under legislation protecting the rights of minority shareholders, as described immediately below.

Russian legislation and our charter provide that our shareholders may demand repurchase of their shares if

- we reorganize;
- our charter is amended and the change negatively affects a shareholder;

- we engage in a major transaction, as defined under Russian law; or
- we decide on a closed subscription for our shares

and as long as the shareholder demanding repurchase opposed the action. We may spend up to 10% of our net assets for a share redemption.

**Directors**

Our charter provides that our entire board of directors is up for election at each annual general shareholders meeting and that our board of directors is elected through cumulative voting. Before the expiration of their term, the directors may be removed as a group at any time without cause by a majority vote of a shareholders meeting.

The Federal Law on Joint Stock Companies requires a seven-member board of directors for an open joint stock company with more than 1,000 holders of common stock, and a nine-member board of directors for an open joint stock company with more than 10,000 holders of common stock. Our charter provides that our board of directors consists of seven members and can be increased to nine members by a resolution of the general shareholders meeting.

The Federal Law on Joint Stock Companies prohibits a board of directors from acting on issues that fall within the exclusive competence of the general shareholders meeting. Our board of directors has the exclusive power to decide the following issues

- issuance of shares following our shareholders' approval of an additional issuance of shares;
- determination of the market price of our property;
- use of our reserve fund and other of our funds;
- organization of shareholders meetings, including setting a date and approving an agenda; and
- approval of some major transactions and interested party transactions, as both are defined under Russian law.

Our charter generally requires a majority affirmative vote of the directors present for an action to pass, with the exception of actions for which Russian legislation requires a unanimous vote, such as approval of major transactions or interested party transactions.

**Interested Party Transactions**

The Federal Law on Joint Stock Companies contains requirements for transactions with "interested parties." The definition of an "interested party" includes members of the board of directors, officers of a company and any person that owns, together with any affiliates, at least 20% of a company's voting shares if that person, or that person's relatives or affiliates is

- a party to a transaction with the company, whether directly or as a representative or intermediary;
- the owner of at least 20% of the issued voting shares of a legal entity that is a party to a transaction with the company, whether directly or as a representative or intermediary; or

- a member of the board of directors or an officer of a company which is a party to a transaction with the company, whether directly or as a representative or intermediary.

The Federal Law on Joint Stock Companies also introduces the definition of "an independent director" who is not a general director or a member of the management board if, in this instance, the person's spouse, parents, children, brothers or sisters are not persons occupying positions in the management authorities of the company.

An interested party transaction entered into by a company with less than 1,000 shareholders shall be adopted by a majority vote of directors who are not "interested parties" in the transaction.

The Federal Law on Joint Stock Companies requires that a transaction by companies with more than 1,000 shareholders with an interested party be approved by a majority vote of the "independent directors" of the company who are not "interested parties" in the transaction. A majority of shareholders who are not "interested parties" in the transaction is also required if:

- the value of such transaction exceeds 2% of the value of the company's assets;
- the transaction involves the issuance of voting shares or securities convertible into voting shares in an amount exceeding 2% of the company's existing voting shares; or
- all the members of the board of directors of the company are interested parties.

**Major Transactions**

The Federal Law on Joint Stock Companies defines a "major transaction" as a transaction, or series of transactions, involving the acquisition or disposition of over 25% of the balance sheet value of a company, with the exception of transaction completed in the normal course of business. Major transactions involving assets ranging from 25% to 50% of the balance sheet value of a company require unanimous approval by the board of directors or, in the absence of such approval, by a three-quarters affirmative vote of a shareholders meeting. Major transactions involving assets in excess of 50% of the balance sheet value of a company require a three-quarters vote by a shareholders meeting.

**General Meetings of Shareholders**

*Procedure*

The powers of a shareholders meeting are set forth in the Federal Law on Joint Stock Companies and in our charter. A shareholders meeting may not decide issues that are specifically reserved by the Federal Law on Joint Stock Companies for the board of directors or president of a company. Among the issues that the shareholders have the exclusive power to decide are

- charter amendments;
- initiation of reorganization or liquidation;
- election of the members of the board of directors;

- appointment and removal of the company's president;
- determination of the number of authorized shares;
- changes in the company's charter capital;
- approval of transactions with interested parties, as defined under "Interested Party Transactions," and major transactions, as defined under "Major Transactions"; and
- distribution of profits and losses.

Voting at a shareholders meetings is generally on the principle of one vote per share of common stock, with the exception of the election of the board of directors, which is done through cumulative voting. Decisions are generally passed by an affirmative vote of a majority of the voting shares present at a shareholders meeting. However, our charter requires a three-quarters affirmative vote of the voting shares present at a shareholders meeting to approve the following:

- charter amendments;
- reorganization or liquidation;
- determination of the number of authorized shares;
- decreases in the charter capital; and
- major transactions, as defined under Russian law.

The quorum requirement for our shareholders meetings is met if more than 50% of the issued voting shares are present. If the 50% quorum requirement is not met, another shareholders meeting must be scheduled and the quorum requirement is satisfied if at least 30% of the issued voting shares are present at that meeting.

The annual shareholders meeting must be convened by the board of directors between May 1 and June 30 of each year, and the agenda must include the following items:

- determination of the number and election of members of the board of directors;
- election of the president of the company, if the president's term is expiring;
- approval of the annual report, balance sheet and profit and loss statement;
- approval of any distribution of profits; and
- approval of an independent auditor.

A shareholder or group of shareholders owning in the aggregate at least 2% of the issued voting shares may introduce up to two proposals for the agenda of the annual shareholders meeting and may nominate candidates for the board of directors and the audit commission. Any agenda proposals or nominations must be provided to the company no later than 105 calendar days after January 1.

Extraordinary shareholders meetings may be called by the board of directors on its own initiative, or at the request of the audit commission, independent auditor or a shareholder or group of shareholders owning in the aggregate at least 10% of the issued voting shares as of the date of the request.

A general meeting of shareholders may be held in direct form or remote form. The direct form contemplates the adoption of resolutions by the general meeting of shareholders through the joint personal attendance of the shareholders and their authorized representatives for the purpose of discussing and voting on issues on the agenda. The remote form contemplates the determination of shareholders' opinions on issues on the agenda by means of a written poll and the holding of remote voting only.

*Notice and Participation*

All shareholders entitled to participate in a given general shareholders meeting shall be notified of such meeting, whether the meeting is to be held in direct or remote form, no less than 30 days prior to the date of the meeting. The list of shareholders entitled to participate in a general shareholders meeting is compiled by the counting commission of the Company, which is an independent, standing working body of the general shareholders meeting elected by the shareholders at the recommendation of the board of directors. The counting commission compiles such list on the basis of data in the Company's register of shareholders as of a date established by the board of directors. Such date may not be earlier than the date of adoption of the resolution to hold the meeting or more than 60 calendar days before the date of the meeting.

When a general meeting of shareholders is to be held in remote form, or where shareholders attending the meeting are to participate in voting using ballots sent to shareholders in preparation for the meeting in accordance with the requirements of the legislation of the Russian Federation, the date established for compilation of the list of persons entitled to participate in the general meeting of shareholders may not be less than 45 days before the date of the meeting. In any event, the date of compilation of the list of shareholders entitled to participate in a general meeting must precede the date established by the Company's charter for notifying the shareholders of a general meeting.

The right to participate in a general meeting of shareholders may be exercised by a shareholder both in person and through his representative. A shareholder may participate in a meeting in the following ways:

- by personally participating in the discussion of agenda items and voting thereon;
- by sending an authorized representative to participate in the discussion of agenda items and to vote thereon;
- by personally participating in the discussion of items on the agenda and voting thereon;
- by remote voting; or
- by delegating the right of remote voting to an authorized representative.

**Registration and Transfer of Shares**

All of our shares are common registered shares. Russian legislation requires that a joint stock company maintain a register of its shareholders. Since May 10, 2000, Registrator NIKoil OJSC has maintained our register of shareholders.

The purchase, sale or other transfer of shares is accomplished through the registration of the transfer in the share register, or the registration of the transfer with a depositary if shares are held by a depositary. The registrar or depositary may not require any documents in addition to that which is required by Russian legislation. Any refusal to register the shares in the name of the transferee or, upon request of the beneficial holder, in the name of a nominee holder, is void and may be disputed.

**Reserve Fund**

Russian legislation requires that each joint stock company establish a reserve fund to be used only to cover the company's losses, redeem the company's bonds and redeem the company's shares in cases when other funds are not available. Our charter provides for a reserve fund of 15% of our charter capital, funded through mandatory annual transfers of at least 5% of our net profits until the reserve fund has reached the 15% requirement.

**C. Material Contracts**

The following is a description of contracts that have been entered into by us and/or our subsidiaries since December 31, 1998, and are or may be material to our business:

**Dresdner Bank Credit Agreement**

In July 1999, we entered into a rollover credit facility with BNP–Dresdner Bank for the purpose of financing working capital. The credit facility in the amount up to $10 million was granted to us with the final repayment date no later than July 2, 2002. The amount advanced under the agreement bears interest of LIBOR plus 2.5% per annum. Default interest is 12% per annum. An advance of $10 million was fully repaid in September of 2000. In this regard, as of December 31, 1999, and December 31, 2000, the outstanding amount under the credit facility was $10 million and nil, respectively.

**Ericsson Loan**

In December 1996, Rosico entered into a credit agreement with Ericsson Project Finance AB ("Ericsson") that provides for a credit facility with an aggregate principal amount of $60 million and has a maximum term of five years. The Ericsson credit agreement contains covenants restricting Rosico's ability to encumber its present and future assets and revenues without the lender's express consent. The loan is repayable in 10 equal consecutive quarterly payments of $6 million commencing on the date falling 33 months after the date of the first advance but not later than five years from the disbursement of the first advance. The amounts advanced under the agreement bear the interest of LIBOR plus 4%. If Rosico fails to pay any amount payable under the credit facility, the overdue amount bears interest at a rate of an additional 6% per annum.

The Ericsson Loan is secured by a pledge of MGTS shares held by an affiliate of Sistema. Subject to the satisfaction of certain conditions, advances under the agreement may be made exclusively for the purposes of financing Rosico's further contribution to the affiliate of Sistema, which has been awarded the task of partially reconstructing and capitalizing MGTS.

Rosico was required to pay Ericsson a front-end commission equal to 2.25% of the principal of the Ericsson Loan. The front-end commission costs have been reflected as a component of debt issuance costs.

At December 31, 1999, and December 31, 2000, $60 million and $42 million were outstanding, respectively, under the Ericsson Loan at an interest rate then in effect of 10.0% and 10.87%, respectively. Interest payable on the Ericsson Loan as of December 31, 1999, and December 31, 2000, is $ nil and $431,000, respectively, and is included in accrued liabilities.

Concurrent with the Rosico Agreement, 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 of Rosico or MTS in connection with the repayment of the Ericsson Loan.

**Inkombank credit facility**

In August 1997, MSS entered into a rollover credit facility with OJSC "AB Inkombank" ("Inkombank") for the purposes of financing GSM-900 network development. The credit facility in the amount up to $12 million was granted to MSS with the final repayment date no later than March 31, 2002. The amount advanced under the agreement bears interest of 16% per annum. Default interest is 32% per annum. Under the term of agreement the amount of assets pledged is $4 million.

As of December 31, 2000, the amount of principal outstanding was $5 million. Interest payable on the credit facility as of December 31, 2000 is $841,000. Interest payable is included in accrued liabilities.

**D. Exchange Controls**

**Capital import and export restrictions**

Pursuant to the Federal Law on Currency Regulation and Currency Control and regulations of the Central Bank, certain payments in foreign currency, including the following, are subject to prior permission by the Russian Central Bank:

- direct investments;
- portfolio investments;
- all secured financing;
- certain financial credits for terms over 180 days;
- payments for export-import transactions with settlement over 90 days following completion; and
- payments with respect to real estate.

Additionally, pursuant to Central Bank Instruction #7 on the Procedure for the Obligatory Sale of Part of the Export Proceeds through Authorized Banks and the Conduct of Operations on the Internal Currency Market of the Russian Federation, Russian companies must repatriate 100% of offshore foreign currency earnings to Russia and convert 75% of such earnings into rubles. In the year ended December 31, 2000, we earned $43 million, constituting 8% of our total revenues, in foreign currency, primarily from roaming agreements. This requirement further increases balances in our ruble-denominated accounts and, consequently, our exposure to devaluation risk.

## Restrictions on the remittance of dividends, interest or other payments to non-residents

The Federal Law on Foreign Investments in the Russian Federation specifically guarantees foreign investors the right to repatriate their earnings from Russian investments. However, the Russian exchange control regime may materially affect your ability to do so.

Central Bank Instruction #93-I On the Procedure for Opening Bank Accounts for Non-Residents in Russian currency, which addreses the payment of dividends to non-residents, provides that ruble dividends on common stock may be paid to the depositary or its nominee and converted into U.S. dollars by the depositary for distribution to owners of ADSs without restriction. Also, ADSs may be sold by non-residents of Russia for U.S. dollars outside Russia without regard to Russian currency control laws as long as the buyer is not a Russian resident.

Under the terms of the deposit agreement, there is no restriction on the sale of our ADSs in Russia to Russian residents. However, Russian currency control legislation will affect the ability of a non-resident of Russia to sell our ADSs to a Russian resident. Without a Central Bank license, Russian residents must purchase securities for rubles and may not purchase foreign-currency denominated securities, such as our ADSs. Additionally, the repatriation of proceeds from the sale of securities in Russia may be subject to costs and delays.

The ability of the depositary and other persons to convert rubles into U.S. dollars or another foreign currency is also subject to the availability of U.S. dollars or other foreign currency in Russia's currency markets. Although there is an existing market within Russia for the conversion of rubles into U.S. dollars and other foreign currencies, including the interbank currency exchange and over-the-counter and currency futures markets, the further development of this market is uncertain. At present, there is no market for the conversion of rubles into foreign currencies outside of Russia and no viable market in which to hedge ruble-currency and ruble-denominated investments.

## E. Taxation

The following discussion describes the material United States federal and Russian income and withholding tax consequences to you if you are a U.S. holder of common stock or ADSs and a resident of the United States for purposes of the United States-Russia income tax treaty and are fully eligible for benefits under the United States-Russia income tax treaty. Subject to certain provisions of the United States-Russia income tax treaty relating to limitations on benefits, you generally will be a resident of the United States for treaty purposes that is entitled to treaty benefits if you are:

- liable, under the laws of the United States, to U.S. tax (other than taxes in respect only of income from sources in the United States or capital situated therein) by reason of your domicile, residence, citizenship, place of incorporation, or any other similar criterion (and, for income derived by a partnership, trust or estate, residence is determined in accordance with the residence of the person liable to tax with respect to such income); and
- not also a resident of the Russian Federation for Russian tax purposes.

The benefits under the United States-Russia income tax treaty discussed in this document generally are not available to U.S. persons who hold ADSs or common stock in connection with the conduct of a business in the Russian Federation through a permanent establishment. This summary does not address the treatment of those holders.

The following discussion is based on:

- the United States Internal Revenue Code of 1986, as amended, the Treasury regulations promulgated thereunder, and judicial and administrative interpretations thereof;
- Russian legislation; and
- the United States-Russia income tax treaty (and judicial and administrative interpretations thereof);

all as in effect on the date of this document. All of the foregoing are subject to change, possibly on a retroactive basis, after the date of this document. This discussion is also based, in part, on representations of the depositary, and assumes that each obligation in the deposit agreement and any related agreements will be performed in accordance with its terms. The discussion with respect to Russian legislation is based on our understanding of current Russian law and Russian tax rules, which are subject to frequent change and varying interpretations.

We believe, and the following discussion assumes, that for United States federal income tax purposes, we are not a passive foreign investment company or a foreign personal holding company for the current taxable year and will not become a passive foreign investment company or foreign personal holding company in the future.

The following discussion is intended as a general description only and is not intended as tax advice to any particular investor. It is also not a complete analysis or listing of all potential United States federal or Russian income and withholding tax consequences to you of ownership of common stock or ADSs. We urge you to consult your own tax adviser regarding the specific United States federal, state, and local and Russian tax consequences of the ownership and disposition of the common stock or ADSs under your own particular factual circumstances.

**Russian Income and Withholding Tax Considerations**

The Russian tax rules applicable to U.S. holders are characterized by significant uncertainties and by an absence of interpretive guidance. Russian tax authorities have not provided any guidance regarding the treatment of ADS arrangements, and there can be no certainty as to how the Russian tax authorities will ultimately treat those arrangements. In particular, it is unclear whether Russian tax authorities will treat U.S. holders as the beneficial owners of the underlying shares for the purposes of the United States-Russia income tax treaty. If the Russian tax authorities were not to treat U.S. holders as the beneficial owners of the underlying shares, then the benefits discussed below regarding the United States-Russia income tax treaty would not be available to U.S. holders. See "Risks Relating to the Russian Legal System and Russian Legislation—You may not be able to benefit from the United States-Russia income tax treaty." Russian tax law and procedures are also not well developed, and local tax inspectors have considerable autonomy and often interpret tax rules without regard to the rule of law. Both the substantive provisions of Russian tax law and the interpretation and application of those provisions by the Russian tax authorities may be subject to more rapid and unpredictable change than in jurisdictions with more developed capital markets.

Currently, the Russian government is in the process of replacing the existing tax legislation with a comprehensive tax code, but it is unclear when this process will be completed and how U.S. holders would be affected. As of January 1, 1999, Part 1 (General) of the Tax Code went into effect. This law defines the general principles of taxation in Russia, the legal status of taxpayers and tax agencies, and determines general rules of tax filings and tax control, as well as procedures for challenging tax agencies. Importantly, Part 1 specifies all the taxes that can be imposed by federal and local authorities. Further, as of January 1, 2001 four chapters (value-added taxes, excise tax, individual income tax and unified social tax) of Part 2 of the Tax Code went into effect. It is expected that Profit Tax Chapter of the Tax Code will be implemented as of January 1, 2002.

*Taxation of Dividends*

Dividends paid to U.S. holders generally will be subject to Russian withholding tax at a 15% rate to 30% rate. This tax may be reduced to 5% to 10% under the United States-Russia income tax treaty to U.S. holders. Under current regulations, the Russian tax authorities are in principle required to authorize us to withhold at reduced rates under applicable tax treaties within 14 days after receipt from the holders or us, as representative of the holders, of a special application form accompanied by a certification from the tax authorities of the holder's home country that the holder is entitled to treaty benefits. U.S. holders wishing to claim treaty benefits with respect to dividends payments should provide the required documentation to us as soon as possible and in any event at least 30 days before the first dividend payment date of each calendar year. The forms and certifications must be renewed annually. These procedures are described in greater detail under "United States-Russia Income Tax Treaty Procedures" below.

If the documentation has not been approved by the Russian tax authorities before the dividend payment date, we are required to withhold tax at the full rate, and U.S. holders qualifying for a reduced rate under the United States-Russia income tax treaty then would be required to file claims for refund within twelve months with the Russian tax authorities. Procedures for processing those claims have not been established, and there is significant uncertainty regarding the availability and timing of such refunds.

*Taxation of Capital Gains*

U.S. holders generally should not be subject to any Russian income or withholding taxes in connection with the sale, exchange, or other disposition of ADSs or common stock outside of Russia if the shares or ADSs are not sold to a Russian resident. Sales or other dispositions of ADSs or common stock to Russian residents, however, are likely to be subject to Russian income or withholding taxes, and for such a sale by a U.S. holder, the Russian resident purchaser may be required to withhold 20% to 30% of any gain realized on the sale. Although the Russian tax rules provide for a procedure to determine a holder's tax basis for the purpose of determining taxable gain, there is some risk that in practice a Russian resident purchaser may withhold tax on the entire proceeds of the transaction. However, U.S. holders may be able to avoid Russian withholding tax on the disposition of common stock or ADSs to Russian residents, or obtain a refund of any withheld amounts, by relying on the United States-Russia income tax treaty and complying with the appropriate procedures described below.

*United States-Russia Income Tax Treaty Procedures*

Under current rules, to claim the benefit of a reduced rate of withholding under the United States-Russia income tax treaty, a non-resident generally must file an advance withholding application with the Russian tax authorities and provide official certification from the U.S. tax authorities of eligibility for the treaty benefits.

Generally, the Russian tax authorities will grant advance United States-Russia income tax treaty clearance to non-resident individuals. However, advance clearance will only be available to non-resident legal entities for income which is "regular and homogenous" in nature. While dividend payments should constitute income which is regular and homogenous in nature, there is a significant risk that capital gains will not be classified as such, and therefore non-resident legal entities may not be able to obtain advance tax treaty clearance with respect to a disposition of ADSs or common stock to a Russian resident.

U.S. holders seeking to obtain relief from Russian withholding tax under the United States-Russia income tax treaty must file an application for advance tax treaty relief. U.S. holders who are legal entities must file an application on Form 1013DT (Appendix No. 11 to Instruction of the State Tax Service of the Russian Federation No. 34 of June 29, 1995), and U.S. holders who are individuals must file an application on Appendix No. 5 to Instruction of the State Tax Service of the Russian Federation No. 35 of June 29, 1995. Blank copies of these forms are available from us on request and are also available upon request to ADS holders from the depositary.

For a U.S. holder, a properly completed Form 1013DT or Appendix No. 5 to Instruction 35 requires a certification from the Internal Revenue Service confirming that holder's tax residency in the United States. A U.S. holder may obtain the appropriate certification by mailing the completed form, together with the holder's name, social security number, tax return form number and the tax period for which certification is requested, to: IRS – Philadelphia Service Center, Foreign Certification Request, P.O. Box 16347, Philadelphia, PA 19114-0447. The procedures for obtaining certification are described in greater detail in Internal Revenue Service Publication 686. Because obtaining this required certification from the Internal Revenue Service may take six to eight weeks, U.S. holders should apply for such certification as soon as possible within the relevant calendar year.

To obtain advance tax treaty relief from withholding tax on dividends, a holder should submit a certified Form 1013DT or Appendix No. 5 to Instruction 35 to us at least 30 days before the first dividend payment date of each calendar year. To obtain relief from tax on the disposition of ADSs or common stock to a Russian resident, a holder must submit a certified

Form 1013DT or Appendix No. 5 to Instruction 35 to the Russian Local Tax Inspectorate for the location where the income tax from the disposition arises. Upon obtaining the necessary approval from the Local Tax Inspectorate, the Form 1013DT should be submitted to the seller, or the agent of the seller who is responsible for withholding tax matters.

Other than as specifically provided for in the foregoing discussion, the depositary will have no obligation to assist an ADS holder with the completion and filing of any application for advance tax treaty relief.

If advance tax treaty clearance is not obtained and a Russian purchaser withholds tax on capital gains or other amounts, U.S. holders may apply for a tax refund by filing Form 1013DT or Appendix No. 5 to Instruction 35 with the Russian Local Tax Inspectorate to which the withholding tax in question was remitted within twelve months from the withholding date. However, procedures for processing such claims have not been established, and there is significant uncertainty regarding the availability and timing of such refunds.

**United States Federal Income Tax Considerations**

The following is a general description of the United States federal income tax consequences that apply to you if you are, for United States federal income tax purposes, a beneficial owner of ADSs or common stock who is a citizen or resident of the United States, a corporation (including any entity treated as a corporation for United States federal income tax purposes) created or organized in or under the laws of the United States or a political subdivision thereof, an estate the income of which is subject to U.S. tax regardless of its source, or a trust, if a United States court can exercise primary supervision over the administration of the trust and one or more United States persons can control all substantial trust decisions or, if the trust was in existence on August 20, 1996 and has properly elected to continue to be treated as a United States person. If a partnership (including any entity treated as a partnership for United States federal income tax purposes) is a beneficial owner of ADSs or common stock, the United States federal income tax treatment of a partner in the partnership will generally depend on the status of the partner and the activities of the partnership. Since your United States federal income and withholding tax treatment may vary depending upon your particular situation, you may be subject to special rules not discussed below. Special rules will apply, for example, if you are:

- an insurance company,
- a tax-exempt organization,
- a financial institution,
- a person subject to the alternative minimum tax,
- a person who is a broker-dealer in securities,
- an S corporation,
- an expatriate subject to Section 877 of the United States Internal Revenue Code,
- an owner of, directly, indirectly or by attribution, 10 percent or more of the outstanding shares of common stock, or
- an owner holding ADSs or common stock as part of a hedge, straddle, synthetic security or conversion transaction.

In addition, this summary is generally limited to you if you will hold common stock or ADSs as "capital assets" within the meaning of Section 1221 of the United States Internal Revenue Code and your functional currency is the United States dollar. The discussion below also does not address the effect of any United States state or local tax law or foreign tax law.

For purposes of applying United States federal income and withholding tax law, a holder of an ADS will be treated as the owner of the underlying shares of common stock represented by that ADS.

*Taxation of Dividends on Common Stock or ADSs*

For United States federal income tax purposes, the gross amount of a distribution, including any Russian withholding taxes, with respect to common stock or ADSs will be treated as a taxable dividend to the extent of our current and accumulated earnings and profits, computed in accordance with United States federal income tax principles. Distributions in excess of our current or accumulated earnings and profits will be applied against and will reduce your tax basis in common stock or ADSs and, to the extent in excess of such tax basis, will be treated as gain from a sale or exchange of such common stock or ADSs. If you are a corporation, you will not be allowed a deduction for dividends received in respect of distributions on common stock or ADSs.

If a dividend distribution is paid in rubles, the amount includible in income will be the U.S. dollar value of the dividend, calculated using the exchange rate in effect on the date the dividend is includible in income by you in accordance with your method of accounting, regardless of whether the payment is actually converted into U.S. dollars. Any gain or loss resulting from currency exchange rate fluctuations during the period from the date the dividend is includible in your income to the date the rubles are converted into U.S. dollars will be treated as ordinary income or loss. You may be required to recognize foreign currency gain or loss on the receipt of a refund of Russian withholding tax pursuant to the United States-Russia income tax treaty to the extent the United States dollar value of the refund differs from the dollar equivalent of that amount on the date of receipt of the underlying dividend.

Russian withholding tax at the 10% rate provided under the United States-Russia income tax treaty will be treated as a foreign income tax that, subject to generally applicable limitations and conditions, is eligible for credit against your U.S. federal income tax liability or, at your election, may be deducted in computing taxable income. If Russian tax is withheld at a rate in excess of the 10% rate provided under the United States-Russia income tax treaty, you may not be entitled to credits for the excess amount, even though the procedures for claiming refunds and the practical likelihood that refunds will be made available in a timely fashion are uncertain.

A dividend distribution will be treated as foreign source income and will generally be classified as "passive income" or, in some cases, "financial services income" for United States foreign tax credit purposes. The rules relating to the determination of the foreign tax credit, or deduction in lieu of the foreign tax credit, are complex and you should consult your own tax advisors with respect to those rules.

*Taxation on Sale or Exchange of Common Stock or ADSs*

The sale of common stock or ADSs will generally result in the recognition of gain or loss in an amount equal to the difference between the amount realized on the sale and your adjusted basis in such common stock or ADSs. That gain or loss will be capital gain or loss if the common stock or ADSs are capital assets in your hands and will be long-term capital gain or loss if the common stock or ADSs have been held for more than one year. Limitations may apply to your ability to offset capital losses against ordinary income.

Deposits and withdrawals of common stock by you in exchange for ADSs will not result in the realization of gain or loss for U.S. federal income tax purposes.

If Russian tax is withheld on the sale of common stock or ADSs, you may not be entitled to credits for the amount withheld, even though the procedures for claiming refunds under the United States-Russia income tax treaty and the practical likelihood that refunds will be made available in a timely fashion are uncertain.

*Information Reporting and Backup Withholding*

Payments or other taxable distributions in respect of common stock or ADSs that are made in the United States or by a U.S. related financial intermediary will be subject to U.S. information reporting rules. If you are U.S. person, you generally will not be subject to a 31% United States backup withholding tax on such payments if you are a corporation or other exempt recipient or you provide your taxpayer identification number and certify that no loss of exemption from backup withholding has occurred. U.S. persons may also be subject to information reporting and backup withholding tax requirements with respect to the proceeds from a sale of common stock or ADSs.

## F. Dividends and Paying Agents

Not applicable.

## G. Statement by Experts

Not applicable.

## H. Documents on Display

The documents that are exhibits to or incorporated by reference in this annual report can be read at the U.S. Securities and Exchange Commission's public reference facilities at Room 1024, 450 Fifth Street, N.W., Washington, D.C. 20549. You may obtain information on the operation of the Public Reference Room by calling the SEC at 1-800-SEC-0330 or, from outside the United States, at 1-202-942-8090. We will not be filing electronically with the SEC.

## I. Subsidiary Information

Not applicable.

## Item 11. *Quantitative and Qualitative Disclosures about Market Risk*

We are exposed to market risk from changes in both foreign currency exchange rates and interest rates. Foreign exchange risks exist to the extent our costs are denominated in currencies other than rubles. We are subject to market risk deriving from changes in interest rates which may affect the cost of our financing. We do not use financial instruments, such as foreign exchange forward contracts, foreign currency options, interest rate swaps and forward rate agreements, to manage these market risks. We do not hold or issue derivative or other financial instruments for trading purposes. It is our strategy not to enter into agreements that have qualities of derivatives or agreements with embedded derivatives.

*Interest Rate Risk*

Interest rate risk exists principally with respect to our indebtedness that bears interest at floating rates. We have not entered into agreements to hedge risks associated with the movement of interest rates. However, in connection with the $42.0 million Ericsson loan shown in the table below, we have, under the terms of the Rosico acquisition agreement, received a commitment from Sistema whereby Sistema agrees to fund Rosico for the full and timely repayment of the loan.

Russian Legislation prohibits us from acquiring financial instruments denominated in foreign currencies, which prevents us from hedging against interest rate risks that may exist under our current or future indebtedness.

For indebtedness as of December 31, 2000, the table below presents principal cash flows and related weighted average interest rates by expected maturity dates.

| | | Expected Maturity Date as of December 31, 2000 | | | | | | |
|---|---|---|---|---|---|---|---|---|
| Variable rate debt | Currency | 2001 | 2002 | 2003 | 2004 | 2005 | Total | Interest Rates at December 31, 2000 |
| | | (in thousands of U.S. dollars) | | | | | | |
| Ericsson loan | USD | 24,000 | 18,000 | -- | -- | -- | $42,000 | LIBOR + 4% (10.875%) |
| Total variable rate debt: | | $24,000 | $18,000 | -- | -- | -- | $42,000 | |
| Weighted average interest rate: | | 10.875 % | 10.875% | -- | -- | -- | | |

It is not practical to determine the fair value of our indebtedness due to the current instability in the Russian economy and its effect on interest rates appropriate for determining fair value.

We have not experienced significant changes in the market risks associated with our debt obligations in the table above subsequent to December 31, 2000.

*Foreign Currency Risk*

Our principal exchange rate risk involves changes in the value of the ruble relative to the U.S. dollar. While the local currency in Russia is the ruble, the economy has been characterized by high levels of inflation and an unstable currency. As a result of inflation and the continued devaluation of the ruble, we link our monetary assets and transactions, when possible, to the U.S. dollar, which under SFAS No. 52 is reported in this document as functional currency.

Substantially all of our capital expenditures and operating costs are either denominated in U.S. dollars or tightly linked to the U.S. dollar exchange rate. In order to hedge against a significant portion of this risk, we also link our tariff revenues, which are payable in rubles, to the U.S. dollar by requiring accounts to be settled at the official exchange rate of the Central Bank on the date of payment.

If the ruble continues to decline against the U.S. dollar and tariffs cannot keep pace, we could have difficulty repaying or refinancing our U.S. dollar-denominated indebtedness.

In terms of U.S. dollars, our investment in monetary assets denominated in rubles is also subject to risk of loss. In particular, we are unable to economically hedge the risks associated with our ruble operating accounts. As of December 31, 1999 and 2000, our ruble cash balances totaled $3.6 million and $10 million, respectively.

*Inflation*

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

| Year | Inflation rate |
|---|---|
| 1996 | 21.8% |
| 1997 | 11.4% |
| 1998 | 84.4% |
| 1999 | 36.7% |
| 2000 | 20.2% |

Substantially all of our costs are denominated in U.S. dollars or are tightly linked to the U.S. dollar. When the rate of inflation is less than or equal to the rate of devaluation, as was the case in 1998, inflation should not put upward pressure on costs. When, however, the rate of inflation exceeds the rate of devaluation, resulting in real appreciation of the ruble versus the U.S. dollar, as was the case for periods prior to 1998 and in 1999 and 2000, we can experience inflation-driven increases in certain of our costs, such as salaries and rents, which are sensitive to rises in the general price level in Russia. While we could seek to raise our tariffs, competitive pressures may not permit increases that are sufficient to preserve operating margins. Accordingly, high rates of inflation in Russia relative to the rate of devaluation could materially adversely affect our results of operations.

## Item 12. *Description of Securities Other than Equity Securities*

Not applicable

## PART II

### Item 13. *Defaults, Dividend Arrearages and Delinquencies*

None.

### Item 14. *Material Modifications to the Rights of Security Holders and Use of Proceeds*

### A. Material Modification to Rights of ADR Holders

On June 30, 2000, the Federal Commission for the Securities Market for the Russian Federation issued a letter to a Russian company clarifying its position on an aspect of shareholder voting, stating that a company may issue only one ballot for each issue to each shareholder. The Federal Commission for the Securities Market may consider a depositary bank holding ADSs to be the beneficial owner of the ADSs. To avoid the risk that resolutions adopted at our shareholders' meetings will later be declared invalid, we will provide only one ballot for each issue on the agenda to Morgan Guaranty Trust Company of New York. Accordingly, Morgan Guaranty Trust Company of New York will not be able to split the votes associated with the ADSs. We have informed Morgan Guaranty Trust Company of New York that, in accordance with the Federal Commission for the Securities Market's letter, it will receive only one ballot for each issue with respect to all of our ADSs and that it may not split its vote. As a result, it will have only three choices for each issue: vote all ADSs for it, vote all ADSs against it, or abstain. Morgan Guaranty Trust Company of New York has not yet informed us as to how it will determine how to vote the ADSs or if it will vote them at all.

### E. Use of Proceeds

On June 29, 2000, we filed a registration statement on Form F-1 (Registration No. 333-12032) under the Securities Act of 1933, as amended, with the Commission with respect to our initial public offering. The Registration Statement was declared effective on June 29, 2000, and the offering was completed on July 6, 2000. All of the 15,010,612 ADSs offered pursuant to the offering at an initial offering price of $21.50 per ADS were sold for a total of $322,728,158 million. The underwriters purchased an additional 2,251,592 ADSs at the offering at the price of $21.50 per ADS for a total of $48,409,228. The underwriters of the offering were Deutsche Bank AG London, ING Barings Limited (as an agent for ING Bank, N.V.), Credit Suisse First Boston (Europe) Limited, J.P. Morgan Securities Ltd., Renaissance Capital Investments (Cyprus) Limited and Salomon Brothers International Ltd. The net proceeds from the offering was approximately $347,029,938 million, after deducting an estimated $17,607,448 million in underwriting discounts and commissions and an estimated $7.1 million in regulatory, legal, accounting and other miscellaneous fees and expenses.

During 2000, we used approximately $107.6 million of our net proceeds for the following purposes:

| Use | Approximate Amount |
|---|---|
| Acquisition of equiment for the Moscow License Area | $77.3 million |
| Equipment assembly and customs charges | $12.7 million |
| New technology equipment | $1.5 million |
| Acqusition of 20% Rosico stake | $16.1 million |
| Total: | $107.6 million |

The remaining proceeds are invested in various time deposits with institutions. None of the net proceeds from our initial public offering were paid, directly or indirectly to any of our directors, officers or general partners or any of their associates, or to any persons owing ten percent or more of any class of our equity securities, or any affiliates.

**Item 15.** ***[Reserved]***

**Item 16.** ***[Reserved]***

## PART III

**Item 17.** ***Financial Statements***

Not applicable.

**Item 18.** ***Financial Statements***

### Index to Financial Statements

**Mobile TeleSystems**

**Report of Independent Public Accountants**

To Mobile TeleSystems:

We have audited the accompanying consolidated balance sheets of Mobile TeleSystems, a Russian Open Joint-Stock Company, and its subsidiaries as of December 31, 1999 and 2000, and the related consolidated statements of operations, cash flows and shareholders' equity for each of the three years in the period ended December 31, 2000. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated 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, the financial statements referred to above present fairly, in all material respects, the financial position of Mobile TeleSystems and its subsidiaries as of December 31, 1999 and 2000, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2000, in conformity with accounting principles generally accepted in the United States.

Arthur Andersen ZAO

Moscow, Russia
March 19, 2001

**MOBILE TELESYSTEMS**
**CONSOLIDATED BALANCE SHEETS**
**AT DECEMBER 31, 1999 and 2000**

(Amounts in thousands of U.S. dollars, except share amounts)

**ASSETS**

| | December 31 | |
|---|---|---|
| | **1999** | **2000** |
| **CURRENT ASSETS:** | | |
| Cash and cash equivalents (Note 5) | $ 10,000 | $ 75,828 |
| Short-term investments (Note 6) | — | 170,000 |
| Trade receivables, net (Note 7) | 24,720 | 15,817 |
| Accounts receivable, related parties (Note 22) | 5,973 | 4,937 |
| Inventory, net (Note 8) | 16,577 | 23,551 |
| Prepaid expenses | 9,588 | 11,268 |
| VAT receivable | 11,708 | 17,741 |
| Deferred tax asset (Note 17) | 2,400 | 2,071 |
| Other current assets | 5,621 | 8,771 |
| Total current assets | 86,587 | 329,984 |
| **PROPERTY, PLANT AND EQUIPMENT**, net of accumulated depreciation of $47,735 and $87,676, respectively (Note 9) | 250,270 | 439,307 |
| **INTANGIBLE ASSETS**, net of Accumulated amortization of $25,787 and $33,648, respectively (Note 10) | 39,861 | 57,586 |
| **LICENSES**, net of accumulated amortization of $16,450 and $43,913, respectively (Notes 4 and 23) | 236,201 | 204,996 |
| **GOODWILL**, net of accumulated amortization of $8,650 and $14,756, respectively (Note 4) | 34,089 | 27,984 |
| **SUBSCRIBER ACQUISITION COSTS**, net of accumulated amortization of $21,199 and $74,803, respectively (Note 11) | 31,925 | 27,553 |
| **DEBT ISSUANCE COSTS**, net of accumulated amortization of $4,103 and $900, respectively (Note 15) | 2,008 | 450 |
| **INVESTMENTS IN AND ADVANCES TO AFFILIATES** (Note 22) | 1,106 | 13,472 |
| **Total assets** | $ 682,047 | $ 1,101,332 |

**MOBILE TELESYSTEMS**
**CONSOLIDATED BALANCE SHEETS**
**AT DECEMBER 31, 1999 and 2000**

(Amounts in thousands of U.S. dollars, except share amounts

## LIABILITIES AND SHAREHOLDERS' EQUITY

| | December 31 | |
|---|---|---|
| | **1999** | **2000** |
| **CURRENT LIABILITIES:** | | |
| Accounts payable, related parties (Note 22) | $ 3,049 | $ 3,792 |
| Trade accounts payable | 43,792 | 39,864 |
| Deferred connection fees (Note 13) | 12,166 | 14,923 |
| Subscriber prepayments and deposits | 23,026 | 44,610 |
| Debt, current portion (Note 15) | 38,333 | 24,000 |
| Income tax payable | — | 15,082 |
| Accrued liabilities (Note 14) | 29,229 | 38,175 |
| Dividends payable | 1,832 | 1,038 |
| Other current liabilities | 1,048 | 1,278 |
| Total current liabilities | 152,475 | 182,762 |
| **LONG-TERM LIABILITIES:** | | |
| Debt, net of current portion (Note 15) | 66,334 | 23,305 |
| Interest payable on debt (Note 15) | 7,456 | — |
| Promissory notes payable (Note 16) | — | 5,468 |
| Deferred connection fees , net of current portion (Note 13) | 12,456 | 16,630 |
| Deferred taxes (Note 17) | 73,344 | 72,083 |
| Total long-term liabilities | 159,590 | 117,486 |
| **Total liabilities** | 312,065 | 300,248 |
| **COMMITMENTS AND CONTINGENCIES** (Notes 2 and 24) | — | — |
| **MINORITY INTEREST** (Note 4) | 26,258 | — |
| **SHAREHOLDERS' EQUITY:** | | |
| Common stock: (2,096,975,792 shares with a par value of 0.1 rubles authorized and 1,634,527,440 shares issued as of December 31, 1999 and 1,993,326,138 shares issued as of December 31, 2000, 345,244,080 of which are in the form of ADS (Note 1) | 49,276 | 50,558 |
| Treasury stock (9,966,631 common shares at cost (Note 19) | — | (10,206) |
| Additional paid-in capital (Note 18) | 182,975 | 552,030 |
| Shareholder receivable (Note 4) | (70,331) | (49,519) |
| Retained earnings | 181,804 | 258,221 |
| Total shareholders' equity | 343,724 | 801,084 |
| **Total liabilities and shareholders' equity** | $ 682,047 | $ 1,101,332 |

**MOBILE TELESYSTEMS**

**CONSOLIDATED STATEMENTS OF OPERATIONS**

**FOR THE YEARS ENDED DECEMBER 31, 1998, 1999 and 2000**

(Amounts in thousands of U.S. dollars, except share and per share data)

| | December 31 | | |
|---|---|---|---|
| | **1998** | **1999** | **2000** |
| **NET REVENUES**: | | | |
| Service revenues, net | $ 313,282 | $ 314,568 | $ 484,469 |
| Connection fees | 8,697 | 12,755 | 14,885 |
| Equipment sales | 16,344 | 31,004 | 36,358 |
| | 338,323 | 358,327 | 535,712 |
| **COST OF SERVICES AND PRODUCTS** (including related party amounts of $5,255, $8,846 and $5,576, respectively): | | | |
| Interconnection and line rental | 43,617 | 38,958 | 41,915 |
| Roaming expenses | 13,223 | 21,725 | 41,178 |
| Cost of equipment | 14,658 | 29,932 | 39,217 |
| | 71,498 | 90,615 | 122,310 |
| **OPERATING EXPENSES** (including related party amounts of $614, $9,670 and $ 5,064 , respectively and expenses associated with management stock bonus plan of $nil, $nil and $4,500, respectively) (Note 20): | 54,641 | 66,606 | 107,839 |
| **SALES AND MARKETING EXPENSES** (including related party amounts of $nil, $930 and $6,400 respectively): | 15,657 | 23,722 | 76,429 |
| **PROVISION FOR DOUBTFUL ACCOUNTS** (Note 7) | 12,829 | 8,006 | 2,403 |
| **DEPRECIATION AND AMORTIZATION** | 19,629 | 53,766 | 87,684 |
| Net operating income | 164,069 | 115,612 | 139,047 |
| **CURRENCY EXCHANGE AND TRANSLATION LOSSES** | 25,125 | 3,238 | 1,066 |
| **OTHER EXPENSES (INCOME)** (including related party amounts of $nil, $nil and $952, respectively): | | | |
| Interest income (Note 6) | (2,181) | (801) | (7,626) |
| Interest expenses, net of amounts capitalized | 8,302 | 11,805 | 11,335 |
| Loss on disposal of other assets (Note 12) | 2,775 | 847 | — |
| Other expense (income) | 2,063 | (1,676) | (502) |
| Total other expenses, net | 10,959 | 10,175 | 3,207 |
| Income before provision for income taxes and minority interest | 127,985 | 102,199 | 134,774 |
| **PROVISION FOR INCOME TAXES** (Note 17) | 62,984 | 18,829 | 51,154 |
| **MINORITY INTEREST** | (1,027) | (2,291) | (6,428) |
| **NET INCOME** | $ 66,028 | $ 85,661 | $ 90,048 |
| Weighted average number of shares outstanding | 1,397,945,938 | 1,634,527,440 | 1,806,968,096 |
| Earnings per share (basic and diluted) | $ 0.047 | $ 0.052 | $ 0.050 |

**MOBILE TELESYSTEMS**
**CONSOLIDATED STATEMENTS OF CASH FLOWS**
**FOR THE YEARS ENDED DECEMBER 31, 1998, 1999 and 2000**

(Amounts in thousands of U.S. dollars)

| | December 31 | | |
|---|---|---|---|
| | **1998** | **1999** | **2000** |
| **CASH FLOWS FROM OPERATING ACTIVITIES:** | | | |
| Net income | $ 66,028 | $ 85,661 | $ 90,048 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | | |
| Minority interest | (1,027) | (2,291) | (6,428) |
| Depreciation and amortization | 19,629 | 53,766 | 87,684 |
| Amortization of deferred connection fees | (8,697) | (12,755) | (14,867) |
| Amortization of deferred subscriber acquisition costs | 6,360 | 12,285 | 53,604 |
| Provision for obsolete inventory | 232 | 590 | 2,114 |
| Provision for doubtful accounts | 12,829 | 8,006 | 2,403 |
| Provision for other assets | 2,775 | 379 | — |
| Bank loan interest accrued | 7,124 | 11,809 | 11,335 |
| Loan interest paid | (4,563) | (11,431) | (17,850) |
| Deferred taxes | 868 | (17,594) | (932) |
| Non-cash expenses associated with stock bonus plan | — | — | 5,297 |
| Changes in operating assets and liabilities: | | | |
| Decrease / (Increase) in trade receivables | (1,575) | 3,435 | 6,730 |
| Decrease/(Increase) in accounts receivable, related parties | 1,682 | (5,245) | 4,223 |
| Increase in inventory | (4,756) | (8,074) | (8,922) |
| Increase in prepaid expenses | (2,339) | (267) | (1,680) |
| Increase in VAT receivable | (1,041) | (2,944) | (6,033) |
| (Increase)/Decrease in other current assets | 2,501 | 2,818 | (7,363) |
| Increase in subscriber acquisition costs | (16,497) | (23,674) | (49,232) |
| Increase/(Decrease) in accounts payable, related parties | 97 | (11,921) | 743 |
| (Decrease)/Increase in trade accounts payable | 1,721 | 29,143 | (29,801) |
| Increase in subscriber prepayments and deposits and deferred connection fees | 15,282 | 7,901 | 43,382 |
| Increase/(Decrease) in income tax payable | (4,928) | (7,401) | 19,787 |
| Increase in accrued liabilities and other payables | 11,781 | 4,605 | 6,672 |
| Total adjustments | 37,458 | 31,140 | 100,866 |
| Net cash provided by operating activities | 103,486 | 116,801 | 190,914 |
| **CASH FLOWS FROM INVESTING ACTIVITIES:** | | | |
| Cash acquired at Rosico Purchase | 18,071 | — | — |
| Advances to shareholder | (17,261) | — | — |
| Purchase of RTC, net of cash acquired | (12,694) | — | — |

**MOBILE TELESYSTEMS**

**CONSOLIDATED STATEMENTS OF CASH FLOWS**

**FOR THE YEARS ENDED DECEMBER 31, 1998, 1999 and 2000**

| | | | |
|---|---|---|---|
| Purchase of UDN-900, net of cash acquired | — | (180) | — |
| Purchase of ACC, net of cash acquired | — | (83) | — |
| Purchase of property, plant and equipment | (79,249) | (109,012) | (194,983) |
| Purchase of intangible assets | (23,883) | (9,326) | (29,915) |
| Purchases of short term investments | — | — | (170,000) |
| Other non-current assets realized (acquired) | (5,088) | 2,313 | — |
| Purchase of 20% in Rosico | — | — | (16,085) |
| Decrease/(Increase) in investments in and advances to affiliates | (1,947) | 1,104 | (12,366) |
| Net cash used in investing activities | (122,051) | (115,184) | (423,349) |
| **CASH FLOWS FROM FINANCING ACTIVITIES:** | | | |
| Proceeds from issuance of capital stock net of direct expenses | — | — | 348,553 |
| Dividends paid | (9,624) | (11,224) | (14,425) |
| Proceeds from short-term debt | — | 18,000 | — |
| Loan principal paid | | (18,333) | (62,665) |
| Payments on receivable from AFK Sistema | — | — | 27,080 |
| Net cash provided by (used in) financing activities | (9,624) | (11,557) | 298,543 |
| Effect of exchange rate changes on cash and cash equivalents | (3,591) | (944) | (280) |
| **NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS:** | (31,780) | (10,884) | 65,828 |
| **CASH AND CASH EQUIVALENTS,** at beginning of year | 52,664 | 20,884 | 10,000 |
| **CASH AND CASH EQUIVALENTS,** at end of year | $20,884 | $10,000 | $75,828 |
| SUPPLEMENTAL INFORMATION: | | | |
| Income taxes paid | $ 56,275 | $ 59,484 | $ 35,052 |
| Non-cash investing activities: | | | |
| 80% of Rosico acquisition (Note 4) | | | |
| RTC acquisition (Note 4) | | | |

**MOBILE TELESYSTEMS**

**CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY**

**FOR THE YEARS ENDED DECEMBER 31, 1998, 1999 and 2000**

(Amounts in thousands of U.S. dollars, except share amounts)

| | **Common Stock** | | **Treasury Stock** | | **Additional Paid-in Capital** | **Shareholder Receivable** | **Retained Earnings** | **Total** |
|---|---|---|---|---|---|---|---|---|
| | **Shares** | **Amounts** | **Shares** | **Amount** | | | | |
| **BALANCES**, December 31, 1997 ................ | 1,225,895,580 | $ 46,800 | — | — | $ 14,367 | — | $ 52,113 | $ 113,280 |
| Common stock issued in connection with acquisition of Rosico ............................... | 408,631,860 | 2,476 | — | — | 115,538 | — | — | 118,014 |
| Receivable from Sistema: | | | | | | | | |
| Amount established concurrent with acquisition of Rosico ............................. | — | — | — | — | 42,739 | (42,739) | — | — |
| Increases for additional advances............................. | — | — | — | — | — | (17,261) | — | (17,261) |
| Increases for interest........... | — | — | — | — | 4,030 | (4,030) | — | — |
| Net income............................. | — | — | — | — | — | — | 66,028 | 66,028 |
| Dividends declared................. | — | — | — | — | — | — | (10,119) | (10,119) |
| **BALANCES**, December 31, 1998 ............. | 1,634,527,440 | 49,276 | — | — | 176,674 | (64,030) | 108,022 | 269,942 |
| Receivable from Sistema: | | | | | | | | |
| Increases for interest........... | — | — | — | — | 6,301 | (6,301) | — | — |
| Net income............................. | — | — | — | — | — | — | 85,661 | 85,661 |
| Dividends declared................. | — | — | — | — | — | — | (11,879) | (11,879) |
| **BALANCES**, December 31, 1999 ................ | 1,634,527,440 | $ 49,276 | — | — | $ 182,975 | $ (70,331) | $ 181,804 | $ 343,724 |
| Receivable from Sistema: | | | | | | | | |
| Increases for interest........... | —— | — | — | — | 6,268 | (6,268) | — | — |
| Payments from AFK Sistema............................... | —— | — | — | — | — | 27,080 | — | 27,080 |
| Issuance of common shares net of direct expenses (Note 1) | 345,244,080 | 1,233 | — | — | 347,320 | — | — | 348,553 |
| Purchase of treasury stock under the stock bonus plan and stock option plan (Note 19) | 13,554,618 | 49 | (13,554,618) | (13,880) | 13,831 | — | — | — |
| Exercise of stock bonus plan (Note 19) | | | 3,587,987 | 3,674 | (3,661) | — | — | 13 |
| Non-cash expense associated with issuance of stock bonus plan.................... | — | — | — | — | 5,297 | — | — | 5,297 |
| Net income............................. | — | — | — | — | — | — | 90,048 | 90,048 |
| Dividends declared................. | — | — | — | — | — | — | (13,631) | (13,631) |
| **BALANCES**, December 31, 2000 .............. | **1,993,326,138** | **$ 50,558** | **9,966,631** | **$(10,206)** | **$ 552,030** | **$ (49,519)** | **$ 258,221** | **$801,084** |

# 1. General

Business of the Company

MTS was created in October 1993 to design, construct and operate a cellular telecommunications network in Moscow and the Moscow region.

MTS was originally registered on October 28, 1993 as a closed joint stock company, and began commercial operations in the middle of 1994.

In November 1993, MTS was granted a 900 MHz or GSM-900 cellular license for operation in Moscow and the Moscow region. The license gave MTS the exclusive right to operate on the GSM-900 standard for 10 years from the commencement of operations. In June 1998, MTS was granted a new license, which gave MTS the right to operate on the GSM standard up to December 2004, however exclusive operating rights were no longer guaranteed.

In 1997, MTS was granted GSM-900 cellular licenses for operations in the Tver region as well as the Kostroma region and the Komi Republic (See Note 23, “Operating Licenses”).

In 1998, MTS acquired controlling stakes in Rosico and RTC, both Russian joint stock companies, which hold licenses to operate, respectively, GSM-1800 and GSM-900 cellular networks in Moscow, certain areas in Central and Northern Russia, the Urals and Western Siberia and GSM-900 cellular networks in certain regions in Central Russia, respectively. Additionally, in 1998 MTS acquired an interest in ReCom, a Russian joint stock company holding GSM-900 licenses to operate in six regions in Central Russia.

In 1999, MTS acquired Udmurt Digital Network (UDN-900), a Russian closed joint stock company, which is licensed to operate GSM-900 cellular network in the Udmurt region, and Amur Cellular Communications (ACC), a Russian closed joint stock company, which is licensed to operate GSM-900 cellular network in the Amursk region.

Reorganization

In March 2000, closed joint stock company Mobile TeleSystems was merged with RTC, MTS’ wholly owned subsidiary, to create the open joint stock company Mobile TeleSystems. This corporate merger has been accounted for at historical cost in a manner similar to that in pooling of interest accounting because the merged companies were entities under common control.

The accompanying financial statements represent those of open joint stock company Mobile TeleSystems and its legal predecessor, closed joint stock company Mobile TeleSystems. Shares, earnings per share and other per share information have been restated in the accompanying financial statements to give retroactive effect to the capital structure of open joint stock company Mobile TeleSystems.

See Note 23, “Operating Licenses”.

(Amounts in thousands of U.S. dollars, unless otherwise stated)

Issuance of Share Capital

As of December 31, 1999 the Company's share capital amounted to the equivalent of $49,276 divided into 1,634,527,440 registered shares with par value of 0.1 Ruble each.

During July 2000, the Company issued additional shares in an initial public offering on the New York Stock Exchange. 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 in the offering. Proceeds from the offering, net of underwriting discount, were $348,553.

On August 11, 2000 the Company registered its shares issuance report with the Federal Securities Commission of the Russian Federation and, accordingly, officially completed its initial public offering.

Ownership

As of December 31, 1999 and 2000, MTS' shareholders and their respective percentage interests were as follows:

| | December 31 | |
|---|---|---|
| | 1999 | 2000 |
| Joint Stock Financial Corporation "Sistema" ("Sistema") | 42.4% | 34.8% |
| DeTeMobil GmbH ("DeTeMobil") | 44.1% | 36.2% |
| Vast, Limited Liability Company ("Vast") | 3.7% | 3.0% |
| Invest-Svyaz-Holding, Closed Joint Stock Company | 9.8% | 8.0% |
| ADS Holders | — | 18.0 % |
| | 100.0% | 100.0% |

## 2. Russian Environment

General

Over recent years, Russia has undergone substantial political, economic and social change. As an emerging market, Russia does not possess a well-developed business and regulatory infrastructure, which would generally exist in a more mature free market economy. As a result, operations carried out in Russia involve significant risks, which are not typically associated with those in developed markets.

Political – In recent years, Russia has been undergoing a substantial political transformation from communist party rule and a centrally controlled economy to a pluralist democracy and a market-oriented economy. The Russian political system is vulnerable to the population's dissatisfaction with reform, as well as to social and ethnic unrest.

Economic – Since August 17, 1998, Russia has experienced acute financial and economic distress. The Russian economy has been characterized by declining industrial production, significant inflation, rising unemployment, an unstable currency, high government debt relative to gross domestic product, high levels of inter-company debt and high levels of corporate insolvency.

Social – The political and economic changes in Russia in recent years have resulted in a substantial increase in social issues, including crime, labor and social unrest, and claims of official corruption.

Legal – The Russian legal system is characterized by (1) inconsistencies between and among laws, Presidential decrees, and Russian governmental, ministerial and local orders, decisions, and resolutions and other acts; (2) conflicting local, regional and federal rules and regulations; (3) the lack of judicial and administrative guidance on interpreting legislation; (4) the relative inexperience of judges and courts in interpreting legislation; and (5) a high degree of discretion on the part of governmental authorities.

Management is unable to estimate what developments may occur or the resulting effect of any such developments on MTS' financial condition or future results of operations. MTS will continue to be affected, for the foreseeable future, by the country's unstable economy. The financial statements do not include any adjustment that may result from these uncertainties.

<u>Effects of the Russian Economic Situation Considered by MTS through December 31, 2000</u>

*Impairment of long-lived assets* – As a result of significant devaluation of the ruble described above, MTS has reassessed the recoverability of its investments in long-lived assets, including property, plant and equipment and intangible assets. MTS' accounting policies require an impairment loss to be recognized whenever a review demonstrates that the book value of a long-lived asset is not recoverable in terms of net undiscounted future cash flows.

Management has considered several factors in its analysis, including the following:

- the continued use of each significant segment of its existing network,
- investment needed to build up MTS' network in accordance with current operating plans,
- the development of license areas acquired, in particular in relation to value allocated to licenses of Rosico (See Note 4), and
- management's assessment of the current economic situation.

Based on these factors management has determined that no impairment has occurred in relation to its investment in long-lived assets during the year ended December 31, 2000. However, management believes that it is reasonably possible that its carrying value for Rosico licenses could be significantly affected by a continuation of the Russian economic situation. Assuming that the Russian economic situation continues over the next few years, the possible impact could be material to MTS' financial position or results of operations.

*Net loss on ruble monetary assets and liabilities*—Substantially all of MTS' accounts receivable are "indexed" to the U.S. dollar exchange rate on the date of payment, and as a result, MTS' exposure to ruble devaluation is significantly mitigated, subject to its subscribers ability to pay during times of devaluation. However, currency regulations restrict MTS' ability to collect and maintain cash in currencies other than rubles that expose MTS to currency devaluation. As a result, MTS incurred exchange losses of approximately $25 million, $3 million and $1 million for the years ended

(Amounts in thousands of U.S. dollars, unless otherwise stated)

December 31, 1998, 1999 and 2000, respectively, which are included as a component of currency exchange and translation losses in the accompanying consolidated statements of operations.

Taxation

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, 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 (as examples, customs and currency control matters), are subject to review and investigation by a number of authorities, who are enabled by law to impose extremely severe fines, penalties and interest charged. These facts create tax risks in Russia substantially 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. The new tax system is generally intended to reduce the number of taxes and, thus, 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. While most of MTS' tax declarations have been inspected without significant penalties, these inspections do not eliminate the possibility of re-inspection. Accordingly, as of December 31, 2000, substantially all of the tax declarations of MTS are open to further review.

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.

Effects of the Russian Economic Situation on Currency Exchange Rates

Foreign currencies, in particular the US dollar, play a significant role in the underlying economics of many business transactions in Russia. The following table summarizes the exchange rate of the ruble to 1 US dollar for the years ended December 31, 1998, 1999 and 2000.

| As of December 31, | Exchange Rate |
|---|---|
| 1998 | 20.65 |
| 1999 | 27.00 |
| 2000 | 28.16 |

The Central Bank of Russia has established strict currency control regulations designed to promote the commercial utilization of the ruble. Such regulations place restrictions on the conversion of rubles into hard currencies and establish requirements for conversion of hard currency sales to rubles.

(Amounts in thousands of U.S. dollars, unless otherwise stated)

In 1998, the ruble suffered a significant devaluation as a result of Russia's unstable economic environment. However, over the past few years, the rate of exchange between the ruble and the US dollar has stabilized. There can be no assurance, though, that devaluation in the ruble, similar to the one that occurred in 1998, will not occur in the future. In the event the ruble suffers a significant decline against the US dollar, the Company's financial position could be adversely affected.

## 3. Summary of Significant Accounting Policies

Accounting principles

MTS maintains its accounting books and records in Russian rubles based on Russian accounting regulations (RAR). 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 generally accepted accounting principles in the United States (U.S. GAAP) and expressed in terms of U.S. dollars (see paragraph "Translation Methodology" below).

Basis of presentation

The consolidated financial statements include the accounts of MTS, and its subsidiaries in which MTS has a direct controlling interest. All significant intercompany balances and transactions have been eliminated.

As of December 31, 1999 and 2000, MTS has investments in the following Russian legal entities:

| | **Accounting Method** | **December 31 1999** | **December 31 2000** |
|---|---|---|---|
| Rosico | Consolidated | 80.0% | 100.0% |
| RTC | Consolidated | 100.0% | — |
| ReCom | Equity | 49.9% | 49.9% |
| MTS-Komi Republic (MTS-RK) | Equity | 26.0% | 26.0% |
| MTS-Kostroma | Equity | 26.0% | 26.0% |
| MTS-Tver (MTS-T) | Equity | 26.0% | 26.0% |
| UDN-900 | Consolidated | 51.0% | 51.0% |
| ACC | Consolidated | 100.0% | 100.0% |
| MSS | Consolidated | — | 51.0% |

Minority interest reflects minority shareholders' interests in Rosico, in UDN-900 and in MSS acquired in March 2000 (Note 4). During 2000, $1,338 of loss attributable to the minority shareholders was recorded as part of MTS' shareholders' equity, as the balance in the minority interests account has been reduced to nil.

Translation methodology

Translation (remeasurement) of MTS' ruble denominated financial statements into U.S. dollars has been performed in accordance with the provisions of SFAS No. 52 "Foreign currency translation", as they relate to hyperinflationary economies. The objective of this remeasurement process is to produce the same results that would have been reported if the accounting records had been kept in U.S. dollars.

Monetary assets and liabilities have been translated at the period-end exchange rate. Non-monetary assets and liabilities have been translated at historical rates. Capital contributions at the time of Company formation have been translated at the official rate of 1.01 rubles to 1 U.S. dollar as stated in MTS Foundation Agreement. Capital contributions at later dates have been recorded at the historical translation rate on the date of the investment. Revenues, expenses and cash flows have been translated at historical rates. Translation differences resulting from the use of these rates have been accounted for as currency translation gains and losses in the accompanying consolidated statements of operations.

Management estimates

The preparation of 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.

Cash and cash equivalents

Cash represents cash on hand and in MTS' bank accounts and short-term investments having original maturities of, or termination clauses for, less than three months.

Short term investments

Short-term investments represent investments in time deposits, which have original maturities in excess of three months but less than twelve months. These investments are being accounted as held to maturity securities and, accordingly, are reported at cost.

Allowance for doubtful accounts

MTS provides an allowance for doubtful accounts based on management's periodic review of accounts, including the delinquency of account balances.

Prepaid expenses

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

Inventory

Inventory, accounted for at lower of cost, on a FIFO basis, or market consists of telephones, accessories and spare parts for equipment stated at the lower of cost or market.

Obsolescence reserves are provided based on specific monthly review of significant inventoried items and expensed as cost of services and products.

Other current assets

Other current assets include prepaid income taxes of $4.7 and $nil million as of December 31, 1999 and 2000, respectively.

Value-added taxes

Value-added taxes related to sales are payable to the tax authorities on an accrual basis based upon invoices issued to the subscriber. VAT incurred for purchases may be reclaimed, subject to certain restrictions, against VAT related to sales.

VAT related to purchase transactions that are not currently reclaimable as of the balance sheet dates are recognized in the balance sheets on a gross basis.

Property, plant and equipment

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 their expected useful lives as follows:

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

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

Maintenance and repair costs are expensed as incurred; while upgrades and improvements are capitalized. MTS capitalizes interest costs with respect to qualifying construction projects.

Intangible assets

Intangible assets represent various purchased software costs (including the billing system), deferred telephone numbering capacity, technical documentation for MTS' cellular network and rights to use premises. The technical documentation for MTS' cellular network and a significant portion of rights to use premises were contributed by shareholders to MTS' charter capital. Deferred telephone numbering capacity costs are being amortized over five to ten years and the rights to use premises are being amortized over ten years using the straight-line method. Amortization of deferred numbering capacity costs started immediately upon the purchase of numbering capacity. The billing system is amortized over four years. Other intangible assets are being amortized over three to four years using the straight-line method.

License costs

License costs are capitalized as a result of (a) purchase price allocated to licenses acquired in business combinations (See Note 4) and (b) licenses granted directly from government organizations which require license payments.

License costs are amortized, subject to periodic review for impairment, on the straight-line method over the term of the license commencing from the date such license area becomes commercially operational.

Goodwill

Goodwill represents the purchase price for businesses acquired in excess of the fair value of net assets identified, primarily related to MTS' acquisition of Rosico. Goodwill is amortized on a straight-line basis over seven years. Amortization expense during the years ended December 31, 1998, 1999 and 2000 amounted to $2.5 million, $6.1 million and $6.1 million, respectively.

Subscriber acquisition costs

Subscriber acquisition costs represent the direct costs paid for each new subscriber enrolled through MTS' independent dealers. These costs are capitalized only to the extent of any revenues that have been deferred from the acquisition of a subscriber, such as connection fees charged to a subscriber to initiate call service. MTS amortizes these costs as a component of sales and marketing expense on a straight-line basis over the estimated average subscriber life.

Investments

Beginning in 1998, MTS has acquired interests in several Russian legal entities, engaged in telecommunications activity. Investments in entities where MTS holds 20 to 50% and can exercise significant influence but not control are accounted for under the equity method. All investments are made in companies that are not traded in open markets. Management periodically assesses realizability of the carrying values of the investments and provides valuation reserves, if required.

Debt issuance costs

Debt issuance costs are amortized using the effective interest method over the terms of the related loans.

Impairment of long-lived assets

MTS periodically evaluates the recoverability of the carrying amount of its long-lived assets in accordance with SFAS 121, *Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be disposed of*. Whenever events or changes in circumstances indicate that the carrying amounts of those assets may not be recoverable, MTS will compare undiscounted net cash flows estimated to be generated by those assets to the carrying amount of those assets. When these undiscounted cash flows are less than the carrying amounts of the assets, MTS will record impairment losses to write the asset down to fair value, measured by the discounted estimated net future cash flows expected to generated from the assets. During the years ended December 31, 1998, 1999 and 2000, management believes that no such impairments have occurred.

Subscriber prepayments

In 1998, MTS initiated a program whereby subscribers were required to pay in advance for telecommunications services. All amounts received in advance of service provided are recorded as a subscriber prepayment liability and are not recorded to revenues until the related services have been provided to the subscriber.

Revenue recognition

Revenues are recognized on an accrual basis, i.e. when the goods and services are actually provided regardless of when the resulting monetary or financial flow occurs.

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

1. Service revenues: (a) subscription fees, (b) usage charge, (c) value added service fees, (d) roaming fees charged to other operators for guest roamers utilizing MTS' network and (e) prepaid phone cards
2. Connection fees.
3. Equipment sales: (a) sales of handsets as part of contracts and (b) sales of accessories.

*Subscription fees*

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

*Usage charges and Value added services fees*

Call fees consist of fees based on airtime used by the caller, the destination of the call and the service utilized.

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

*Pre-paid phone cards*

MTS also sells to subscribers pre-paid phone cards, separately from the handset. These cards allow subscribers to make a predetermined allotment of wireless phone calls and/or take advantage of other services offered by the Company, such as short messages and sending or receiving faxes.

At the time that the pre-paid phone card is purchased, MTS records the receipt of cash as subscriber deposit. The Company recognizes revenues from the phone cards in the period when subscriber uses time under the phone card. Unused time on sold phone cards is not recognized as revenues until the related services have been provided to the subscriber or the prepaid phone card has expired.

*Roaming fees*

MTS charges roaming per-minutes fees to other wireless operators for guest roamers utilizing MTS' network. Guest roaming fees were $56,516, $44,048 and $43,214 for the years ended December 31, 1998, 1999 and 2000, respectively.

*Connection fees*

MTS defers initial connection fees from the moment of initial signing of the contract with subscribers and the estimated average subscriber life. The Company estimates that the average expected term of the subscriber relationship is three years and one quarter. (See Note 13).

*Equipment sales*

The Company recognizes revenues from the sale of a handset and accessories upon the initial signing of the contract.

MTS also records estimated returns and claims as a direct reduction of sales at the time the related sales are recorded.

Expense recognition

Expenses incurred by MTS in relation to the provision of wireless communication services relate to interconnection and line rental costs, roaming expenses, costs of handsets and other accessories sold, commissions payable to dealers for obtaining wireless subscribers on behalf of the Company and marketing, depreciation and maintenance of the network.

Calls made by subscribers from areas outside of territories are subject to roaming fees charged by the wireless provider in those territories. These roaming charges are recorded as air time revenues on a gross basis, with the related roaming charges being recorded as an cost operating expense, as MTS acts as the principal in the transaction with the subscriber and bears the risk of non-collection from the subscriber.

The costs of the handset, whether sold to subscribers through the distribution channel or as part of the contract, are expensed as cost of equipment at the initial signing of the contract.

Commission paid to dealers related to new subscriptions is deferred to the extent of deferred initial connection fees and amortized as a component of sales and marketing expense over the same period and in the same manner. Deferred costs in excess of deferred revenues are expensed. (See Note 11).

Taxation

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

Advertising costs

Advertising costs are expensed as incurred. Advertising costs for the years ended December 31, 1998, 1999 and 2000 were $8,029, $11,437 and $22,218, respectively, and are reflected as a component of sales and marketing expenses in the accompanying consolidated statement of operations.

Earnings per share

Earnings per share have been determined using the weighted average number of shares outstanding during the year. Basic and diluted earnings per share are equivalent as MTS does not have any potentially dilutive securities. Earnings and other per share information have been restated to give retroactive effect to the merger of MTS and RTC (see Note 1).

Fair value of financial instruments

The fair market value of financial instruments, consisting of cash and cash equivalents, current receivables, and accounts payable, which are included in current assets and liabilities, approximates the carrying value of these items due to the short term nature of these amounts. The fair value of debt and promissory notes is equivalent to their carrying value because these debts bear variable rates of interest.

It is not practical to determine the fair value of MTS' receivable from Sistema and advances to affiliates, due to the current instability in the Russian economy and its effect on interest rates appropriate for determining fair value. Management believes, however, that the fair value does not differ significantly from carrying value.

Comprehensive income

Comprehensive income is defined as net income plus all other changes in net assets from non-owner sources. For the years ended December 31, 1998, 1999 and 2000, comprehensive income equaled net income.

Comparative information

Certain prior year amounts and disclosures have been reclassified to conform to the 2000 presentation.

Segment reporting

SFAS No. 131 requires that a business enterprise report financial and descriptive information about its reportable operating segments. MTS currently manages its business as one operating segment, and accordingly, does not report segment information. Furthermore, all of MTS' long-lived assets and revenues are derived in Russia.

New accounting pronouncements

**SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities"**

In June 1998, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards (SFAS or FASB Statement) 133, *Accounting for derivative instruments and hedging activities*. SFAS 133 establishes accounting and reporting standards requiring that every derivative instrument (including certain derivative instruments embedded in other contracts) be recorded on the balance sheet as either an asset or liability measured at its fair value. The statement requires that changes in the derivative's fair value be recognized currently in earnings unless specific accounting criteria are met. If a derivative instrument qualifies for hedge accounting, the gains or losses from the derivative may offset results from the hedged item in the statement of operations or other comprehensive income, depending on the type of hedge. To adopt hedge accounting, a company must formally document, designate and assess the effectiveness of transactions that receive hedge accounting.

In June 2000 Financial Accounting Standards Board SFAS 138 *"Accounting for Certain Derivative Instruments and Certain Hedging Activities", an amendment of FASB Statement No. 133***.** This Statement amends the accounting and reporting standards of Statement 133 for certain derivative instruments and certain hedging activities. SFAS 137 delayed the effective date of SFAS 133 to fiscal years beginning after June 15, 2000. SFAS 133 cannot be applied retroactively. MTS plans to adopt SFAS 133 effective January 1, 2001.

MTS does not expect SFAS 133 or SFAS 138 to have a material effect on MTS' consolidated balance sheet or its results of operations.

**SFAS No. 140, "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities" a replacement of SFAS Statement No. 125**

In September 2000 FASB issued SFAS No. 140 *"Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities"* which replaces SFAS No. 125, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*. This pronouncement revises the accounting for securitizations and other transfers of financial assets and collateral and requires certain disclosures.

Specifically, SFAS 140 provides accounting and reporting standards for transfers and servicing of financial assets and extinguishments of liabilities. Those standards are based on consistent application of a *financial-components approach* that focuses on control. Under that approach, after a transfer of financial assets, an entity recognizes the financial and servicing assets it controls and the liabilities it has incurred, derecognizes financial assets when control has been surrendered, and derecognizes liabilities when extinguished. Statement No. 140 provides consistent standards for distinguishing transfers of financial assets that are sales from transfers that are secured borrowings.

SFAS 140 also provides guidance about whether a transferor has retained effective control over assets transferred to qualifying SPEs through removal-of-accounts provisions, liquidation provisions, or other arrangements.

SFAS 140 is effective for transfers and servicing of financial assets and extinguishments of liabilities occurring after March 31, 2001, and is effective for recognition and reclassification of collateral and for disclosures relating to securitization transactions and collateral for fiscal years ending after December 15, 2000.

(Amounts in thousands of U.S. dollars, unless otherwise stated)

SFAS 140 is to be applied prospectively with certain exceptions. Other than those exceptions, earlier or retroactive application of its accounting provisions is not permitted.

MTS does not expect that this new statement will have a material impact on MTS' consolidated balance sheet or results of operations.

## 4. Businesses Acquired

Rosico acquisition

In August 1998, MTS acquired from Sistema 80% of the outstanding common stock of Rosico, a Russian closed joint stock company, in exchange for 408,631,860 shares of newly issued common stock of MTS representing 25% of the issued and outstanding shares of MTS. Prior to the acquisition, Sistema held a 90% controlling interest in Rosico. Rosico holds GSM-1800 licenses covering the Moscow area, 18 regions of Central Russia and 11 regions in the Northern, the Urals and Western Siberia Regions of Russia.

The Rosico acquisition was accounted for using the purchase method of accounting. The purchase price was recorded at $118,014 and allocated at the purchase date as follows with a corresponding increase to consolidated shareholders' equity:

| | |
|---|---|
| Current assets | $ 19,795 |
| License costs | 230,769 |
| Other assets | 1,546 |
| Goodwill | 42,739 |
| Current liabilities | (6,784) |
| Long-term liabilities | (60,000) |
| Deferred taxes | (80,769) |
| Minority interests | (29,282) |
| Purchase price allocation | $ 118,014 |

(Amounts in thousands of U.S. dollars, unless otherwise stated)

During 2000, MTS completed other acquisitions of Rosico stock that are presented in the table below:

| Date of acquisition | Seller | Number of shares | Percentage of ownership | Price per share | Total purchase price |
|---|---|---|---|---|---|
| August 2000 | Bradleys of London LTD, a subsidiary of Sistema | 1,232 | 7.2% | $ 5.8401 | $ 7,195 |
| September 2000 | MGTS, a subsidiary of Sistema | 392 | 2.3% | 5.8674 | 2,300 |
| December 2000 | Siemens AG | 1,710 | 10.0% | 3.5614 | 6,090 |
| December 2000 | DeTeMobil | 86 | 0.5% | 5.8140 | 500 |
| | Total | 3,420 | 20.0% | — | $16,085 |

As of December 31, 2000 MTS owns 100% interest of Rosico.

As a result of the initial Rosico acquisition in 1998, MTS' consolidated financial statements reflect all of Rosico obligation to Ericsson Project Finance AG (including interest at LIBOR plus 4% and any later charges). Concurrent with the initial acquisition of an 80% in interest in Rosico, MTS and Sistema agreed that Sistema would fund principal, interest at LIBOR plus 4% and other costs associated with the Ericsson loan (see Note 15) provided that Rosico remains primarily liable under the third party 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, a significant portion of payments being received by MTS is in exchange for the issuance by MTS of long-term, ruble-denominated promissory notes with 0% interest and maturities in 2050. The carrying amount of these notes is negligible for financial statements of the Company.

Through December 31, 2000, Sistema had made payments to Rosico under the Rosico commitment in the amount of $27,080 of which $14,572 in the form of long-term, ruble-denominated promissory notes with 0% interest.

(Amounts in thousands of U.S. dollars, unless otherwise stated)

The following unaudited pro forma financial data for the years ended December 31, 1998, 1999 and 2000 give effect to the acquisition of Rosico as if it had occurred at the beginning of the respective years.

| | December 31 | | |
|---|---|---|---|
| | **1998** | **1999** | **2000** |
| Net revenues | $338,513 | $ 358,327 | $ 535,712 |
| Net operating income | 160,075 | 115,612 | 139,047 |
| Net income | 60,841 | 83,370 | 83,620 |
| Earnings per share, Basic and Diluted | $ 0.044 | $ 0.051 | $ 0.046 |

Purchase of Mobilnye Sistemy Svyasi

In March 2000, MTS acquired for approximately $15 a 51% interest in Mobilnye Sistemy Svyazi OJSC, or MSS, a Russian open joint-stock company. MSS has license No. 5544 to operate a GSM- 900 network in the Omsk Region of Russia. At the time of acquisition, MSS had approximately 3,000 subscribers.

RTC acquisition

In September 1998, MTS acquired the issued and outstanding capital stock of RTC, a Russian closed joint stock company, for approximately $13,000. Prior to the acquisition, DeTeMobil held substantially all of the shares of RTC. RTC holds GSM-900 licenses covering six regions (Ryazan, Kaluga, Smolensk, Pskov, Vladimir and Tula). The RTC acquisition was accounted for under the purchase method of accounting, including assigned license costs of $19,503 and the associated deferred tax liabilities of $6,826.

Commencing from September 1998, the results of RTC are consolidated in the accompanying financial statements.

## 5. Cash and Cash Equivalents

Cash and cash equivalents as of December 31, 1999 and 2000 were comprised as follows:

| | December 31 | |
|---|---|---|
| | **1999** | **2000** |
| Rubles | $ 3,618 | $ 9,950 |
| U.S. dollar deposits | — | 50,607 |
| U.S. dollars current accounts | 5,552 | 14,999 |
| Other | 830 | 272 |
| Total cash and cash equivalents | $ 10,000 | $ 75,828 |

(Amounts in thousands of U.S. dollars, unless otherwise stated)

## 6. Short Term Investments

Short-term investments as of December 31, 2000 were comprised as follows:

| | Annual interest rate | Maturity date | December 31 2000 |
|---|---|---|---|
| OJSC Moscow Bank of Reconstruction and Development | 6.0% | August 31, 2001 | $ 30,000 |
| OJSC Moscow Bank of Reconstruction and Development | 5.8% | March 31, 2001 | 20,000 |
| Sberbank | 9.5% | September 11, 2001 | 60,000 |
| Sberbank | 9.1% | September 11, 2001 | 60,000 |
| | | | $170,000 |

$7,626 million of interest income was recognized as of December 31, 2000. Interest receivable as of December 31, 2000 amounted to $2,988 and is recorded as other current assets.

## 7. Trade Receivables

Trade receivables as of December 31, 1999 and 2000 were comprised as follows:

| | December 31 | |
|---|---|---|
| | 1999 | 2000 |
| Accounts receivable, subscribers | $ 20,402 | $ 9,280 |
| Accounts receivable, roaming, (net) | 9,713 | 8,356 |
| Allowance for doubtful accounts | (5,395) | (1,819) |
| Trade receivables, net | $ 24,720 | $ 15,817 |

In addition to roaming activities and related receivables from third parties, as of December 31, 1999 and 2000, MTS also had short-term accounts receivable from roaming activities with DeTeMobil in amounts of $618 and $1,082, respectively, which are included in Accounts receivable, related parties in the accompanying balance sheets (see Note 22).

(Amounts in thousands of U.S. dollars, unless otherwise stated)

The following table summarizes the changes in the allowance for doubtful accounts for the years ended December 31, 1999 and 2000:

| | December 31 | |
|---|---|---|
| | 1999 | 2000 |
| Balance, beginning of year | $ 19,610 | $5,395 |
| Provision for doubtful accounts | 8,006 | 2,403 |
| Accounts receivable written off | (22,221) | (5,979) |
| Balance, end of year | $ 5,395 | $ 1,819 |

## 8. Inventory

MTS' inventory was comprised as follows at December 31, 1999 and 2000:

| | December 31 | |
|---|---|---|
| | 1999 | 2000 |
| Spare parts for base stations | $ 5,614 | $ 8,469 |
| Handsets and accessories | 11,001 | 16,363 |
| Other inventory | 785 | 1,656 |
| Provision for obsolescence | (823) | (2,937) |
| Inventory, net | $ 16,577 | $ 23,551 |

Obsolescence expense during the year ended December 31, 1998, 1999 and 2000 amounted to $232, $590 and $2,114, respectively, and was included in operating expenses in the accompanying statements of operations.

(Amounts in thousands of U.S. dollars, unless otherwise stated)

## 9. Property, Plant and Equipment

The net book value of property, plant and equipment at December 31, 1999 and 2000 were comprised as follows:

| | December 31 | |
|---|---|---|
| | **1999** | **2000** |
| Network and base station equipment | $ 224,844 | $ 387,664 |
| Leasehold improvements | 6,642 | 6,720 |
| Office equipment, computers and software | 12,158 | 21,134 |
| Buildings | 5,211 | 12,301 |
| Vehicles | 1,296 | 2,725 |
| Property, plant and equipment, at cost | 250,051 | 430,544 |
| Accumulated depreciation | (47,735) | (87,676) |
| | 202,316 | 342,868 |
| Equipment for installation | 36,740 | 61,214 |
| Construction in progress | 11,214 | 35,225 |
| Property, plant and equipment, net | $ 250,270 | $ 439,307 |

MTS capitalized interest costs of $1,286 and $929 in 1999 and 2000, respectively, with respect to qualified construction projects.

Depreciation expense during the years ended December 31, 1998, 1999 and 2000 amounted to $12.7 million, $24.8 million and $39.9 million, respectively.

## 10. Intangible Assets

Intangible assets at December 31, 1999 and 2000 were comprised as follows:

| | December 31 | |
|---|---|---|
| | **1999** | **2000** |
| Numbering capacity | $ 32,951 | $ 55,177 |
| Rights to use premises | 16,894 | 20,877 |
| Software and other | 10,703 | 15,180 |
| Technical documentation | 5,100 | - |
| | 65,648 | 91,234 |
| Accumulated amortization | (25,787) | (33,648) |
| Total intangible assets, net | $ 39,861 | $ 57,586 |

As a result of 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 telecommunications operators in Moscow. Costs of acquiring numbering capacity are amortized over periods of five to ten years in accordance with the terms of the contract entered into to acquire such capacity. For contracts wherein the terms of use are unlimited, MTS amortizes such costs over ten years.

(Amounts in thousands of U.S. dollars, unless otherwise stated)

The principal component of MTS' right to use premises were obtained in the form of contributions to its original capital in 1993 and were granted for ten years under MTS' original charter. These premises included MTS' administrative offices and facilities utilized for mobile switching centers.

Amortization expense of $3.5 million, $7.1 million and $12.9 million was recognized related to these assets during 1998, 1999 and 2000, respectively.

## 11. Deferred Subscriber Acquisition Costs

Deferred subscriber acquisition costs for the years ended December 31, 1999 and 2000 were as follows:

| | December 31 | |
|---|---|---|
| | **1999** | **2000** |
| Balance at beginning of year | $ 20,536 | $ 31,925 |
| Payments made and deferred during the year | 23,675 | 49,232 |
| Amounts amortized and recognized as expenses during the year | (12,286) | (53,604) |
| Balance at end of year | $ 31,925 | $ 27,553 |

## 12. Other Assets

Other assets at December 31, 1999 and 2000 were comprised of the following:

| | December 31 | |
|---|---|---|
| | **1999** | **2000** |
| Apartments at cost | $ 379 | $ — |
| Provision for apartments market value | (379) | — |
| Total other assets, net | $ — | $ — |

In 1998, the Company acquired 60 apartments for resale using restricted funds at AO InkomBank (see Note 2). As of December 31, 1999, MTS sold a portion of the apartments for $1,474 in cash. The cost of these apartments was $4,709. Based on the Company's estimation of the Moscow real estate market, the Company provided for the remaining cost of apartments in full. During the years ended December 31, 1998, 1999 and 2000 the Company recognized losses related to the apartments in the amounts of $2,775, $847 and $nil respectively.

(Amounts in thousands of U.S. dollars, unless otherwise stated)

## 13. Deferred Connection Fees

Deferred connection fees for the years ended December 31, 1999 and 2000 were as follows:

| | December 31 | |
|---|---|---|
| | **1999** | **2000** |
| Balance at beginning of year | $ 21,087 | $ 24,622 |
| Payments received and deferred during the year | 16,290 | 21,798 |
| Amounts amortized and recognized as revenue during the year | (12,755) | (14,867) |
| Balance at end of year | $ 24,622 | $ 31,553 |

## 14. Accrued Liabilities

Accrued liabilities at December 31, 1999 and 2000, were comprised as follows:

| | December 31 | |
|---|---|---|
| | **1999** | **2000** |
| VAT | $ 17,548 | $ 21,345 |
| Taxes other than income | 8,393 | 10,816 |
| Interest | 505 | 1,909 |
| Other accruals | 2,783 | 4,105 |
| Total accrued liabilities | $ 29,229 | $ 38,175 |

## 15. Debt

EBRD Loan

In August 1995, MTS entered into a loan agreement with European Bank for Reconstruction and Development (the "EBRD") for the purpose of financing the development of MTS' telecommunication network. The $45 million loan facility comprised $31 million for the Bank Loan received from the EBRD in June 1997 and $14 million for the Participant Loan received during 1996. The Participant Loan represents a shareholder funded loan arrangement for the benefit of MTS.

Interest of LIBOR plus 4% and LIBOR plus 6% for the Bank Loan and the Participant Loan, respectively, is payable quarterly on January 15, April 15, July 15 and October 15. For the years ended December 31, 1998, 1999 and 2000, interest expense on the Participant Loan amounted to $0.9 million, $1.0 million and $1.3 million, respectively.

Interest payable on the Bank Loan as of December 31, 1999 and 2000 is $450 and $nil, respectively, and is included in accrued liabilities (see Note 14, ‘‘Accrued Liabilities’’).

The agreement called for repayment of the Bank Loan principal in twelve equal quarterly installments commencing January 15, 1999; the Participant Loan was repayable in eight equal quarterly installments commencing January 15, 2002.

In September 2000 MTS agreed with EBRD to fully prepay the remaining amount of Bank Loan and Participant Loan and appropriate outstanding interest in October 2000. Therefore, on October 16, 2000 MTS prepaid the remaining principal balance of $26,916 and accrued interest of $10,012.

MTS was required to pay to the EBRD a front-end commission equal to 1% of the principal of the Bank Loan and 1% of the principal of the Participant Loan. In addition, MTS had to pay up to $150 to cover the legal fees incurred by the EBRD. Such amounts totaling $600 had been reflected as a component of debt issuance costs. In connection with the repayment of loans the remaining amount of this front-end commission was written off on interest expenses in 2000.

Additionally, in conjunction with this loan agreement, the EBRD received an equity participation in MTS through the transfer of shares previously held by DeTeMobil representing 4% of the outstanding shares of MTS. The estimated fair value of such transfer totaling $4,000 was recorded as additional debt issuance costs with a corresponding increase to additional paid in capital.

Amortization expense of deferred debt costs during the years ended December 31, 1998, 1999 and 2000, amounted to $1,178, $1,154 and $1,209, respectively.

<u>Ericsson Loan</u>

In December 1996, Rosico entered into a credit agreement with Ericsson Project Finance AB (“Ericsson”) that provides for a credit facility with an aggregate principal amount of $60,000 and has a maximum term of five years. The Ericsson credit agreement contains covenants restricting Rosico’s ability to encumber its present and future assets and revenues without the lender’s express consent.  The loan is repayable in ten equal consecutive quarterly payments of $6,000 commencing on the date falling 33 months after the date of first advance but not later than five years from disbursement of the first advance. The amounts advanced under the agreement bear interest of LIBOR plus 4%.  If Rosico fails to pay any amount payable under the credit facility, the overdue amount bears interest at a rate of an additional 6% per annum.

The Ericsson Loan is secured by a pledge of MGTS (a related party - see Note 22) shares held by an affiliate of Sistema.  Subject to the satisfaction of certain conditions, advances under the agreement may be made exclusively for the purposes of financing Rosico's further contribution to the affiliate of Sistema, which has been awarded the task of partially reconstructing and capitalizing MGTS.

Rosico was required to pay Ericsson a front-end commission equal to 2.25% of the principal of the Ericsson Loan. The front-end commission costs have been reflected as a component of debt issuance costs.

(Amounts in thousands of U.S. dollars, unless otherwise stated)

At December 31, 1999 and 2000, $60 million and $42 million were outstanding, respectively, under the Ericsson Loan at an interest rate then in effect of 10.0% and 10.87%, respectively. Interest payable on the Ericsson Loan as of December 31, 1999 and 2000 is $ nil and $431, respectively, and is included in accrued liabilities (see Note 14).

Concurrent with the Rosico Agreement, 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 of Rosico or MTS in connection with the repayment of the Ericsson Loan (see Notes 4).

Dresdner credit facility

In July 1999, MTS entered into a rollover credit facility with "BNP – Dresdner Bank" ("Dresdner Bank") for the purpose of financing working capital. The credit facility in the amount up to $10 million was granted to MTS with the final repayment date no later than July 2, 2002. The amount advanced under the agreement bears interest of LIBOR plus 2.5% per annum. Default interest is 12% per annum.

An advance of $10 million was fully repaid in September 2000. In this regard, as of December 31, 1999 and 2000 the outstanding amount under the credit facility was $10 million and $ nil, respectively.

Inkombank credit facility

In August 1997, MSS entered into a rollover credit facility with OJSC "AB Inkombank" ("Inkombank") for the purposes of financing GSM-900 network development. The credit facility in the amount up to $12 million was granted to MSS with the final repayment date no later than March 31, 2002. The amount advanced under the agreement bears interest of 16% per annum. Default interest is 32% per annum. Under the term of agreement the amount of assets pledged is $4 million.

At December 31, 2000 outstanding amount of principal was $5 million. Interest payable on the credit facility as of December 31, 2000 is $841. Interest payable is included in accrued liabilities (see Note 14).

Loan repayments

Loan repayments over the five-year period beginning on December 31, 2000 are as follows:

| | Ericsson Loan | Inkombank | Total |
|---|---|---|---|
| Current | $ 24,000 | $ — | $ 24,000 |
| 2002 | 18,000 | 5,305 | 23,305 |
| Total | $ 42,000 | $ 5,305 | $ 47,305 |
| Less: current portion | (24,000) | (—) | (24,000) |
| Long-term debt | $ 18,000 | $ 5,305 | $ 23,305 |

(Amounts in thousands of U.S. dollars, unless otherwise stated)

## 16. Promissory Notes Payable

Promissory notes represent MSS' outstanding notes payable to Motorola Inc. for the delivery and installation of GSM-900 cellular equipment in Omsk region. Promissory notes in the amount of $5,468 were issued in April 1999. MSS has other amounts payable to Motorola Inc. for the delivery of cellular equipment totaling $923 and stated as other payable. Promissory notes and accounts payable in the amounts of $3,755 and $923, respectively, were in technical default as of December 31, 2000.

MSS currently is in the process of renegotiation and restructuring its liability to Motorola Inc. Management believes that notes payable and accounts payable to Motorola Inc will be successfully restructured.

## 17. Income Tax

MTS' provision for income taxes is as follows for the respective periods ended:

| | December 31 | | |
|---|---|---|---|
| | **1998** | **1999** | **2000** |
| Current provision | $ 62,016 | $ 36,423 | $ 52,086 |
| Deferred provision (benefit) | 968 | (17,594) | (932) |
| Total | $ 62,984 | $ 18,829 | $ 51,154 |

(Amounts in thousands of U.S. dollars, unless otherwise stated)

MTS' statutory income tax rate in 1998 was 35%. From April 1, 1999, MTS' statutory income tax rate was 30% as a result of changes in Russian legislation. This reduction in the statutory income tax rate resulted in the recognition of a deferred tax benefit of approximately $15 million in 1999. From January 1, 2001, MTS' statutory income tax rate is 35% as a result of changes in Russian legislation. The increase in tax rate to 35% resulted in recognition of a deferred tax liability of approximately $10 million in 2000. The statutory rate reconciled to MTS' effective tax rate is as follows for the respective periods ended:

| | December 31 | | |
|---|---|---|---|
| | **1998** | **1999** | **2000** |
| Statutory tax rate for year | 35% | 30% | 30% |
| Adjustments: | | | |
| Effect from realization of benefits previously reserved | — | (7.7) | — |
| Expenses not deductible for Russian statutory taxation purposes | 17.6 | 23.9 | 17.4 |
| Tax allowance generated from investment in infrastructure | (8.7) | (16.7) | (18.2) |
| Effects of increase in income tax rate | — | — | 7.0 |
| Effects of decrease in income tax rate | — | (18.6) | — |
| Other | 5.3 | 7.5 | 1.8 |
| Effective tax rate | 49.2% | 18.4% | 38.0% |

Unused credits may not be carried forward under Russian tax legislation. Accordingly, tax credits are reflected in MTS' financial statements only to the extent, and in the year in which the credits are utilized.

(Amounts in thousands of U.S. dollars, unless otherwise stated)

Temporary differences between the Russian statutory accounts and these financial statements give rise to the following deferred tax assets and liabilities at December 31, 1999 and 2000:

| | December 31 | |
|---|---|---|
| | **1999** | **2000** |
| Assets/(liabilities) arising from tax effect of: | | |
| **Deferred tax assets** | | |
| Allowance for doubtful accounts | $ 2,400 | $ 671 |
| Loss carryforward (Rosico and MSS) | 7,245 | 12,823 |
| Other | 2,893 | 6,266 |
| | 12,538 | 19,760 |
| Reserve for deferred tax assets | (10,138) | (17,689) |
| Total deferred tax assets | 2,400 | 2,071 |
| **Deferred tax liabilities** | | |
| Licenses acquired (Note 4) | (71,180) | (72,083) |
| Other | (2,164) | — |
| Total deferred tax liabilities | (73,344) | (72,083) |
| Net deferred tax (liability) | $ (70,944) | $ (70,012) |

Russian legislation provides for the deductibility of bad debt reserves based on the completion of certain documentation and demonstration of the uncollectibility of amounts over a period of time, generally up to three years. Because of these limitations and the frequent changes in Russian tax legislation it has been uncertain as to MTS' ability to satisfy the taxation authorities as to the deductibility of such amounts. As a result of these uncertainties, valuation allowances have been provided against this current deferred tax asset in 1998.

In 1999, MTS put in place the necessary formal documentation to support the deduction of bad debt expenses totaling approximately $26 million substantially related to bad debts which had been realized for accounting purposes prior to 1999. MTS expects to continue to be able to comply with the formal documentation requirements and realize bad debt expenses in accordance with current legislation and has suspended the practice of reserving for these tax benefits.

As of December 31, 1999 and 2000, Rosico and MSS were entitled to a loss carryforwards in the amounts of $24,151 and $36,638, respectively. These loss carryforwards resulted in a deferred tax asset for the years ended December 31, 1999 and 2000 in the amounts of $7,245 and $12,823, 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. Due to uncertainties with regards to Rosico's and MSS's ability to realize this benefit, a valuation reserve was provided for the entire amount.

## 18. Shareholders' Equity

In accordance with Russian statutory accounting regulations, earnings available for dividends are limited to profits, denominated in rubles, after certain deductions. At December 31, 1999 and 2000 retained earnings which are distributable under Russian legislation totaled 2,552 million rubles ($94,519) and 136 million rubles ($4,845), respectively.

## 19. Management Stock Bonus and Stock Option Plans

On April 27, 2000, contingent on the closing of the stock offering (Note 1), MTS established a stock bonus plan and stock option plan for selected officers and key employees. Under the plans, such key employees received 3,587,987 of MTS' common shares and will participate in a stock option plan under which they may receive up to 9,966,631 of MTS' common shares. At the time of the initial public offering, the Company issued 13,554,618 shares of its common stock to its subsidiary Rosico pursuant to these plans at a price of $1.024 per share for the total amount of $13,880. These shares of common stock have been reflected as treasury stock in the consolidated balance sheet as of December 31, 2000.

Under the stock bonus plan, during the period from September 12, 2000 through September 22, 2000, officers, key employees and key advisors of MTS purchased 3,587,987 common shares of MTS from Rosico at nominal price of 0.1 Rbls per share. Officers, key employees and key advisors will be restricted from selling these shares for two years from the date of purchase. However, if the employees should leave the company before the end of the two year restricted period, they will be able to retain the rights to the shares purchased. Accordingly, on the date of grant, the Company recognized aggregate expenses under this plan as compensation and consulting expenses in the amount of $4,500 and $797, respectively, based on the intrinsic value of the shares on the date of grant.

Under the stock option plan, officers and key employees will receive the right to convert portions of their annual cash bonuses into options to purchase up to 9,966,631 common shares of MTS. On the second anniversary of entering the option agreement, officers and key employees must either take their bonus in cash or forfeit their bonus in exchange for common shares of MTS at the 100-day average sales price of the shares at the date of entering into the option agreement. The option agreement has not been formally agreed and approved with individual employees at December 31, 2000 and, accordingly, an exercise price for the option agreements has not yet been determined. Should the 100-day average sales price of the shares at the exercise date be lower than that at the date of entering into the option agreement, MTS will provide officers and key employees with an option to receive additional shares at the 100-day average sales price of the shares at the date of entering the original option agreement.

MTS is accounting for this arrangement in accordance with FASB Interpretation No. 44 and EITF No. 00-23. Accordingly, MTS will record compensation related to this award in a manner akin to a combined variable award. Specifically, and estimate of compensation expense under this arrangement will be made at the time that the option is granted to the officers and key employees. This expense generally will be based on the fair value of the cash bonus that the employee is entitled to receive and will be updated each reporting period based on changes in facts or circumstances. To the extent that officers or key employees elect to convert their bonus into options to purchase shares, it is likely that the compensation expense to be recorded by the Company would differ from expense based on the fair value of the cash bonus, as the Company would need to employ variable plan accounting under the provisions of Accounting Principles Board Opinion No. 25. Under variable plan accounting, the Company would record compensation expense based on the difference between the fair market value of the Company's common stock at the end of a reporting period and the exercise price of the underlying options. Such expense would be recorded ratably over the vesting period of the options. At December 31, 2000, employees under this plan are not contractually obligated to receive any cash bonus under this plan. Accordingly, no compensation expense has been recorded during the year ended December 31, 2000.

(Amounts in thousands of U.S. dollars, unless otherwise stated)

## 20. Operating Expenses

Operating expenses for 1998, 1999 and 2000 were comprised of the following:

| | December 31 | | |
|---|---|---|---|
| | **1998** | **1999** | **2000** |
| Salaries and social contributions | $ 12,273 | $ 17,108 | $ 32,956 |
| Taxes other than income | 16,471 | 15,655 | 26,859 |
| General and administrative | 8,595 | 11,633 | 20,355 |
| Rent | 3,534 | 4,062 | 7,241 |
| Insurance | 2,437 | 4,953 | 4,251 |
| Repair and maintenance | 953 | 3,252 | 3,225 |
| Consulting expenses | 1,913 | 1,390 | 3,418 |
| Billing and data processing | 603 | 444 | 2,285 |
| Other operating expenses | 7,862 | 8,109 | 7,249 |
| Total operating expenses | $ 54,641 | $ 66,606 | $ 107,839 |

For use of certain base station sites, MTS provides specified amounts of free usage of mobile telephones in lieu rent payments. Amounts of revenues for such free usage and expenses for base station site rentals are shown at fair value. Base station site expenses incurred under barter arrangements of approximately $1,401, $2,427 and $3,251 for 1998, 1999 and 2000 are shown as a component of rent.

## 21. Pension Costs

MTS contributes to the Russian Federation state pension scheme, (as well as social insurance and employment funds) in respect of its employees. MTS' pension scheme contribution amounts to 28% of employees' gross salaries, and is expensed as incurred. Pension costs amounted to $2,000, $2,675 and $4,553 in 1998, 1999 and 2000, respectively. MTS has no other pension obligations.

(Amounts in thousands of U.S. dollars, unless otherwise stated)

## 22. Related Parties

Related party balances at December 31, 1999 and 2000, were comprised of the following:

| | December 31 | |
|---|---|---|
| | **1999** | **2000** |
| Accounts receivable, related parties: | | |
| DeTeMobil receivable for roaming | $ 618 | $ 1,082 |
| ReCom receivable for network equipment | 4,997 | 3,187 |
| ReCom receivable for telecommunication services | 195 | 425 |
| Receivables from other investee companies | 163 | 243 |
| Total accounts receivable, related parties | $ 5,973 | $ 4,937 |
| Accounts payable, related parties: | | |
| DeTeMobil payable for consulting services | $ 1,970 | $ 1,970 |
| DeTeMobil other payables | 1,079 | 1,308 |
| Telmos for interconnection | — | 411 |
| MGTS for interconnection | — | 103 |
| Total accounts payable, related parties | $ 3,049 | $ 3,792 |

During 1999 and 2000, MTS acted as the general contractor for the construction of ReCom's network. During these years, MTS delivered to ReCom network equipment in the amount of $15,156. In connection with this, in November 2000, ReCom issued to MTS bonds in the amount of $11,969, convertible under certain circumstances into common stock of ReCom. These bonds have maturities varying from 2003 to 2005. If MTS were to exercise these conversion options in full, it would become holder of up to 75% of the outstanding common stock of ReCom. As of December 31, 2000 these bonds are shown as a component of investments and advances to affiliates.

Starting August 2000, MTS has been keeping certain bank and deposit accounts with Moscow Bank of Reconstruction and Development (MBRD), whose major shareholder is Sistema. As of December 31, 2000 MTS' cash position at MBRD amounted to $51 million including time deposit and a current account in the amount of $50 million and $1 million, respectively (see Note 6). During 2000 the related interest accrued and collected on the deposit amounted to $952 was shown as a component of interest income.

MTS has insured its property at the amounts of approximately $193 million and $274 million in 1999 and 2000, respectively, with Rosno Insurance whose major shareholder is Sistema. Insurance premiums paid to Rosno amounted to $4.7 million and $6.5 million in 1999 and 2000, respectively, including premiums paid for medical insurance amounted to $682 and $1,583 in 1999 and 2000, respectively. Management believes that that all of the insurance contracts with Rosno have been entered on market terms.

In 1999 and 2000, MTS entered into contracts for advertising services with Maxima Advertising Agency (Maxima). Maxima related to MTS trough MTS' directors who are members of Maxima' board of directors. Advertising fees paid to Maxima amounted to $6.4 million in 2000.

MTS purchased telephone numbering capacity from Moscow City Telephone Network (MGTS). MGTS related to MTS trough its directors who are members of MGTS' board of directors. MTS' primary interconnection arrangement is also with MGTS. MTS purchased a building from MGTS for the amount of approximately $2.9 million in 2000. Management believes that this purchase was made on market terms.

## 23. Operating Licenses

In connection with providing telecommunication services, MTS and its legal predecessor have been issued various operating licenses by the Ministry of Communications (the "Ministry").

The Russian licensing legislation requires licenses to be issued in the name of a specific legal entity. Further, licenses are generally non-transferable as is the case for MTS. In case of a re-organization, licenses are to be re-issued in the name of the successor legal entity.

As discussed in Note 1, on March 1, 2000, MTS was merged with RTC to form open joint-stock company Mobile TeleSystems (MTS OJSC). MTS OJSC, as the legal successor to MTS, filed an application with the Ministry for re-issuing MTS' and RTC's licenses in the name of MTS OJSC. In April 2000, MTS received the re-issued licenses.

MTS' principal operating licenses are presented below.

<u>GSM-900 licenses</u>

*Moscow and Moscow Region* — In November 1993, MTS was granted a GSM-900 cellular license (License No. 688) for operation in Moscow and the Moscow region. The license gave MTS the exclusive right to operate on the GSM standard for 10 years from the commencement of operations. In June 1998, MTS was granted a new GSM-900 cellular license (License No. 10263) for operation in Moscow and the Moscow region that replaced, in its entirety, License No. 688. This license effectively removed any additional license payment requirements and allowed MTS to increase subscriber capacity above 100,000 subscribers. Valid until December 2004, the new License No. 10263 no longer gives MTS exclusive rights to operate on the GSM standard.

In connection with the restructuring of MTS on March 1, 2000, MTS was granted a new GSM - 900 cellular license (License No. 14665). License No. 14665 has terms substantially identical to License No. 10263 and is valid until December 2004.

*Tver Region* — In April 1997, MTS was granted a GSM-900 cellular license (License No. 6263) for operations in the Tver region. This license was to expire in April 2007.

In connection with the restructuring of MTS on March 1, 2000, MTS was granted a new GSM – 900 cellular license in the Tver region (License No. 14662). License No. 14662 has terms substantially identical to License No. 6263 and is valid until April 2007.

*Kostroma Region* — In August 1997, MTS received a GSM-900 cellular license (License No. 8235) to operate in the Kostroma region. This license was to expire in August 2007.

In connection with the restructuring of MTS on March 1, 2000, MTS was granted a new GSM – 900 cellular license in the Kostroma region (License No. 14664). License No. 14664 has terms substantially identical to License No. 8235 and is valid until August 2007.

*Komi Republic* — In August 1997, MTS was granted a GSM-900 cellular license (License No. 8234) for operations in the Komi Republic. This license was to expire in August 2007.

In connection with the restructuring of MTS on March 1, 2000, MTS was granted a new GSM – 900 cellular license in the Komi Republic (License No. 14463). License No. 14463 has terms substantially identical to License No. 8234 and is valid until August 2007.

RTC held additional GSM-900 licenses (Licenses Nos. 6243 through 6248) covering six regions bordering the Moscow region. These licenses were to expire in September 2006. In connection with the merger of RTC with MTS, these licenses were re-issued to MTS when License Nos. 14452 through 14457 were granted and registered on March 23, 2000.

ReCom also holds certain GSM – 900 licenses for operation in Voronezh, Belgorod, Bryansk, Kursk, Lipetsk, and Orel regions. The license for Orel region (License No. 10015) expires in February 2008 while other licenses (Licenses No. 10020 through 10024) expire in May 2008.

In connection with the UDN – 900 and ACC acquisition, MTS gained access to the GSM–900 licenses covering Udmurt Republic (License No. 5964) and Amur region (License No. 5608), respectively. These licenses expire in February 2007 and January 2007, respectively.

In connection with MSS acquisition on March 2000, MTS gained access to GSM – 900 license (License No. 5544) covering Omsk Region of Russia.

<u>GSM – 1800 licenses</u>

In connection with the Rosico acquisition, MTS also gained access to three GSM-1800 licenses covering Moscow and the Moscow region, 18 regions in Central Russia and 11 regions in the Northern, the Urals and Western Siberia Regions of Russia. These licenses expire in 2008.

*Moscow and Moscow Region* – In April 1998, Rosico was granted a GSM-1800 cellular license (License No. 10006) for operation in Moscow and the Moscow region. The license allows Rosico to operate from April 1998 to April 2008 provided that commencement of cellular services occurs no later then June 1999. Additionally, the license requires that the installed network numbering capacity supports 100,000 numbers as of December 2001.

*Central, Central Black Earth and Volga Regions* – In April 1998, Rosico was granted a GSM-1800 cellular license (License No. 10007) for operation in 17 regions of Central, Central Black Earth and Volga regions of Russia as follows: Bryansk, Vladimir, Ivanovo, Tver, Kaluga, Kostroma, Orel, Ryazan, Smolensk, Tula, Yaroslavl, Belgorod, Voronezh, Kursk, Lipetsk, Tambov, Kirov and Nizhny Novgorod. Additionally, in October 2000, an amendment to this License was approved by the Ministry that allows Rosico to operate on the GSM –900/1800 standards on the territory of Nizhniy Novgorod Region. The license allows Rosico to operate from April 1998 to April 2008 provided that commencement of cellular services occurs no later than October 1999. Additionally, the license requires that the network numbering capacity achieve 20,000 numbers as of December 2001. Services under the license commenced in March 2000. Management believes that the risk that the aforementioned delay would cause the license to be revoked is remote.

*The Northern, Urals and Western Siberia Regions* – In April 1998, Rosico was granted a GSM-1800 cellular license (License No. 10011) for operation in a total of 7 regions of the Urals Region of Russia as follows: Udmurt Republic; Kurgan, Orenburg, Perm, the Komi-Permyatsk Autonomous district, Sverdlovsk and Chelyabinsk Regions in the Urals, the Komi Republic in the Northern Region of Russia; and three regions of Western Siberia as follows: Tyumen Region, and Khanty-Mansiysk and Yamalo-Nenetsk autonomous districts. Additionally, in October 2000 amendments to this License were approved by the Ministry that allow Rosico to operate on the GSM –900/1800 standards on the territory of Kirov, Perm and Chelyabinsk Regions. The license allows Rosico to operate from April 1998 to April 2008 provided that commencement of cellular services occurs no later than October 1999. Additionally, the license requires that the network numbering capacity achieve 16,000 numbers as of December 2001. Cellular services under this license had not commenced in October 1999. Other services under the license commenced in February 2000. Management believes that that the risk that the aforementioned delay would cause the license to be revoked is remote.

When MTS commenced its operations in 1994, licenses generally contained certain provisions for unspecified fees to be paid for utilization of the frequency. Most of MTS’ current licenses now provide for payments to be made to finance telecommunication infrastructure improvements, which in the aggregate could total approximately $65,000. However, no decisions regulating the terms and conditions of such payments have been formulated. Accordingly, no payments have been made to date pursuant to any of the current licenses, which could require such payments. Further, management does not expect to be required to make additional payments. If such payments would be required in the future, management believes that it would be limited to purchasing certain equipment for its own use in the related license area.

In relation to these uncertainties, no amounts have been recorded in the accompanying financial statements.

Other telecommunication licenses

In connection with the restructuring of MTS on March 1, 2000, MTS was granted a new license No. 14668 for fixed local and intercity telephone communication operations in Moscow and Moscow region, Tver, Kostroma regions and Komi Republic. License No. 14668 has terms substantially identical to License No. 12746. The license allows MTS to operate from August 1999 to August 2004, and specifies that the operations should commence no later than August 25, 2000. Among other requirements, the license requires the number of subscribers as of the end of 2004 to be greater than 30,000.

In connection with the restructuring of MTS on March 1, 2000, MTS was granted a new license No. 14666 for channel rent in Moscow and the Moscow region, Kostroma, Tver regions and Komi Republic. License No. 14666 has terms substantially identical to License No. 11016 and is valid until November 2003.

In connection with the RTC acquisition, MTS gained access to the channel rent license (License No. 11739) covering Vladimir, Kaluga, Pskov, Ryazan, Smolensk and Tula regions. This license expires in April 2004.

In connection with the restructuring of MTS on March 1, 2000, MTS was granted a new license No. 14680. License No. 14680 has terms substantially identical to License No. 11739 and is valid until April 2004.

In connection with the restructuring of MTS on March 23, 2000, MTS was granted a new license No. 14667 for data transmission services in Moscow and Moscow region, Kostroma, Tver regions and Komi Republic. License No. 14667 is valid until December 2004.

On July 3, 2000 MTS was granted a new license No 15282 for fixed local and intercity telephone communication operations in Vladimir, Kaluga, Pskov, Ryazan, Smolensk and Tula regions. The license expires in July 3, 2005, and specifies that the operations should commence no later than July 3, 2001. Among other requirements, the license requires the numbering capacity of net work at the end of the third year of operation to be not less than 14,700 numbers. The total numbering capacity should be greater than 21,000.

On July 3, 2000 MTS was granted a new license No 15403 for data transmission services in Vladimir, Kaluga, Pskov, Ryazan, Smolensk and Tula regions. The license expires in July 3, 2005 and specifies that the operations should commence no later than July 3, 2001.

## 24. Commitments and Contingencies

Commitments

As of December 31, 2000, authorized expenditures for the purchase of property, plant and equipment totaled approximately $400 million. Of this total, approximately $125 million has been contractually committed primarily for the expansion of MTS' cellular network.

Negative net equity of Rosico

In accordance with Russian legislation, joint stock companies must maintain a level of equity (net assets) that is greater than the charter capital. In the event that a company's equity (net assets), as determined under Russian accounting legislation, falls below certain minimum levels, specifically below zero, such company can be forced to liquidate.

During 1999 and 2000, Rosico reported significant losses in its financial statements compiled in accordance with Russian accounting legislation. As a result, at December 31, 1999 and 2000, Rosico reported a deficit in equity (negative net equity) in its financial statements compiled in accordance with Russian accounting legislation.

This negative net equity position limits Rosico's ability to issue additional shares, and MTS' options to finance the operations of Rosico, and creates a risk that statutory liquidation procedures will be commenced.

No steps have been taken by MTS to rectify Rosico's negative net assets position as management believes that the risk of the initiation of statutory liquidation procedures or other material adverse actions are remote. However, if such actions were taken, it could have a material adverse effect on the MTS Group's results of operations, financial position and operating plans.

Registration of shares of closed joint stock company MTS

Pursuant to Russian legislation existing at the time of closed joint stock company MTS' formation on October 28, 1993, initial shares were required to be registered by the Ministry of Finance of the Russian Federation. MTS did not register these initial shares with the Ministry of Finance, but registered the shares only on September 22, 1997, with the FCSM, which replaced the Ministry of Finance as the relevant authority for the registration of securities.

Under Russian legislation, transfers of unregistered shares are prohibited and void. As a result, share transfers, if challenged, could result in a return of shares to the seller or monetary compensation, invalidation of decisions taken by all shareholders' meeting after such transfers, or invalidation of decisions taken by MTS' board of directors.

Management believes that the reorganization and merger of closed joint stock company MTS into open joint stock company MTS (Note 1) significantly mitigates these risks.

# TABLE OF CONTENTS