



**MEGAFON**

**Condensed Consolidated Financial Statements**  
(Unaudited)

*Three and six months ended June 30, 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 June 30, 2009, and the related condensed consolidated statements of operations and cash flows for the three and six months ended June 30, 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.

*Ernst & Young LLC*

September 7, 2009

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# MegaFon

## Condensed Consolidated Balance Sheets

(In millions of Rubles)

	<b>December 31, 2008</b>	<b>June 30, 2009 (Unaudited)</b>
<b>Assets</b>		
Current assets:		
Cash and cash equivalents	6,465	17,894
Short-term investments	33,738	41,337
Accounts receivable, net of allowance for doubtful accounts of 511 and 1,148 at December 31, 2008 and June 30, 2009, respectively	5,698	4,572
Inventory	2,352	1,267
VAT receivable	2,640	2,596
Deferred tax assets	1,167	802
Prepaid expenses	4,942	9,104
Other current assets	1,227	1,049
Total current assets	58,229	78,621
Property, plant and equipment, net of accumulated depreciation of 75,515 and 88,275 at December 31, 2008 and June 30, 2009, respectively	128,691	129,379
Goodwill and intangible assets, net of accumulated amortization of 14,411 and 15,789 at December 31, 2008 and June 30, 2009, respectively (Note 3)	13,512	14,493
Other non-current assets	2,317	1,654
Total assets	202,749	224,147

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>June 30, 2009 (Unaudited)</b>
<b>Liabilities</b>		
Current liabilities:		
Accounts payable	6,263	5,565
Accounts payable to equipment suppliers	5,728	2,823
Accrued compensation and social contributions	2,031	1,539
Subscribers' prepayments	6,182	4,869
Taxes payable	1,012	1,238
VAT payable	2,187	3,949
Deferred revenue	247	266
Loans from shareholders	97	–
Current portion of long-term debt	15,660	16,947
Other current liabilities	516	826
Total current liabilities	39,923	38,022
Debt, less current portion	16,223	17,293
Loans from shareholders, less current portion	3,647	3,977
Deferred tax liabilities, less current portion	2,159	2,053
Asset retirement obligations	2,349	2,902
Other non-current liabilities	322	814
Total liabilities	64,623	65,061
<b>Equity</b>		
MegaFon shareholders' equity:		
Common stock (par value of 10 Rubles, 6,200,002 shares authorized, issued and outstanding)	581	581
Reserve fund	17	17
Additional paid-in capital	13,875	13,875
Retained earnings	123,910	144,031
Accumulated other comprehensive loss	(257)	(290)
Total MegaFon shareholders' equity	138,126	158,214
Noncontrolling interest	–	872
Total Equity	138,126	159,086
Total liabilities and equity	202,749	224,147

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)

	Three months ended June 30,		Six months ended June 30,	
	2008	2009	2008	2009
<b>Revenue</b> (Note 4)	42,420	<b>43,878</b>	80,209	<b>86,074</b>
Cost of services (excluding depreciation and amortization) (Note 5)	8,324	<b>8,849</b>	15,621	<b>17,645</b>
<b>Gross margin</b>	34,096	<b>35,029</b>	64,588	<b>68,429</b>
Sales and marketing expenses (excluding depreciation and amortization) (Note 6)	4,482	<b>4,325</b>	7,895	<b>7,122</b>
Operating expenses (excluding depreciation and amortization) (Note 7)	9,069	<b>10,038</b>	17,193	<b>19,728</b>
Depreciation, amortization and accretion	6,843	<b>7,812</b>	13,511	<b>15,397</b>
<b>Operating income</b>	13,702	<b>12,854</b>	25,989	<b>26,182</b>
Other income/(expense):				
Interest expense	(459)	<b>(372)</b>	(999)	<b>(781)</b>
Interest income	706	<b>510</b>	1,274	<b>1,218</b>
Other gain/(loss), net	15	<b>(65)</b>	30	<b>(41)</b>
Loss on derivatives, net (Note 8)	(261)	<b>(743)</b>	(219)	<b>(502)</b>
Foreign currency exchange gain/ (loss), net	108	<b>(1,007)</b>	388	<b>(566)</b>
<b>Total other income/(expense), net</b>	109	<b>(1,677)</b>	474	<b>(672)</b>
<b>Income before income taxes and noncontrolling interest</b>	13,811	<b>11,177</b>	26,463	<b>25,510</b>
Provision for income taxes	3,738	<b>2,183</b>	7,145	<b>5,408</b>
<b>Net income</b>	10,073	<b>8,994</b>	19,318	<b>20,102</b>
Net loss attributable to noncontrolling interest	(8)	<b>(1)</b>	(20)	<b>(19)</b>
<b>Net income attributable to MegaFon</b>	10,081	<b>8,995</b>	19,338	<b>20,121</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>Six months ended June 30,</b>	
	<b>2008</b>	<b>2009</b>
<b>Net cash provided by operating activities</b>	35,137	35,298
<b>Cash flows from investing activities:</b>		
Purchases of property, plant and equipment and intangible assets	(17,539)	(17,647)
Proceeds from sale of property, plant and equipment	19	51
Acquisitions of subsidiaries, net of cash acquired	–	(553)
Increase in short-term investments	(6,130)	(5,226)
Net cash used in investing activities	(23,650)	(23,375)
<b>Cash flows from financing activities:</b>		
Proceeds from long-term debt	2,330	4,431
Repayments of long-term debt	(6,620)	(3,557)
Deferred finance charges paid	–	(243)
Net cash provided by/(used in) financing activities	(4,290)	631
Effect of exchange rate changes on cash and cash equivalents	(4)	(1,125)
<b>Net increase in cash and cash equivalents</b>	7,193	11,429
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>	11,452	17,894
<b>Supplemental cash flow information:</b>		
Cash paid during the period for income taxes	6,931	6,437
Cash paid during the period for interest	1,001	829
Non-cash financing and investing activities:		
Equipment purchased under credit	120	624

*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 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 and six months ended June 30, 2009 are not indicative of the operating results for the full year. These financial statements include information updated and subsequent events evaluated through September 7, 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 (“RUR”) 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.

During the six months ended June 30, 2009, the RUR exchange rate established by the Russian Central Bank significantly fluctuated in comparison to major currencies. The RUR depreciated against the US dollar from 29.3916 RUR per US dollar at January 1, 2009 to 31.2904 at June 30, 2009, the reporting date, which represents a 6.5% decline in the RUR value. At September 7, 2009, the date of issuance of the condensed consolidated financial statements, the exchange rate was 31.6062 RUR 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 six months ended June 30, 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 June 30, 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 FASB issued SFAS No. 157, "Fair Value Measurements" ("SFAS No. 157"). The standard establishes a framework for measuring fair value in US GAAP, clarifies the definition of fair value within that framework, and expands disclosures about the use of fair value measurements. SFAS No. 157 is effective for fiscal years beginning after

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

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

November 15, 2007. In February 2008, the FASB issued FASB Staff Position ("FSP") SFAS No. 157-2, "*Effective Date of FASB Statement No. 157*". This FSP deferred the effective date of SFAS No. 157, for non-financial assets and liabilities that are not on a recurring basis recognized or disclosed at fair value in the financial statements, to fiscal years, and interim periods, beginning after November 15, 2008. 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 April 2009, the FASB issued FSP No. FAS 157-4, which provides guidance on (1) estimating the fair value of an asset or liability (financial and nonfinancial) when the volume and level of activity for the asset or liability have significantly decreased and (2) identifying transactions that are not orderly. The FSP is effective for interim and annual periods ending after June 15, 2009. The adoption of FSP No. FAS 157-4 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, 2009. The adoption of SFAS No. 157-3 did not have a significant effect on the Company's 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; (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

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

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

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.

In April 2009, the FASB issued FSP No. FAS 141(R)-1, *“Accounting for Assets Acquired and Liabilities Assumed in a Business Combination That Arise from Contingencies”*. FSP No. 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 No. FAS 141(R)-1 provides guidance on initial recognition and measurement and subsequent measurement and accounting. FSP No. FAS 141(R)-1 is 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 No. FAS 141(R)-1 did not have a material impact on the Company's financial statements.

In April 2009, the FASB issued FSP No. FAS 115-2 and FAS 124-2, *“Recognition and Presentation of Other-Than-Temporary Impairments”*. FSP No. 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 No. FAS 115-2 and FAS 124-2 replaces the current requirement that a holder have the positive intent and ability to hold an impaired

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

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

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 No. FAS 115-2 and FAS 124-2 is effective for interim and annual reporting periods ending after June 15, 2009. The adoption of FSP No. FAS 115-2 and FAS 124-2 did not have a significant effect on the Company's financial statements.

In April 2009, the FASB issued FSP No. FAS 107-1 and APB 28-1, "*Interim Disclosures about Fair Value of Financial Instruments*". This FSP requires enhanced disclosures on financial instruments, and is effective for interim reporting periods ending after June 15, 2009. The adoption of FSP No. FAS 107-1 and APB 28-1 did not have a significant effect on the Company's 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 June 15, 2009. The adoption of SFAS No. 165 did not have a significant effect on the Company's financial statements.

In June 2009, the FASB issued Statement of Financial Accounting Standards No. 166, "*Accounting for Transfers of Financial Assets – an amendment of FASB Statement No. 140*" (SFAS No. 166). SFAS No. 166 amends FASB Statement of Financial Accounting Standards No. 140, "*Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*" (SFAS No. 140), removing the concept of a qualifying special-purpose entity, and removing the exception from applying FASB Interpretation No. 46(R) (revised December 2003), "*Consolidation of Variable Interest Entities*" (FIN 46(R)), to qualifying special-purpose entities. This statement is effective for both interim and annual periods as of the beginning of each reporting entity's first annual reporting period that begins after November 15, 2009, and its impact will vary with each future transfer of financial assets.

In June 2009, the FASB issued Statement of Financial Accounting Standards No. 167, "*Amendments to FASB Interpretation No. 46(R)*" (SFAS No. 167). SFAS No. 167 amends FIN 46(R), to require an enterprise to perform an analysis to determine whether the enterprise's variable interest or interests give it a controlling financial interest in a variable interest entity. This statement is effective for both interim and annual periods as of the beginning of each reporting entity's first annual reporting period that begins after November 15, 2009. The Company is currently evaluating the impact of SFAS No. 167 on its financial statements.

In June 2009, the FASB issued SFAS No. 168, "*The FASB Accounting Standards Codification™ and the Hierarchy of Generally Accepted Accounting Principles, a replacement of FASB Statement No. 162*", which is effective for interim and annual periods ending after September 15, 2009. SFAS No. 168 makes the FASB Accounting Standards Codification ("Codification") the single authoritative source for US GAAP. The Codification

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

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

replaces all previous US GAAP accounting standards. The adoption of SFAS No. 168 will only impact references for accounting guidance.

### 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 Aquafon GSM, (“Aquafon”) 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 Aquafon and Ostelecom, from the date of acquisition.

The primary reason for this acquisition was to facilitate the Company’s entry into the mobile telephony market in the Republics of Abkhazia and South Ossetia, where the Company did not previously have a license to conduct mobile services.

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 and 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 six months ended June 30 are as follows:

	<u>2008</u>	<u>2009</u>
Revenues from local subscribers	67,404	<b>71,136</b>
Revenues from interconnection charges	11,347	<b>12,380</b>
Roaming charges to other wireless operators	1,014	<b>931</b>
Connection fees	154	<b>31</b>
Sales of handsets and accessories	—	<b>991</b>
Other revenues	290	<b>605</b>
<b>Total revenues</b>	<u>80,209</u>	<u><b>86,074</b></u>

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

### 5. Cost of Services

Cost of services for the six months ended June 30 are as follows:

	<b>2008</b>	<b>2009</b>
Interconnection charges	14,050	<b>15,001</b>
Roaming expenses	1,120	<b>975</b>
Cost of SIM-cards	451	<b>581</b>
Cost of handsets and accessories sold	—	<b>1,059</b>
Other costs	—	<b>29</b>
<b>Total cost of services</b>	<b>15,621</b>	<b>17,645</b>

### 6. Sales and Marketing Expenses

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

	<b>2008</b>	<b>2009</b>
Advertising	3,451	<b>2,823</b>
Commissions to dealers for connection of new subscribers	2,974	<b>2,822</b>
Commissions to dealers for distribution of prepaid cards and for cash collection from subscribers	1,470	<b>1,477</b>
<b>Total sales and marketing expenses</b>	<b>7,895</b>	<b>7,122</b>

### 7. Operating Expenses

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

	<b>2008</b>	<b>2009</b>
Salaries and social charges	5,755	<b>6,478</b>
Rent	3,340	<b>4,287</b>
Operating taxes	2,221	<b>2,271</b>
Network repairs and maintenance	1,729	<b>1,865</b>
Radio frequency fees	1,058	<b>1,269</b>
Office maintenance	706	<b>677</b>
Inventory write-down	—	<b>332</b>
Professional services	377	<b>319</b>
Materials and supplies	183	<b>124</b>
Insurance	126	<b>92</b>
Other expenses	1,698	<b>2,014</b>
<b>Total operating expenses</b>	<b>17,193</b>	<b>19,728</b>

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

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# MegaFon

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

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

The Company measures financial assets and financial liabilities at fair value on a recurring basis.

The Company follows the provisions of SFAS No. 157, "*Fair Value Measurements*", and considers the following three levels of inputs to measure the fair value:

Level 1: Quoted prices for identical assets or liabilities in active markets that the entity has the ability to access as of the measurement date.

Level 2: Quoted prices for similar instruments in active markets; quoted prices for identical or similar instruments in markets that are non-active; inputs other than quoted prices that are observable and derived from or corroborated by observable market data.

Level 3: Valuations derived from valuation techniques in which one or more significant inputs are unobservable.

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 5,204 as of June 30, 2009.

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 fixed-rate cross-currency swaps are valued using standard valuation techniques as no quoted market prices exist for the instruments. The principal technique used to value these instruments is through comparing the foreign currency exchange rates at the time that the derivatives were acquired to the forward exchange rates quoted in the existing market which is inactive as of the valuation date. The key inputs include interest rate yield curves, foreign exchange spot and forward rates. The fair value of fixed-rate cross-currency swaps includes the effects of the counterparty's non-performance risk, including credit risk.

# MegaFon

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

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

Fair values of these derivative financial instruments in the condensed consolidated balance sheet are presented below:

	<b>December 31, 2008</b>	<b>June 30, 2009</b>
Other current assets	888	729
Other non-current assets	1,342	663

As of June 30, 2009, the fair value of variable rate debt approximates its carrying value. The carrying value and fair value of fixed rate long-term loans (based on future cash flows discounted at current market rates) was as follows at June 30:

	<b>Carrying amount</b>	<b>Fair Value</b>
Long-term debt	38,230	38,234

The fair value of other financial instruments not included in the table above approximates carrying amount.

### 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 June 30, 2009, the Company has granted 3,932 million phantom share options to its employees and recorded compensation expense of approximately 353 inclusive of all related taxes for the six months ended June 30, 2009.

As of June 30, 2009, total unrecognized compensation cost related to non-vested phantom share options is approximately 1,002 which is expected to be recognized over a weighted-average period of 3 years.

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

### 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, financial and monetary measures undertaken by the government.

Recently Russia, like many other countries, has been experiencing economic instability. Since Russia produces and exports large amounts of oil and metals, its economy is particularly vulnerable to prices of energy and commodities in the world market. Hence, the recent decreases in such international prices from the previous high levels experienced in early 2008 have adversely affected and may continue to adversely affect the Russian economy. The Russian economic instability has caused declines in the value of shares traded on its stock exchanges, devaluation of the national currency, accelerating capital flight, increasing unemployment, and declining gross domestic product. Russia has also shared in the effects of the ongoing global financial and economic crisis, such as frozen capital markets, heightened risk aversion, significantly reduced liquidity in the banking sector, and tightened credit conditions generally. While the Russian government, like many other governments, has taken a number of stabilization measures to provide liquidity and credit to Russian banks and companies, and also to prop up general employment and consumer income, there continues to be uncertainty regarding the economy, general business conditions, access to capital and the general economic health of the consumer, all of which could continue to adversely affect the Company's 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.

#### *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 September 7, 2009, the date of consolidated financial statements issuance, the Company continues to comply with its 2009 obligations, including constructing the required number of base stations under the license requirements.

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# MegaFon

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

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

#### *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 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 during six months of 2009 and through September 7, 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

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## MegaFon

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

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

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 June 2009, the Company recorded an inventory write-down to lower-of-cost-or-market value of 242 related to its iPhones stock.

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.

#### **11. Subsequent Events**

##### *Merger*

On July 1, 2009, the Company merged with its subsidiaries, Sonic Duo, MSS-Povolzhie, Mobicom-Centre, Uralsky GSM, Mobicom-Kavkaz, Mobicom-Novosibirsk and Mobicom-Khabarovsk.