

**MEGAFON**

**Condensed Consolidated Financial Statements**  
(Unaudited)

*Three months ended March 31, 2009 and 2008*  
*With Independent Accountant's Report*



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## Independent Accountant's Report

The Board of Directors and Shareholders  
OJSC MegaFon -

We have reviewed the condensed consolidated balance sheet of OJSC MegaFon and subsidiaries as of March 31, 2009, and the related condensed consolidated statements of operations and cash flows for the three-month periods ended March 31, 2009 and 2008. 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, 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 sheet of OJSC MegaFon and subsidiaries as of December 31, 2008, and the related consolidated statements of operations, shareholders' equity, and cash flows for the year then ended (not presented herein); and in our report dated April 15, 2009, 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, 2008, is fairly stated, in all material respects, in relation to the consolidated balance sheet from which it has been derived.

June 12, 2009

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# MegaFon

## Condensed Consolidated Balance Sheets

(In millions of Rubles)

	<b>December 31, 2008</b>	<b>March 31, 2009 (Unaudited)</b>
<b>Assets</b>		
Current assets:		
Cash and cash equivalents	6,465	<b>26,562</b>
Short-term investments	33,738	<b>30,579</b>
Accounts receivable, net of allowance for doubtful accounts of 511 and 808 at December 31, 2008 and March 31, 2009, respectively	5,698	<b>4,871</b>
Inventory	2,352	<b>1,693</b>
VAT receivable	2,640	<b>2,161</b>
Deferred tax assets	1,167	<b>1,203</b>
Prepaid expenses	4,942	<b>5,506</b>
Other current assets	1,227	<b>1,374</b>
Total current assets	58,229	<b>73,949</b>
Property, plant and equipment, net of accumulated depreciation of 75,515 and 82,001 at December 31, 2008 and March 31, 2009, respectively	128,691	<b>129,117</b>
Goodwill and intangible assets, net of accumulated amortization of 14,411 and 15,119 at December 31, 2008 and March 31, 2009, respectively	13,512	<b>14,319</b>
Other non-current assets	2,317	<b>2,380</b>
Total assets	202,749	<b>219,765</b>

*The accompanying notes are an integral part of these unaudited condensed consolidated financial statements.  
See independent accountant's report.*

# MegaFon

## Condensed Consolidated Balance Sheets (continued)

(In millions of Rubles)

	<b>December 31, 2008</b>	<b>March 31, 2009 (Unaudited)</b>
<b>Liabilities</b>		
Current liabilities:		
Accounts payable	6,358	<b>6,104</b>
Accounts payable to equipment suppliers	5,633	<b>3,824</b>
Accrued compensation and social contributions	2,031	<b>1,647</b>
Subscribers' prepayments	6,182	<b>5,042</b>
Taxes payable	1,012	<b>1,301</b>
VAT payable	2,187	<b>2,910</b>
Deferred revenue	247	<b>271</b>
Loans from shareholders	97	–
Current portion of long-term debt	15,660	<b>18,278</b>
Other current liabilities	516	<b>820</b>
Total current liabilities	39,923	<b>40,197</b>
Debt, less current portion	16,223	<b>19,976</b>
Loans from shareholders, less current portion	3,647	<b>4,280</b>
Deferred tax liabilities, less current portion	2,159	<b>2,179</b>
Asset retirement obligations	2,349	<b>2,465</b>
Other non-current liabilities	322	<b>598</b>
Total liabilities	64,623	<b>69,695</b>
<b>Equity</b>		
MegaFon shareholders' equity:		
Common stock (par value of 10 Rubles, 6,200,002 shares authorized, issued and outstanding)	581	<b>581</b>
Reserve fund	17	<b>17</b>
Additional paid-in capital	13,875	<b>13,875</b>
Retained earnings	123,910	<b>135,036</b>
Accumulated other comprehensive loss	(257)	<b>(306)</b>
Total MegaFon shareholders' equity	138,126	<b>149,203</b>
Noncontrolling interest	–	<b>867</b>
Total Equity	138,126	<b>150,070</b>
Total liabilities and equity	202,749	<b>219,765</b>

The accompanying notes are an integral part of these unaudited condensed consolidated financial statements.  
See independent accountant's report.

# MegaFon

## Condensed Consolidated Statements of Operations

(In millions of Rubles)  
(Unaudited)

	<b>Three months ended March 31,</b>	
	<b>2008</b>	<b>2009</b>
<b>Revenue</b> (Note 4)	37,789	<b>42,196</b>
Cost of services (excluding depreciation and amortization) (Note 5)	7,297	<b>8,796</b>
<b>Gross margin</b>	30,492	<b>33,400</b>
Sales and marketing expenses (excluding depreciation and amortization) (Note 6)	3,413	<b>2,797</b>
Operating expenses (excluding depreciation and amortization) (Note 7)	8,124	<b>9,690</b>
Depreciation, amortization and accretion	6,668	<b>7,585</b>
<b>Operating income</b>	12,287	<b>13,328</b>
Other income/(expense):		
Interest expense	(540)	<b>(409)</b>
Interest income	568	<b>708</b>
Other gain, net	15	<b>24</b>
Gain on derivatives, net (Note 8)	42	<b>241</b>
Foreign currency exchange gain, net	280	<b>441</b>
<b>Total other income, net</b>	365	<b>1,005</b>
<b>Income before income taxes and noncontrolling interest</b>	12,652	<b>14,333</b>
Provision for income taxes	3,407	<b>3,225</b>
<b>Net income</b>	9,245	<b>11,108</b>
Net loss attributable to noncontrolling interest	(12)	<b>(18)</b>
<b>Net income attributable to MegaFon</b>	9,257	<b>11,126</b>

The accompanying notes are an integral part of these unaudited condensed consolidated financial statements.  
See independent accountant's report.

# MegaFon

## Condensed Consolidated Statements of Cash Flows

(In millions of Rubles)  
(Unaudited)

	<b>Three months ended March 31,</b>	
	<b>2008</b>	<b>2009</b>
<b>Net cash provided by operating activities</b>	18,215	19,122
<b>Cash flows from investing activities:</b>		
Purchases of property, plant and equipment and intangible assets	(6,776)	(8,473)
Proceeds from sale of property, plant and equipment	10	39
Acquisitions of subsidiaries, net of cash acquired	–	(553)
(Increase)/ decrease in short-term investments	(5,865)	7,899
Other investing activities	13	–
Net cash used in investing activities	(12,618)	(1,088)
<b>Cash flows from financing activities:</b>		
Proceeds from long-term debt	1,298	2,768
Repayments of long-term debt	(661)	(594)
Deferred finance charges paid	–	(125)
Net cash provided by financing activities	637	2,049
Effect of exchange rate changes on cash and cash equivalents	(16)	14
<b>Net increase in cash and cash equivalents</b>	6,218	20,097
Cash and cash equivalents at the beginning of the period	4,259	6,465
<b>Cash and cash equivalents at the end of the period</b>	<b>10,477</b>	<b>26,562</b>
<b>Supplemental cash flow information:</b>		
Cash paid during the period for income taxes	3,532	4,257
Cash paid during the period for interest	70	104
Non-cash financing and investing activities:		
Equipment purchased under credit	39	381

*The accompanying notes are an integral part of these unaudited condensed consolidated financial statements.  
See independent accountant's report.*

# MegaFon

## Notes to Unaudited Condensed Consolidated Financial Statements

*(In millions of Rubles, unless otherwise indicated)*

### **1. Financial Presentation and Disclosures**

Open Joint Stock Company MegaFon (the “Company” or MegaFon”) is a provider of a broad range of voice, data and other wireless telecommunications services to businesses, other telecommunications service providers and retail subscribers. MegaFon also sells handsets and accessories to dealers and final customers.

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 2008 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 2008 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 2008 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 months ended March 31, 2009 are not indicative of the operating results for the full year. These financial statements include information updated through June 12, 2009.

### **2. Summary of Significant Accounting Policies and Recent Accounting Pronouncements**

#### *Foreign Currency Translation*

The functional currency of the Company’s subsidiaries domiciled in Russia, the Republic of Abkhazia and the Republic of South Ossetia is the Russian Ruble as a majority of their revenues, costs, property and equipment purchased, debt and trade liabilities is either priced, incurred, payable or otherwise measured in Rubles.

The functional currency of TT-Mobile, the Company’s 75% owned subsidiary in Tajikistan, is the US dollar as a majority of its revenues, costs, property and equipment purchased, debt and trade liabilities is either priced, incurred, payable or otherwise measured in US dollars.

In the beginning of 2009, the Russian Central Bank devalued the Ruble against major currencies. The Ruble depreciated against the US dollar, from 29.3804 Rubles per US dollar at January 1, 2009 to 34.0134 at March 31, 2009, the reporting date which represents a 15.8% decline in the Russian currency value. At June 12, 2009, the date of the consolidated financial statements issuance, the exchange rate was 30.9124 Rubles per US dollar.

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# MegaFon

## Notes to Unaudited Condensed Consolidated Financial Statements (continued)

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

#### *Income Taxes*

Provision for income taxes is made in the financial statements for taxation of profits in accordance with Russian legislation currently in force. The Company accounts for income taxes using the liability method required by Statement of Financial Accounting Standards (“SFAS”) No. 109, “*Accounting for Income Taxes*”. For interim reporting purposes, the Company also follows the provisions of Accounting Principles Board Opinion No. 28, “*Interim Financial 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 three months ended March 31, 2009 and 2008, multiplied by the Russian statutory tax rate, is mainly due to non-deductibility of certain expenses for income tax purposes.

The Company recognizes accrued interest and penalties related to unrecognized tax liabilities in income taxes. As of March 31, 2009, the tax years ended December 31, 2006, 2007 and 2008 remained subject to examination by the tax authorities.

#### *Management Estimates*

The preparation of financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results may differ from those estimates. The most significant estimates with regard to the accompanying condensed consolidated financial statements relate to the useful lives of tangible and intangible assets, revenue recognition, deferred revenue, collectability of accounts receivables, asset retirement obligations, fair value of derivative financial instruments, income tax provision and recoverability of deferred taxes.

#### *Comparative Information*

Certain prior period amounts have been reclassified to conform to the current period presentation.

#### *Recent Accounting Pronouncements*

In September 2006, the Financial Accounting Standards Board (“FASB”) issued SFAS No. 157, “Fair Value Measurements”. The standard provides guidance for using fair value to

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## Notes to Unaudited Condensed Consolidated Financial Statements (continued)

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

measure assets and liabilities. The standard also responds to investors' requests for expanded information about the extent, to which companies measure assets and liabilities at fair value, the information used to measure fair value, and the effect of fair value measurements on earnings. The standard applies whenever other standards require (or permit) assets or liabilities to be measured at fair value. The standard does not expand the use of fair value in any new circumstances. In February 2008, the FASB issued FASB Staff Position ("FSP") FAS No. 157-2 which delays the effective date of SFAS No. 157 for non-financial assets and non-financial liabilities, except for items that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually), to fiscal years beginning after November 15, 2008, and interim periods within those fiscal years. The Company has adopted SFAS No. 157 for non-financial assets and liabilities measured at fair value on a nonrecurring basis at January 1, 2009 and will continue to apply its provisions prospectively from January 1, 2009. The application of SFAS No. 157 for non-financial assets and liabilities did not have a significant impact on the Company's financial statements.

In October 2008, the FASB issued FSP No. FAS 157-3, "*Determining the Fair Value of a Financial Asset When the Market for That Asset Is Not Active*", which clarifies the application of SFAS No. 157 in a market that is not active and provides an example to illustrate key considerations in determining the fair value of a financial asset. The Company adopted the standard for items that are recognized or disclosed at fair value beginning from January 1, 2008. The adoption of SFAS No. 157-3 did not have a significant effect on the Company's financial statements.

In April 2009, the FASB issued FSP FAS 157-4, "*Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly*" ("FSP FAS 157-4"). FSP FAS 157-4 provides additional guidance for estimating fair value in accordance with SFAS No. 157, "*Fair Value Measurements*", when the volume and level of activity for the asset or liability have significantly decreased. FSP FAS 157-4 also includes guidance on identifying circumstances that indicate a transaction is not orderly. FSP FAS 157-4 reaffirms what SFAS No. 157 states is the objective of fair value measurement—to reflect how much an asset would be sold for in an orderly transaction (as opposed to a distressed or forced transaction) at the date of the financial statements under current market conditions. Specifically, it reaffirms the need to use judgment to ascertain if a formerly active market has become inactive and in determining fair values when markets have become inactive. FSP FAS 157-4 is effective for interim and annual reporting periods ending after June 15, 2009. The Company does not expect FSP FAS 157-4 to have a material impact on its financial statements.

In December 2007, the FASB issued SFAS No. 141 (Revised 2007), "*Business Combinations*". SFAS No. 141(R) significantly changes accounting for business combinations. Under SFAS No. 141(R) an acquiring entity is required to recognize all the assets acquired and liabilities assumed in a transaction at the acquisition-date fair value with limited exceptions. SFAS No. 141(R) changes the accounting treatment for certain specific acquisition related items including: (1) expensing acquisition related costs as incurred;

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### Notes to Unaudited Condensed Consolidated Financial Statements (continued)

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

(2) valuing noncontrolling interests at fair value at the acquisition date; and (3) expensing restructuring costs associated with an acquired business. SFAS No. 141(R) also includes a substantial number of new disclosure requirements. SFAS No. 141(R) is applied prospectively to business combinations for which the acquisition date is on or after January 1, 2009. After the adoption of SFAS No. 141(R), the reversal of tax contingencies related to the Company's acquisitions will be recorded on its consolidated statement of operations and not as an adjustment to goodwill. The adoption of SFAS No. 141(R) did not have a significant impact on the Company's financial statements.

In December 2007, the FASB issued SFAS No. 160, *“Noncontrolling Interests in Consolidated Financial Statements”*. SFAS No. 160 establishes new accounting and reporting standards for the noncontrolling interest in a subsidiary and for the deconsolidation of a subsidiary. This statement became effective for the Company on January 1, 2009. From the date of adoption the Company is required to report its noncontrolling interests as a separate component of shareholders' equity. Among other requirements, this statement requires consolidated net income to include the amounts attributable to both the parent and the noncontrolling interest. It also requires disclosure, on the face of the consolidated statement of operations, of the amounts of consolidated net income attributable to the parent and to the noncontrolling interest. SFAS No. 160 requires retroactive adoption of the presentation and disclosure requirements for existing minority interests. All other requirements of SFAS No. 160 are to be applied prospectively. The Company has adopted SFAS No. 160 and the required reclassifications and disclosures have been made in its financial statements.

In March 2008, the FASB issued SFAS No. 161, *“Disclosures about Derivative Instruments Hedging Activities, an amendment of FASB Statement No. 133”*. SFAS No. 161 amends and expands the disclosure requirements of SFAS No. 133 with the intent to provide users of financial statements with an enhanced understanding of how and why an entity uses derivative instruments; how derivative instruments and related hedged items are accounted for under SFAS No. 133 and its related interpretations; and how derivative instruments and related hedged items affect an entity's financial position, financial performance and cash flows. This statement is effective for financial statements issued for fiscal years and interim periods beginning after November 15, 2008, with early application encouraged. SFAS No. 161 does not change the accounting treatment for derivative instruments. The adoption of SFAS No. 161 did not have a significant impact on the Company's financial statements.

In April 2008, the FASB issued FSP No. FAS 142-3, *“Determination of the Useful Life of Intangible Assets”*, which aims to improve consistency between the useful life of a recognized intangible asset under SFAS No. 142, *“Goodwill and Other Intangible Assets”*, and the period of expected cash flows used to measure the fair value of the asset under SFAS No. 141(R), especially where the underlying arrangement includes renewal or extension terms. The FSP is effective prospectively for fiscal years beginning after December 15, 2008 and early adoption is prohibited. The adoption of FSP No. 142-3, did not have a significant impact on the Company's financial statements.

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## Notes to Unaudited Condensed Consolidated Financial Statements (continued)

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

In April 2009, the FASB issued FSP FAS 141(R)-1, *“Accounting for Assets Acquired and Liabilities Assumed in a Business Combination That Arise from Contingencies”*. FSP FAS 141 (R)-1 applies to all assets acquired and liabilities assumed in a business combination that arise from contingencies that would be within the scope of SFAS No. 5, *“Accounting for Contingencies”*, if not acquired or assumed in a business combination, except for assets or liabilities arising from contingencies that are subject to specific guidance in SFAS No. 141(R), *“Business Combinations”*. FSP FAS 141(R)-1 provides guidance on initial recognition and measurement and subsequent measurement and accounting. FSP FAS 141(R)-1 shall be effective for assets or liabilities arising from contingencies in business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008. The adoption of FSP FAS 141(R)-1 did not have a material impact on the Company’s financial statements.

In April 2009, the FASB issued FSP FAS 115-2 and FAS 124-2, *“Recognition and Presentation of Other-Than-Temporary Impairments”*. FSP FAS 115-2 and FAS 124-2 amends the other-than-temporary impairment guidance for debt securities and presentation and disclosure of other-than-temporary impairments on debt and equity securities in the financial statements. Among other things FSP FAS 115-2 and FAS 124-2 replaces the current requirement that a holder have the positive intent and ability to hold an impaired security to recovery in order to conclude an impairment was temporary with a requirement that an entity conclude it does not intend to sell an impaired security and it is not more likely than not it will be required to sell the security before the recovery of its amortized cost basis. FSP FAS 115-2 and FAS 124-2 is effective for interim and annual reporting periods ending after June 15, 2009. The Company does not expect FSP FAS 115-2 and FAS 124-2 to have a material impact on its financial statements.

In May 2009, the FASB issued SFAS No. 165 *“Subsequent Events”*. SFAS No. 165 establishes general standards of accounting for and disclosure of events that occur after the balance sheet date but before financial statements are issued or are available to be issued. SFAS No. 165 is effective on a prospective basis for interim or annual financial periods ending after 15 June 2009. The Company does not expect SFAS No. 165 to have a material impact on its financial statements.

### **3. Business Combination**

In March 2009, the Company completed the acquisition of 100% ownership interest in Debton Investment Limited (“Debton”) for approximately 935 cash consideration. Debton owns 51% of CJSC Aquaфон GSM, (“Aquaфон”) a mobile operator in the Republic of Abkhazia, which owns GSM 900/1800 and UMTS licenses, frequencies and numbering capacity, and 51% of CJSC Ostelecom (“Ostelecom”), a company holding a mobile license and frequencies in the Republic of South Ossetia. The Company has consolidated the financial position and the results of operations of Debton, including Aquaфон and Ostelecom, from the date of acquisition.

The primary reason for this acquisition was to facilitate the Company’s entry into the mobile

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## Notes to Unaudited Condensed Consolidated Financial Statements (continued)

### 3. Business Combination (continued)

telephony market in the Republics of Abkhazia and South Ossetia, where the Company did not previously have a license to conduct cellular operations, as part of the development of its mobile operations in the Caucasus region generally.

The Company's condensed consolidated financial statements reflect the preliminary allocation of the purchase price based on a preliminary fair value assessment of the assets acquired and liabilities assumed. The fair value of acquired identifiable net assets amounted to approximately 728. The Company has assigned approximately 1,113 to goodwill and intangible assets. 902 is attributable to noncontrolling interest. The purchase price allocation will be finalized upon completion of the valuation of the acquired fixed and intangible assets.

### 4. Revenues

Revenues for the three months ended March 31 are as follows:

	<b>2008</b>	<b>2009</b>
Revenues from local subscribers	31,762	<b>34,853</b>
Revenues from interconnection charges	5,380	<b>6,006</b>
Roaming charges to other wireless operators	440	<b>393</b>
Connection fees	91	<b>15</b>
Sales of handsets and accessories	—	<b>618</b>
Other revenues	116	<b>311</b>
<b>Total revenues</b>	<b>37,789</b>	<b>42,196</b>

### 5. Cost of Services

Cost of services for the three months ended March 31 is comprised of:

	<b>2008</b>	<b>2009</b>
Interconnection charges	6,624	<b>7,294</b>
Roaming expenses	497	<b>537</b>
Cost of SIM-cards	176	<b>259</b>
Cost of handsets and accessories sold	—	<b>678</b>
Other costs	—	<b>28</b>
<b>Total cost of services</b>	<b>7,297</b>	<b>8,796</b>

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## Notes to Unaudited Condensed Consolidated Financial Statements (continued)

### 6. Sales and Marketing Expenses

Sales and marketing expenses for the three months ended March 31 are as follows:

	<u>2008</u>	<u>2009</u>
Advertising	1,473	<b>1,105</b>
Commissions to dealers for connection of new subscribers	1,239	<b>1,022</b>
Commissions to dealers for distribution of prepaid cards and for cash collection from subscribers	701	<b>670</b>
<b>Total sales and marketing expenses</b>	<u>3,413</u>	<u><b>2,797</b></u>

### 7. Operating Expenses

Operating expenses for the three months ended March 31 are as follows:

	<u>2008</u>	<u>2009</u>
Salaries and social charges	2,735	<b>3,304</b>
Rent	1,619	<b>2,075</b>
Operating taxes	1,001	<b>1,131</b>
Network repairs and maintenance	795	<b>889</b>
Radio frequency fees	512	<b>617</b>
Office maintenance	320	<b>319</b>
Professional services	127	<b>148</b>
Materials and supplies	87	<b>43</b>
Insurance	78	<b>52</b>
Other expenses	850	<b>1,112</b>
<b>Total operating expenses</b>	<u>8,124</u>	<u><b>9,690</b></u>

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

### 8. Derivative Financial Instruments and Fair Value Measurements

In the third quarter of 2006 and the second quarter of 2007, the Company entered into several long-term fixed-to-fixed rate cross-currency swaps. These derivative financial instruments are used to limit exposure to changes in foreign currency exchange rates on certain long-term debt denominated in foreign currencies.

The swaps effectively converted, using the then-effective foreign currency exchange rates, some of the Company's outstanding fixed-to-fixed rate long-term US dollar and Euro denominated loans (specifically the EKN, Finnvera, Finnvera II and Finnvera III Credit Facilities ) into synthetically equivalent Ruble long-term loans with fixed rates ranging from 3.95% to 6.65%. The carrying amount of such long-term loans was 7,006 as of December 31, 2008 and 7,845 as of March 31, 2009.

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## Notes to Unaudited Condensed Consolidated Financial Statements (continued)

### 8. Derivative Financial Instruments and Fair Value Measurements (continued)

For accounting purposes, the Company has chosen not to designate these fixed to fixed rate cross-currency swaps as hedging instruments and, therefore reports all gains and losses from the change in fair value (Level 2) of these derivative financial instruments directly in the consolidated statements of operations.

The tabular disclosure of fair value of these derivative financial instruments in the condensed consolidated balance sheet is presented below:

<b>Balance sheet location</b>	<b>December 31, 2008</b>	<b>March 31, 2009</b>
Other current assets	888	1,059
Other non-current assets	1,342	1,412

### 9. Long Term Incentive Program

In April 2008, the Company's Board of Directors approved a long-term motivation and retention program. The program provides that certain key executive and senior level employees will be eligible for awards of options to acquire phantom shares at an exercise price of 1 Ruble each. A maximum of 4,554 million phantom share options will be awarded to all participants. The value ascribed to the full package of phantom share options for which options may be awarded is 1.1% of the value of the Company, which in turn is calculated as six times earnings before interest, taxes, depreciation and amortization (EBITDA) reduced by debt, net of cash and cash equivalents and short-term investments (net debt). The value of the phantom shares will be re-calculated as of December 31, 2009 and participants in the program will be permitted to exercise 50% of their options, assuming continued employment by the Company, in May 2010. The value of the remaining 50% of options will be re-calculated again as of December 31, 2011 and participants in the program will be permitted to exercise the remainder of their options, assuming continued employment by the Company, in May 2012. The in-the-money phantom share options will be settled in cash.

As of March 31, 2009, the Company has granted 4,101 million phantom share options to its employees and recorded compensation expense of approximately 195 inclusive of all related taxes for the three months ended March 31, 2009.

As of March 31, 2009, total unrecognized compensation cost related to non-vested phantom share options is approximately 1,250, which is expected to be recognized over a weighted-average period of 4 years.

### 10. 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 by a market economy. The future stability of the Russian economy is largely dependent upon these reforms and developments and the effectiveness of economic,

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# MegaFon

## Notes to Unaudited Condensed Consolidated Financial Statements (continued)

### 10. Commitments, Contingencies and Uncertainties (continued)

financial and monetary measures undertaken by the government.

Recently Russia, like many other countries, is experiencing economic instability. This instability has been characterized by a steep decline in the value of shares traded on its stock exchanges, devaluation of its currency, accelerating capital flight and a decline in gross domestic product in 2009. The concomitant global credit crisis and the related turmoil in the global financial system have had and may continue to have a material negative impact on the Russian economy. This ongoing global financial crisis has resulted in capital markets instability, significant deterioration of liquidity in the banking sector, and tighter credit conditions within Russia. While the Russian government has introduced a range of stabilization measures aimed at providing liquidity and supporting refinancing of foreign debt for Russian banks and companies, there continues to be uncertainty regarding the economy, general business conditions, access to capital and the marginal cost of such capital for the Company and its counterparties as well as consumer purchase patterns, which could affect the Company's financial position, results of operations and business prospects. Additionally, because Russia produces and exports large amounts of oil, its economy is particularly vulnerable to the price of oil on the world market and the recent significant decreases in international oil prices from the previous high levels experienced in early 2008 have adversely affected and may continue to adversely affect its economy.

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.

#### *Telecom licenses capital commitments*

In April 2007, MegaFon was awarded a license that expires on May 21, 2017, for the provision of "3G" mobile radiotelephony communications services for the entire territory of the Russian Federation. The 3G license was granted subject to certain capital commitments. The three major conditions are that the Company will have to build a certain number of base stations that support 3G standards, will have to 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 will have to 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 June 12, 2009, the date of consolidated financial statements issuance, the Company continues to comply with its 2009 obligations and the planned construction of base stations in compliance with the license requirements.

#### *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 the transactions and activity of the Company may be challenged by the relevant regional and federal authorities. Recent events within the Russian Federation suggest that the tax authorities are taking a more assertive position in their interpretation and enforcement of

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# MegaFon

## Notes to Unaudited Condensed Consolidated Financial Statements (continued)

### 10. Commitments, Contingencies and Uncertainties (continued)

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. It is not practical to determine the amount of claims that may be asserted, if any, or the likelihood of any unfavorable outcome. 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.

Based on tax examinations of other telecommunications companies operating in Russia, the tax authorities are currently focusing on a number of specific areas, which include, but are not limited to revenues from interconnection charges. As a result of such examinations, the tax authorities are claiming additional taxes which are currently being disputed in the courts by these Russian telecommunications companies.

Management believes that the Company and its subsidiaries are in compliance with the tax laws affecting its operations; however, the risk remains that governmental authorities could take differing positions with regard to interpretative issues.

#### *Litigation*

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

#### *Commitments*

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 million unlocked 3G iPhone handsets over a two-year period for further resale in Russia. The Company fulfilled its requirement with respect to the fourth quarter of 2008 but, because of its inability to re-sell all of the iPhones purchased from Apple due to significantly reduced demand as a result of the economic crisis in Russia, the Company did not purchase any iPhones from Apple in the first quarter of 2009 and through June 12, 2009. The Company is in discussions with Apple and believes that Apple is amenable to certain revisions to the quarterly purchase requirement to reflect the decline in sales in Russia, although to date the terms of this have not been discussed in detail. In the event that no revision can be agreed, it is possible that Apple could declare the Company to be in default under the Agreement and bring a claim against the Company. In light of the aforementioned uncertainty, the Company is not able to estimate the amount of loss, if any, that the Company may sustain.

In March 2009, the Company entered into an eighteen-month distribution contract with one of the largest Russian mobile retailers to connect approximately 7.2 million subscribers. The

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# MegaFon

## Notes to Unaudited Condensed Consolidated Financial Statements (continued)

### **10. Commitments, Contingencies and Uncertainties (continued)**

total cash consideration for this deal was approximately \$146 million, of which approximately \$97 million has been prepaid and a promissory note has been issued for the remaining amount in the second quarter of 2009.

### **11. Subsequent Events**

In April 2009, the Company and another telecommunications operator entered into an agreement with the Organizational Committee of the 2014 XXII Olympic Winter Games and XI Paralympic Winter Games in Sochi, to acquire rights and licenses to use the Olympic mascot, logos, and other Olympic symbols. Under the agreement the Company committed to a payment of \$65 million in cash to be made in several installments from 2009 through 2014. In addition, the Company and the other telecommunications operator are jointly responsible to provide services in-kind of up to \$130 million. In May 2009, the Company prepaid \$13 million under the agreement.

In June 2009, the Company entered into a credit facility agreement with China Development Bank Corporation (“China Development Bank III Credit”) for up to \$300 million with interest at LIBOR plus 2.7%. The proceeds under the credit facility can only be used for purchases of Huawei equipment. Amounts drawn down from this credit facility are repayable during 2011-2016 in semi-annual installments. As of March 31, 2009, the outstanding amount due to Huawei was approximately \$7.5 million (255.8 at the exchange rate as of March 31, 2009). The Company intends to repay this amount using the proceeds from the China Development Bank III Credit.