MEGAFON

Condensed Consolidated Financial Statements
(Unaudited)

Three and six months ended June 30, 2012 and 2011
With Report of Independent Accountants

ERNST & YOUNG

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Report of Independent Accountants

The Board of Directors and Shareholders
OJSC MegaFon

We have reviewed the condensed consolidated balance sheet of OJSC MegaFon and subsidiaries as of June 30, 2012, and the related condensed consolidated statements of comprehensive income and cash flows for the three and six months ended June 30, 2012 and 2011. This condensed financial information is the responsibility of the Company's management.

We conducted our reviews in accordance with standards established by the American Institute of Certified Public Accountants. A review of interim financial information consists principally of applying analytical procedures and making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an audit conducted in accordance with auditing standards generally accepted in the United States of America, the objective of which is the expression of an opinion regarding the financial information taken as a whole. Accordingly, we do not express such an opinion.

Based on our reviews, we are not aware of any material modifications that should be made to the condensed financial information referred to above for it to be in conformity with accounting principles generally accepted in the United States of America.

We have previously audited, in accordance with auditing standards generally accepted in the United States of America, the consolidated balance sheets of OJSC MegaFon and subsidiaries as of December 31, 2011, 2010 and 2009, and the related consolidated statements of comprehensive income, shareholders' equity, and cash flows for the years then ended (not presented herein); and in our report dated May 14, 2012, we expressed an unqualified opinion on those consolidated financial statements. In our opinion, the information set forth in the accompanying condensed consolidated balance sheet as of December 31, 2011, is fairly stated, in all material respects, in relation to the consolidated balance sheet from which it has been derived.

Ernst & Young LLC

August 9, 2012

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Condensed Consolidated Balance Sheets

(In millions of Rubles)

	June 30, 2012 (Unaudited)	**December 31, 2011**
Assets		
Current assets:		
Cash and cash equivalents	**15,421**	2,887
Short-term investments	**1,218**	84,509
Accounts receivable, net of allowances of 1,535 and 1,447	**9,676**	9,626
Inventory	**4,575**	4,551
Prepaid income taxes	**5,106**	6,957
VAT receivable	**2,243**	1,779
Deferred tax assets	**2,690**	1,972
Prepaid expenses and other current assets	**6,640**	8,012
Total current assets	**47,569**	120,293
Long-term bank deposits	**3**	2,002
Property, plant and equipment, net of accumulated depreciation of 183,536 and 164,765	**219,961**	223,718
Goodwill and intangible assets:		
Goodwill	**15,406**	15,393
Intangible assets, net of accumulated amortization of 27,130 and 24,817	**18,327**	19,672
Deferred tax assets	**756**	712
Deferred finance charges	**1,180**	729
Other non-current assets	**1,054**	949
Total assets	**304,256**	383,468

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

Condensed Consolidated Balance Sheets (continued)

(In millions of Rubles)

	Note	June 30, 2012 (Unaudited)	December 31, 2011
Liabilities			
Current liabilities:			
Accounts payable		**11,629**	9,997
Accounts payable to equipment suppliers		**5,485**	8,115
Current portion of liability for marketing related licenses		**498**	402
Current portion of liability for deferred and contingent consideration		**3,062**	2,550
Accrued compensation		**3,220**	5,360
Subscribers' prepayments		**7,165**	7,903
Taxes payable		**2,760**	3,056
VAT payable		**4,873**	2,965
Deferred revenue		**1,094**	954
Short-term loans and current portion of long-term debt	8	**52,394**	7,415
Other current liabilities		**2,022**	1,256
Total current liabilities		**94,202**	49,973
Debt, less current portion	8	**120,213**	36,294
Deferred tax liabilities		**10,607**	10,543
Asset retirement obligations		**5,392**	5,248
Liability for marketing related licenses, less current portion		**388**	621
Liability for deferred and contingent consideration, less current portion		**—**	1,829
Deferred revenue, less current portion		**1,321**	1,569
Other non-current liabilities		**433**	759
Total liabilities		**232,556**	106,836
Equity			
MegaFon shareholders' equity:			
Common shares (par value of 10 Rubles, 6,200,002 shares issued; 5,307,205 and 6,200,002 shares outstanding)		**581**	581
Treasury shares (892,797 ordinary shares at cost)	7	**(63,883)**	—
Reserve fund		**17**	17
Additional paid-in capital		**13,852**	13,852
Retained earnings	7	**121,061**	261,950
Accumulated other comprehensive loss		**(484)**	(291)
Total MegaFon shareholders' equity		**71,144**	276,109
Noncontrolling interest		**556**	523
Total equity		**71,700**	276,632
Total liabilities and equity		**304,256**	383,468

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

Condensed Consolidated Statements of Comprehensive Income

(In millions of Rubles, except share and per share amounts)
(Unaudited)

	Note	Three months ended June 30, 2012	Three months ended June 30, 2011	Six months ended June 30, 2012	Six months ended June 30, 2011
Revenue	3	**66,760**	58,557	**129,864**	113,713
Cost of revenues	4	**16,495**	14,055	**32,796**	26,843
Sales and marketing expenses	5	**5,352**	5,052	**10,421**	8,732
Operating expenses	6	**16,650**	14,214	**32,847**	29,095
Depreciation		**12,081**	10,673	**23,568**	21,010
Amortization		**1,294**	1,266	**2,643**	2,490
Operating income		**14,888**	13,297	**27,589**	25,543
Other income/(expense):					
Interest expense		**(1,879)**	(120)	**(2,006)**	(455)
Interest income		**301**	955	**892**	1,775
Other loss, net		**(52)**	(45)	**(67)**	(39)
Gain/(loss) on derivatives, net		**—**	16	**—**	(40)
Foreign currency exchange loss, net		**(9,912)**	(27)	**(11,352)**	(65)
Total other income/(expense), net		**(11,542)**	779	**(12,533)**	1,176
Income before income taxes and noncontrolling interest		**3,346**	14,076	**15,056**	26,719
Provision for income taxes	2	**1,600**	2,738	**4,041**	5,296
Net income		**1,746**	11,338	**11,015**	21,423
Net (gain)/loss attributable to noncontrolling interest		**(44)**	5	**(41)**	11
Net income attributable to MegaFon		**1,702**	11,343	**10,974**	21,434
Weighted average number of ordinary shares outstanding – basic and diluted		**5,535,364**	6,200,002	**5,866,429**	6,200,002
Earnings per share – basic and diluted, Rubles		**307**	1,830	**1,871**	3,457
Other comprehensive income/(loss):					
Foreign currency translation adjustment		**(120)**	13	**(33)**	58
Change in fair value of derivatives, net of tax of nil		**(124)**	—	**(168)**	—
Other comprehensive income/(loss)		**(244)**	13	**(201)**	58
Total comprehensive income		**1,502**	11,351	**10,814**	21,481
Comprehensive (income)/loss attributable to noncontrolling interest		**(14)**	2	**(33)**	(3)
Comprehensive income attributable to MegaFon		**1,488**	11,353	**10,781**	21,478

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

Condensed Consolidated Statements of Cash Flows

(In millions of Rubles)
(Unaudited)

	Note	Six months ended June 30, 2012	2011
Net cash provided by operating activities		**51,529**	46,128
Cash flows from investing activities:			
Purchases of property, plant and equipment and intangible assets		**(24,868)**	(33,879)
Proceeds from sale of property, plant and equipment		**206**	89
Acquisitions of subsidiaries, net of cash acquired of 192		**—**	(7,362)
Change in short-term investments and long-term bank deposits		**80,374**	(13,545)
Net cash provided by/(used in) investing activities		**55,712**	(54,697)
Cash flows from financing activities:			
Proceeds from short-term and long-term debt	8	**174,498**	14,222
Repayments of short-term and long-term debt	8	**(50,268)**	(3,393)
Deferred finance charges paid		**(771)**	(191)
Payments of contingent consideration	10	**(1,490)**	(491)
Payments of liabilities for marketing related licenses		**(193)**	(163)
Purchase of treasury shares	7	**(63,883)**	—
Dividends paid	7	**(151,863)**	—
Net cash provided by/(used in) financing activities		**(93,970)**	9,984
Effect of exchange rate changes on cash and cash equivalents		**(737)**	(436)
Net increase in cash and cash equivalents		**12,534**	979
Cash and cash equivalents at the beginning of the period		**2,887**	2,667
Cash and cash equivalents at the end of the period		**15,421**	3,646

1. Financial Presentation and Disclosures

Open Joint Stock Company MegaFon (the "Company" or "MegaFon") is a leading universal telecommunications operator in the Russian Federation ("Russia") and provides a broad range of voice, data and other telecommunication services to businesses, other telecommunication service providers and retail subscribers, with licenses to operate in all regions of Russia. The Company intends, wherever possible, to offer its integrated telecommunication services under the "MegaFon" brand, although some services still carry local brand names because of recent acquisitions. In addition to its operations in Russia, the Company provides mobile services through its subsidiaries in the Republic of Tajikistan ("Tajikistan"), the Republic of Abkhazia ("Abkhazia") and the Republic of South Ossetia ("South Ossetia").

In Russia, MegaFon has constructed and continues to operate a nationwide wireless communications network that operates on the dual band GSM 900/1800 standard. In May 2007, the Company was awarded a license that expires on May 21, 2017, for the provision of 3G wireless telephony services based on IMT-2000/UMTS standards throughout the entire territory of Russia. In July 2012, the Company was awarded a license which expires in July 2022 for the provision of fourth-generation ("4G") technology services under Long Term Evolution ("LTE") standard throughout the entire territory of Russia. As of June 30, 2012, the Company is providing and expanding 3G services in almost all of the regions in which it operates throughout Russia and has commenced providing 4G/LTE services in Moscow, Novosibirsk, Krasnodar, and Sochi.

The Company also holds licenses for local and long-distance telephony services, data transmission, broadband access services, and communication channels leasing covering the whole territory of Russia. The Company has its own land-line and leased satellite transmission network capacities.

The accompanying condensed financial statements of the Company have been prepared in accordance with generally accepted accounting principles in the United States of America ("US GAAP") for interim financial reporting and do not include all disclosures required by US GAAP. The Company omitted certain disclosures which would substantially duplicate the disclosures contained in its 2011 audited consolidated financial statements, such as accounting policies and details of accounts which have not changed significantly in amount or composition. Additionally, the Company has provided disclosures where significant events have occurred subsequent to the issuance of its 2011 audited consolidated financial statements. Management believes that the disclosures are adequate to make the information presented not misleading if these financial statements are read in conjunction with the Company's 2011 audited consolidated financial statements and the notes related thereto. In the opinion of management, the financial statements reflect all adjustments of a normal and recurring nature necessary to present fairly the Company's consolidated financial position, results of operations and cash flows for the interim periods. The results of operations for the three and six months ended June 30, 2012 are not indicative of the operating results for the full year (e.g. seasonality).

1. Financial Presentation and Disclosures (continued)

These financial statements include information updated and subsequent events evaluated through August 9, 2012, the date these interim condensed consolidated financial statements were available to be issued.

In the second quarter of 2012, the Ruble depreciated against all major currencies. In particular, the Ruble depreciated against the US dollar, from 29.3282 Rubles per US dollar at March 31, 2012 to 32.8169 at June 30, 2012, the reporting date, which represents an 11.9% decline in the Russian currency value. At August 9, 2012, the date these condensed consolidated financial statements were available to be issued, the exchange rate was 31.6907 Rubles per US dollar.

2. Summary of Significant Accounting Policies and Recent Accounting Pronouncements

Income Taxes

Provision for income taxes is made in the financial statements for taxation of profits in accordance with local tax legislation currently in force. The Company accounts for income taxes using the liability method required by the FASB in ASC 740, *"Income Taxes"*. For interim reporting purposes, the Company also follows the provisions of accounting standard ASC 270, *"Interim Reporting"*, which requires the Company to account for income taxes based on the Company's estimate of the effective tax rate expected to be applicable for the full fiscal year on a current year-to-date basis.

The rate so determined is based on the currently enacted tax rate applicable to the Company, and includes estimates of the annual tax effect of items that do not have tax consequences and the realization of certain deferred tax assets.

The difference between income tax expense reported in the accompanying condensed consolidated financial statements and income before taxes for the six months ended June 30, 2012 and 2011, multiplied by the statutory tax rate, is mainly due to non-deductibility of certain expenses for income tax purposes, and recognized tax benefits and preferences.

Significant variations in the customary relationship between income tax expense and pretax accounting income during the six months ended June 30, 2012 as compared to the three months ended March 31, 2012 were mainly due to an increase in non-deductible expenses in foreign jurisdictions caused primarily by revaluation of intragroup borrowings denominated in foreign currencies.

Treasury Shares

Ordinary shares repurchased by the Company are recorded at cost as treasury shares and reduce the shareholders' equity in the Company's consolidated financial statements.

2. Summary of Significant Accounting Policies and Recent Accounting Pronouncements (continued)

Earnings per Common Share

Basic earnings per share are computed by dividing income available to shareholders by the weighted-average number of ordinary shares outstanding during the period. The Company does not have any potentially dilutive securities, therefore diluted earnings per share equal basic earnings per share.

Comparative Information

Certain prior year amounts have been reclassified to conform to the presentation adopted in the current year.

Recent Accounting Pronouncements

Intangibles—Goodwill and Other. In July 2012, the FASB issued ASU 2012-02 *"Intangibles—Goodwill and Other (Topic 350): Testing Indefinite-Lived Intangible Assets for Impairment"*. This ASU states that an entity has the option first to assess qualitative factors to determine whether the existence of events and circumstances indicates that it is more likely than not that an indefinite-lived intangible asset is impaired. If, after assessing the totality of events and circumstances, an entity concludes that it is not more likely than not that an indefinite-lived intangible asset is impaired, then the entity is not required to take further action. However, if an entity concludes otherwise, then it is required to determine the fair value of the indefinite-lived intangible asset and perform the quantitative impairment test by comparing the fair value with the carrying amount in accordance with Codification Subtopic 350-30, *"Intangibles—Goodwill and Other, General Intangibles Other than Goodwill"*.

Under the guidance in this ASU, an entity also has the option to bypass the qualitative assessment for any indefinite-lived intangible asset in any period and proceed directly to performing the quantitative impairment test. An entity will be able to resume performing the qualitative assessment in any subsequent period.

The amendments in this ASU are effective for annual and interim impairment tests performed for fiscal years beginning after September 15, 2012. Early adoption is permitted. The Company does not expect this ASU to have a material impact on its financial statements.

Fair Value Measurements. In May 2011, the FASB issued ASU 2011-04, "*Fair Value Measurement (Topic 820): Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in US GAAP and IFRSs"*, which clarifies Topic 820, "*Fair Value Measurements and Disclosures*", but also includes some instances where a particular principle or requirement for measuring fair value or disclosing information about fair value measurements has changed.

2. Summary of Significant Accounting Policies and Recent Accounting Pronouncements (continued)

This ASU results in common principles and requirements for measuring fair value and for disclosing information about fair value measurements in accordance with US GAAP and International Financial Reporting Standards issued by the International Accounting Standards Board ("IFRS").

The amendment is effective for public entities for interim and annual periods beginning after December 15, 2011. The adoption of the guidance did not have a material impact on the Company's financial statements.

Receivables. In April 2011, the FASB issued ASU 2011-02, "*Receivables (Topic 310): A Creditor's Determination of Whether a Restructuring is a Troubled Debt Restructuring*", which provides additional guidance to assist creditors in determining whether a restructuring of a receivable meets the criteria to be considered a troubled debt restructuring. The amendment is effective for public entities for the first interim or annual period beginning on or after June 15, 2011. The amendment did not have any impact on the Company's financial statements.

3. Revenues

Revenues for the three and six months ended June 30 are as follows:

	Three months ended June 30,		**Six months ended June 30,**	
	2012	**2011**	**2012**	**2011**
Wireless revenues	**59,649**	53,756	**115,541**	104,047
Wireline revenues	**4,407**	3,118	**8,834**	6,526
Sales of handsets and accessories	**2,704**	1,683	**5,489**	3,140
Total revenues	**66,760**	58,557	**129,864**	113,713

4. Cost of Revenues

Cost of revenues for the three and six months ended June 30 are as follows:

	Three months ended June 30,		**Six months ended June 30,**	
	2012	**2011**	**2012**	**2011**
Cost of services	**13,956**	10,787	**27,341**	21,351
Cost of handsets, accessories and SIM-cards sold	**2,539**	3,268	**5,455**	5,492
Total cost of revenues	**16,495**	14,055	**32,796**	26,843

5. Sales and Marketing Expenses

Sales and marketing expenses for the three and six months ended June 30 are as follows:

	Three months ended June 30,		Six months ended June 30,	
	2012	**2011**	**2012**	**2011**
Advertising	**2,060**	1,869	**4,020**	3,233
Commissions to dealers for connection of new subscribers	**2,043**	2,071	**4,181**	3,445
Commissions to dealers for cash collection from subscribers	**1,249**	1,112	**2,220**	2,054
Total sales and marketing expenses	**5,352**	5,052	**10,421**	8,732

6. Operating Expenses

Operating expenses for the three and six months ended June 30 are as follows:

	Three months ended June 30,		Six months ended June 30,	
	2012	**2011**	**2012**	**2011**
Salaries and social charges	**6,512**	5,734	**12,967**	11,735
Rent and utilities	**3,903**	3,394	**7,769**	6,728
Operating taxes	**1,756**	1,445	**3,285**	2,814
Network repairs and maintenance	**1,284**	1,159	**2,459**	2,341
Radio frequency fees	**1,024**	875	**2,038**	1,730
Office maintenance	**449**	384	**894**	706
Bad debt expense	**334**	305	**813**	739
Professional services	**460**	310	**849**	678
Vehicle costs	**166**	157	**325**	297
Materials and supplies	**26**	79	**118**	137
Insurance	**23**	28	**45**	56
Other expenses	**713**	344	**1,285**	1,134
Total sales and marketing expenses	**16,650**	14,214	**32,847**	29,095

Rent represents expenses related to the lease of premises for offices, base stations and switches.

7. Shareholders' Equity

In April 2012, the Company's shareholders agreed to a series of transactions to permit the payment of the Company's first dividend and re-organize the shareholding structure. The principal impacts of these agreements on the Company's financial position were as follows:

- the special dividend, paid on April 24, 2012, resulted in an aggregate distribution of 151,863 to the shareholders (or 24,494 Rubles per ordinary share);

- on April 24, 2012, the Company re-purchased (through MegaFon Investments (Cyprus) Limited ("MICL"), a wholly-owned subsidiary of the Company) from Allaction Limited, part of the Alfa Group of companies, 892,797 (or 14.4%) of the Company's ordinary shares for 63,883, including transaction costs.

The transactions described above were financed from the Company's existing cash and short-term investments, and additional borrowings of approximately 142,400, net of repayments *(see Note 8)*.

As a result of the dividend payment and the re-purchase of 14.4% of its ordinary shares, and the additional new borrowings *(see Note 8)*, the Company has substantially depleted its working capital, including available cash and short-term investments. As of August 9, 2012, the Company believes it will continue to be able to generate significant operating cash flows and have access to undrawn lines of credit of approximately 74,000 that can be used to cover capital and operating expenditures. Additionally, the Company can defer capital expenditures if necessary in order to meet short-term liquidity requirements. Accordingly, management believes that cash flows from operating and financing activities will be sufficient for the Company to meet its obligations as they become due.

In April 2012, the Company's Board of Directors approved a number of other capital raising options. While the Company believes that financing options will be available, the timing and ultimate completion of any financing will be dependent on a number of factors beyond its control. Accordingly, there is no guarantee that the Company will be able to obtain financing on favorable terms or otherwise.

Voting Agreement

In accordance with a Voting Agreement executed between the Company's shareholders and MICL on April 24, 2012, TeliaSonera Group, one of the Company's shareholders, will direct the voting of the shares in the Company held by MICL on any issues other than the appointment or removal of the CEO and the planned redemption and cancellation by the Company from MICL of two shares held by MICL, until the first to occur of (a) the completion of an initial public offering ("IPO") of the Company, (b) the date at which the TeliaSonera Group or AF Telecom Group reduce their interest in the Company below 25% plus one share, or (c) December 31, 2014. In certain circumstances this period can be extended beyond this date.

8. Short-Term and Long-Term Debt

(1) Bridge Facility with Barclays Bank PLC, BNP Paribas and Citibank N.A., London branch ("Bridge Facility")

In April 2012, the Company entered into a Bridge Facility with Barclays Bank PLC, BNP Paribas and Citibank N.A., London branch to facilitate the payment of dividends and repurchase of the Company's shares described above. The Bridge Facility carried interest at a rate of LIBOR plus 1.5% which is increased by 0.5% every three months. The Bridge Facility was subject to mandatory earlier repayment upon the completion of certain debt or capital raising transactions. A payment of 241 as an arrangement fee was made for the Bridge Facility.

In April 2012, the Company drew $1.5 billion (49,225 at the exchange rate as of June 30, 2012) under the Bridge Facility. In June 2012, the Company voluntarily repaid $200 million (6,563 at the exchange rate as of June 30, 2012).

Subsequently, in July 2012, the Company voluntarily repaid the remaining outstanding amount of $1.3 billion (42,662 at the exchange rate as of June 30, 2012) using part of the proceeds from the Sberbank Credit Facilities *(see Note 8 (4) below)*. The portion of the Bridge Facility, which was refinanced (the amount of 28,986) is included in long-term debt in the accompanying condensed consolidated balance sheets.

(2) VTB Credit Facility

In April 2012, the Company entered into a revolving credit facility with VTB Bank ("VTB Credit Facility") for up to 30,000. The VTB Credit Facility was fully drawn for a one-year period subject to an interest rate of 3-months MosPrime plus 2.2% which is payable every three months.

(3) Gazprombank Credit Facility

In April 2012, the Company and Gazprombank modified the terms of the existing revolving credit facility agreement ("Gazprombank Credit Facility") by increasing the debt limit on the facility from 15,000 to 30,000. The Gazprombank Credit Facility is subject to fees of 0.15% per annum on the amount of the unutilized balance.

On April 18, 2012, the Company drew the entire 30,000 and subsequently, on April 25, 2012, voluntarily repaid 23,700. The Gazprombank Credit Facility carries an interest rate of 9.05% per annum which is payable every three months. The interest rate can be changed by Gazprombank unilaterally in an event of revision of the refinancing rate by the Central Bank of Russia. The principal is due for repayment in September 2016.

(4) Sberbank Credit Facilities

In April 2012, the Company entered into two credit facility agreements with Sberbank, one

8. Short-Term and Long-Term Debt (continued)

for up to the Ruble equivalent of $1 billion (32,817 at the exchange rate as of June 30, 2012) and the other for up to the Ruble equivalent of $1.5 billion (49,225 at the exchange rate as of June 30, 2012) (together, the "Sberbank Credit Facilities").

As of June 30, 2012, the Company has fully drawn the $1 billion Credit Facility in an amount of 29,512 and the $1.5 billion Credit Facility was drawn in the amount of 17,707. Subsequently, in July 2012, the Company drew down the remaining amount of 28,986 under the $1.5 billion Credit Facility. A payment of 434 as an arrangement fee was made for the Sberbank Credit Facilities during the six month period ending June 30, 2012.

The principal purpose of the Bridge Facility, the VTB Credit Facility, the Gazprombank Credit Facility and the Sberbank Credit Facilities is the funding of the dividend payout and the re-purchase of shares by the Company. Any excess will be used to fund operating, investment and financial activities. The covenants of these Credit Facilities are substantially consistent with those which the Company has in its other existing loan agreements.

(5) Other

On April 6, 2012, the Company drew down and subsequently, on April 24, 2012, repaid in full 11,000 under its revolving credit facility with UniCredit Bank Moscow which carried interest at a rate of 8.87% per annum.

Also, in April 2012, the Company drew down 5,500 under its agreement with Nordea Bank at an interest rate of 1-month MosPrime plus 2.95% per annum. In May 2012, the Company repaid the amount borrowed under the agreement in full.

In April 2012, the Company drew down $41 million (1,345 at the exchange rate as of June 30, 2012) under its credit facility agreement with Fortis Bank, Nordea Bank Finland and Skandinaviska Enskilda Banken which bears interest at a rate of 1.92% per annum. This credit facility can only be used to purchase Nokia Siemens Networks equipment.

In April and June 2012, the Company drew an aggregate amount of $107 million (3,511 at the exchange rate as of June 30, 2012) under the credit facility agreement with China Development Bank which bears interest at a rate of LIBOR plus 2.4% per annum. This credit facility can only be used to purchase Huawei equipment.

In June 2012, the Company entered into a credit facility with Nordic Investment Bank ("NIB Credit Facility") for up to 80 million Euros. The NIB Credit Facility carries interest at a rate of EURIBOR plus 2.05% per annum. The NIB Credit Facility is subject to payment of a commitment fee of 0.4% per annum on the amount of the unutilized balance and a front-end fee of 0.25% on the principal amount. The NIB Credit Facility can only be used to upgrade the network of the Company in the Moscow region and other regions of Russia to improve the network performance and prepare for the 4G/LTE service roll-out. As at June 30, 2012, the NIB Credit Facility remains undrawn.

9. Cash Flow Hedges of Interest Rate Risk

The Company's objective in using interest rate derivatives is to add certainty and stability to its interest expense and to manage its exposure to interest rate movements. To accomplish this objective, the Company primarily uses interest rate swaps as part of its interest rate risk management strategy. Interest rate swaps designated as cash flow hedges involve the receipt of variable-rate amounts from a counterparty in exchange for the Company making fixed-rate payments over the life of the agreements without the exchange of the underlying principal amount of long-term debt.

As at June 30, 2012 and December 31, 2011, the Company had the following outstanding interest rate derivatives stated at their notional amounts that were designated as cash flow hedges of interest rate risk:

	June 30, 2012		**December 31, 2011**	
	Millions of original currency	**Millions of Rubles**	**Millions of original currency**	**Millions of Rubles**
Euro-denominated interest rate swaps	**45**	**1,860**	57	2,375
USD-denominated interest rate swaps	**693**	**22,742**	693	22,312

Interest rate swaps are recorded on the balance sheet at fair value (Level 2). The effective portion of changes in the fair value of derivatives designated and qualifying as cash flow hedges is recorded in other comprehensive income/(loss) and is subsequently reclassified into earnings in the period that the hedged forecast transaction affects earnings. The ineffective portion of the change in fair value of the derivatives is recognized directly in earnings. For derivative instruments that are not designated as hedges or do not qualify as hedged transactions, the changes in the fair value are reported in the consolidated statement of comprehensive income.

As at June 30, 2012, the fair values of the Company's interest rate swaps in the amounts of 86 and 89 were recorded in other current and other non-current liabilities, respectively, in the accompanying consolidated balance sheets. The fair values of the swaps are based on a forward yield curve and represent the estimated amount the Company would receive or pay to terminate these agreements at the reporting date, taking into account current interest rates, creditworthiness, nonperformance risk, and liquidity risks associated with current market conditions. The amount reclassified into earnings during the six months ended June 30, 2012 was immaterial. All movements in fair values are reflected in other comprehensive income/(loss). At June 30, 2012, the amount recorded in other comprehensive income/(loss) which is expected to be reclassified to interest expense in the next 12 months is 86.

10. Settlement of Contingent Consideration

In June 2012, the Company paid approximately $44 million (1,431 at the exchange rates as of payment dates) in full and final settlement of contingent consideration liability for NetByNet acquisition completed in June 2011.

11. Commitments, Contingencies and Uncertainties

Russian Environment and Current Economic Situation

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

The Russian economy is vulnerable to market downturns and economic slowdowns elsewhere in the world. In 2011 and during the six months ended June 30, 2012, the Russian Government continued to take measures to support the economy in order to overcome the consequences of the global financial crisis.

Despite some indications of recovery there continues to be uncertainty regarding further economic growth, access to capital and cost of capital, which could negatively affect the Company's future financial position, results of operations and business prospects.

While management believes it is taking appropriate measures to support the sustainability of the Company's business in the current circumstances, unexpected further deterioration in the areas described above could negatively affect the Company's results and financial position in a manner not currently determinable.

3G License Capital Commitments

In May 2007, MegaFon was awarded a license that expires on May 21, 2017, for the provision of 3G wireless communications services for the entire territory of the Russian Federation. The 3G license was granted subject to certain capital and other commitments. The three major conditions were that the Company build a specified number of base stations that support 3G standards, start commercial exploitation of the 3G technology in each region of the Russian Federation over the period from May 2008 through May 2010, and also build a certain number of base stations by the end of the third, fourth and fifth years from the date of granting of the license. As of August 9, 2012, the Company believes it is in full compliance with these license conditions, including constructing the number of base stations required at this time.

Taxation

Russian tax, currency and customs legislation are subject to varying interpretations and changes, which can occur frequently. Management's interpretation of such legislation as applied to transactions and activities of the Company may be challenged by the relevant regional and federal authorities. Recent events within Russia suggest that the tax authorities are taking a more assertive position in their interpretation and enforcement of the legislation and assessments and as a result, it is possible that transactions and activities that have not been challenged in the past may now be challenged. Therefore, significant additional taxes, penalties and interest may be assessed. Fiscal periods remain open to review by the authorities in respect of taxes for the three calendar years preceding the current year. Under certain circumstances reviews may cover longer periods.

11. Commitments, Contingencies and Uncertainties (continued)

The Company's management believes that its interpretation of the relevant legislation is appropriate and is in accordance with the current industry practice and that the Company's tax, currency and customs positions will be sustained. However, the interpretations of the relevant authorities could differ. As of August 9, 2012, the Company's management estimated the possible effect of additional income taxes, fines and interest on these condensed consolidated financial statements, if the authorities were successful in enforcing different interpretations, in the amount of up to approximately 960.

Litigation

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

Put and Call Option Agreement

On April 24, 2012, the shareholders of the Company signed an agreement (the “Put and Call Option Agreement”) to the effect that, if an IPO of the Company has not been consummated by December 31, 2014, Sonera Holding B.V., a member of TeliaSonera Group, will have the right to sell to MICL (the “Put Option”) and MICL will have the right to buy from Sonera Holding B.V. (the “Call Option”) the lesser of (a) such number of shares in the Company as are equal to approximately 10.6% of the Company and (b) such number of shares in the Company by which the total number of shares in the Company that are directly or indirectly owned by the TeliaSonera Group in aggregate exceeds 25% plus one share of the entire issued share capital of the Company (the “Option Shares”). The price payable to exercise the Put and Call Options will be based on the fair value of the Company’s shares as determined at the date of exercise. Telecominvest Holdings Limited, a company controlled by AF Telecom Group, at its sole discretion can elect to purchase any or all of the Option Shares under the Put and Call Options.

Sonera Holding B.V., Telecominvest Holdings Limited or MICL may only exercise the Put and Call Options during the period from January 1, 2015 to February 1, 2015. The Company has given a guarantee to Sonera Holding B.V. of the performance of MICL’s obligations under the Put and Call Option Agreement.

The Company assesses the fair values of the Put and Call Options as immaterial.

Apple Commitment

In August 2008, the Company entered into a two-year fixed commitment with Apple Sales International (“Apple”), an Irish affiliate of Apple Computer Inc., to purchase a total of one

11. Commitments, Contingencies and Uncertainties (continued)

million unlocked iPhone handsets over a two-year period for further resale in Russia. The Company fulfilled this requirement with respect to the fourth quarter of 2008, but due to the significantly reduced handset demand caused by the economic crisis in Russia, the Company experienced difficulty re-selling these iPhones.

While the Company placed several orders for iPhone handsets thereafter, none of these orders fulfilled the minimum quarterly requirement for the applicable quarters.

The contract with Apple terminated in August 2010 and, since such date, Apple has not asserted any claim against the Company with respect to any alleged non-fulfillment of its obligation to purchase iPhone handsets, and the Company has no basis to believe that any such claim will be asserted.

Goodwill

There were no indicators of impairment for the Company's goodwill or long-lived assets, and the Company was not required to record any impairment charges. The Company considers all current information in determining the need for impairment loss; however, future changes in events or circumstances, such as a continuation or worsening of the current economic instability, or increased competition, could result in decreases in the fair value of its goodwill and may require the Company to record impairment charges in future periods.

In June 2011, the Company completed the acquisition of a 100% ownership interest in Fairlie Holding and Finance Limited, which holds a 100% interest in a group of subsidiaries that provide broadband internet, IP telephony, IP TV and other multimedia services in Russia under the NetByNet brand ("NetByNet") for total consideration having a fair value of 8,731 as of the date of acquisition, consisting of cash consideration of 7,507 and contingent consideration of 1,224. This fair value measurement is based on significant inputs not observable in the market and thus represents a Level 3 measurement.

The primary reason for the acquisition was to facilitate the Company's entry into the broadband internet market in Moscow, the Moscow region and the Central Federal District, where the Company did not previously provide broadband internet services for end-customers.

The allocation of the purchase price for the acquisition of NetByNet to individual assets and liabilities along with the allocation of the resulting goodwill to reporting units was finalized in June 2012. There were no changes to the previously reported amounts of the net assets and goodwill upon finalization of the purchase price allocation.

As of June 30, 2012, the Company's management believes that the carrying amount of the NetByNet reporting unit approximates its fair value. However, if the Company does not achieve planned cost savings assumed in the original fair value calculation, the Company may recognize an impairment loss.

12. Scartel Agreement

In February 2012, MegaFon entered into a mobile virtual network operator ("MVNO") agreement with Scartel LLC ("Scartel"), a related party of the Company since July 2012, which operates under the "Yota" brand, for the joint development and provision of 4G/LTE services in Russia.

The MVNO agreement enables the Company to provide 4G/LTE services to its customers using the network of Scartel and enables Scartel to use network infrastructure of MegaFon to provide voice services to its customers.

In March and April 2012, the Company prepaid Scartel an aggregate amount of $50 million (1,641 at the exchange rate as of June 30, 2012) for the provision of future interconnection services under the MVNO agreement. The amount of the advance was included in prepaid expenses in the accompanying consolidated balance sheets as at June 30, 2012.

13. Segment Information

The Company conducts its business activities in three operating segments, which are wireless, wireline and retail, of which only the wireless segment meets quantitative thresholds as a reportable segment. Less than 1% of the Company's revenues and results are generated by segments outside of Russia. No single customer represents 10% or more of the consolidated revenues.

14. Subsequent Events

4G/LTE License Capital Commitments

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

Under the terms and conditions of this license, the Company is obligated to provide 4G/LTE services in each population center with over 50,000 inhabitants in Russia by 2019. The Company is also obligated to make capital expenditures of at least 15,000 annually toward the 4G/LTE roll-out until the network is fully deployed, to clear frequencies currently allocated to the military at its own cost and to compensate other operators for surrendering frequencies in an aggregate amount of 401.

Common Shares

In July 2012, the Company retired two of 892,797 the Company's treasury shares for the purpose of reducing total number of authorized ordinary shares to 6,200,000.

Also, in July 2012, the Company filed a prospectus with Federal Commission for Financial Markets, the Russian market regulator, to register 1-to-100 share split which is expected to become effective in September 2012.