

MEGAFON

Condensed Consolidated Financial Statements

Three months ended March 31, 2007 and 2006

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Condensed Consolidated Balance Sheets

(In millions of Rubles, except as stated)

(Note 1)

	<i>Note</i>	December 31, 2006	March 31, 2007	March 31, 2007
				Convenience translation, thousands US \$
Assets				
Current assets:				
Cash and cash equivalents		6,965	13,098	\$ 503,534
Short-term investments		569	3,356	129,019
Accounts receivable, net of allowance for doubtful accounts of 203 in 2007 and 143 in 2006		4,740	4,600	176,832
Accounts receivable, related parties		418	508	19,520
Inventories		457	458	17,604
VAT receivable		3,322	2,865	110,159
Deferred tax assets	3	739	923	35,493
Prepayments and other current assets		2,272	2,150	82,669
Total current assets		19,482	27,958	1,074,830
Property, plant and equipment, net of accumulated depreciation of 38,052 in 2007 and 34,890 in 2006		87,812	88,592	3,405,921
Intangible assets, net of accumulated amortization of 11,201 in 2007 and 10,435 in 2006		13,725	13,447	516,972
Other non-current assets		1,680	1,862	71,585
Total assets		122,699	131,859	\$ 5,069,308
Liabilities and shareholders' equity				
Current liabilities:				
Accounts payable		4,553	5,363	\$ 206,186
Accounts payable and accruals to equipment suppliers		2,387	1,624	62,446
Accounts payable, related parties		586	525	20,166
Subscribers' prepayments		5,515	4,487	172,499
Deferred revenue, current portion		1,238	1,536	59,070
Accrued liabilities		2,663	3,800	146,103
Debt, current portion		7,496	8,316	319,712
Other current liabilities		143	183	7,017
Total current liabilities		24,581	25,834	993,199
Debt, net of current portion		31,893	33,535	1,289,242
Loans from shareholders		3,241	3,259	125,294
Other non-current liabilities		1,945	2,159	82,973
Deferred tax liabilities	3	1,449	1,031	39,633
Total liabilities		63,109	65,818	2,530,341
Commitments and contingencies	8	-	-	-
Minority interest		55	53	2,059
Shareholders' equity:				
Common stock (par value of 10 Rubles, 6,200,002 shares authorized, issued and outstanding)		581	581	22,338
Reserve fund		17	17	661
Additional paid-in capital		13,875	13,875	533,409
Retained earnings		45,309	51,762	1,989,994
Accumulated other comprehensive income		(247)	(247)	(9,494)
Total shareholders' equity		59,535	65,988	2,536,908
Total liabilities and shareholders' equity		122,699	131,859	\$ 5,069,308

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

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Condensed Consolidated Statements of Operations

(In millions of Rubles, except as stated)

(Note 1)

	Note	Three months ended March 31,		
		2006	2007	2007 Convenience translation, thousands US \$
Revenues	4	19,720	29,338	\$ 1,127,879
Cost of services, excluding depreciation and amortization	5	2,975	5,731	220,329
Gross margin		16,745	23,607	907,550
Sales and marketing expenses	6	2,290	2,972	114,267
Operating expenses	7	4,795	6,358	244,424
Depreciation and amortization		4,761	5,406	207,831
Operating income		4,899	8,871	341,028
Other income and expenses:				
Interest expense		765	626	24,057
Change in fair value of derivative financial instruments (C-loans)		358	—	—
Other income, net		(73)	(141)	(5,419)
Net foreign exchange gain		(1,324)	(136)	(5,236)
Total other (income)/ expenses, net		(274)	349	13,402
Income before income taxes and minority interest		5,173	8,522	327,626
Provision for income taxes	3	1,448	2,387	91,735
Minority interest in net earnings of a subsidiary		5	(2)	(59)
Net income		3,720	6,137	\$ 235,950

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

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Condensed Consolidated Statements of Cash Flows

(In millions of Rubles, except as stated)

(Note 1)

	Three months ended March 31,		
	2006	2007	2007
			Convenience translation, thousands US \$
Cash flows from operating activities:			
Net income	3,720	6,137	\$ 235,950
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization	4,761	5,406	207,831
Net foreign exchange gain	(1,324)	(136)	(5,236)
Minority interest in earnings of a subsidiary	5	(2)	(59)
Provision for deferred income taxes	(599)	(697)	(26,803)
Change in fair value of derivative financial instruments (C-loans)	358	-	-
Amortization of deferred finance charges and other non-cash items	276	317	12,203
Decrease/(increase) in:			
Accounts receivable	141	81	3,101
Accounts receivable, related parties	(11)	(90)	(3,450)
Inventories	131	(1)	(27)
VAT receivable	571	457	17,565
Prepayments and other current assets	78	274	10,522
Increase/(decrease) in:			
Accounts payable	345	813	31,273
Accounts payable, related parties	15	38	1,469
Deferred revenue	176	291	11,191
Subscribers' prepayments	(809)	(1,028)	(39,516)
Accrued liabilities	751	1,141	43,880
Net cash provided by operating activities	8,585	13,001	499,894
Cash flows from investing activities:			
Purchases of property, plant and equipment and intangible assets	(5,116)	(5,769)	(221,815)
Proceeds from sale of property, plant and equipment	-	20	781
Increase in short-term investments	-	(2,800)	(107,643)
Other non-current assets	89	(10)	(374)
Net cash used in investing activities	(5,027)	(8,559)	(329,051)
Cash flows from financing activities:			
Proceeds from long-term debt	1,374	2,409	92,619
Repayments of long-term debt	(1,052)	(629)	(24,201)
Deferred finance charges paid	(8)	(66)	(2,538)
Capital lease principal repayments	(48)	(4)	(136)
Net cash provided by financing activities	266	1,710	65,744
Effect of exchange rate changes on cash and cash equivalents	(121)	(19)	(803)
Net increase in cash and cash equivalents	3,703	6,133	235,784
Cash and cash equivalents at the beginning of the period	7,872	6,965	267,750
Cash and cash equivalents at the end of the period	11,575	13,098	\$ 503,534
Supplemental cash flow information:			
Cash paid during the period for income taxes	1,417	2,534	\$ 97,434
Cash paid during the period for interest	266	253	9,723
Non-cash financing and investing activities:			
Equipment purchased under credit	149	936	35,969

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

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Notes to Condensed Consolidated Financial Statements

(Amounts 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 wireless telecommunication services to businesses, other telecommunications service providers and retail subscribers.

The financial statements included herein are unaudited and 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 2006 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 2006 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 2006 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, 2007 are not indicative of the operating results for the full year. These financial statements include information updated through June 15, 2007.

As further discussed in Note 2, effective January 1, 2007, the Company’s reporting currency changed from the US dollar to the Ruble.

2. Summary of Significant Accounting Policies

Foreign Currency Translation Methodology

The Company’s functional currency is the Ruble as the largest portion of its revenues, capital expenditures and operating costs are denominated in Rubles.

Until December 31, 2006, the Company used the US dollar as its reporting currency. Effective January 1, 2007, the Company changed its reporting currency from the US dollar to the Ruble, since this is the currency of the prime economic environment in which substantially all operations of the Company are conducted.

Prior period comparative financial statements have been recast to the Ruble using a methodology consistent with Statement of Financial Accounting Standards (“SFAS”) No. 52, “Foreign Currency Translation”. All assets and liabilities were translated using the December 31, 2006 exchange rate. Shareholders’ equity was translated at the applicable historical rates. Income and expenses were translated using quarterly average exchange rate. The objective of this procedure is to present comparative financial statements as if the Company had always used the Ruble as its reporting currency.

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Notes to Condensed Consolidated Financial Statements (continued)

2. Summary of Significant Accounting Policies (continued)

Foreign Currency Translation Methodology (continued)

The US dollar amounts disclosed in the accompanying financial statements are presented solely for the convenience of the reader and have been translated at the exchange rate of 26.0113 Rubles per US dollar as of March 31, 2007, the exchange rate determined by the Central Bank of Russian Federation as of such date. This translation should not be construed as representing that the Ruble amounts actually represent or have been, or could be, converted into US dollars at that exchange rate or at any other rate of exchange.

Accounting for Uncertainty in Income Taxes

On January 1, 2007, the Company adopted the provisions of Financial Accounting Standards Board (“FASB”) Interpretation (“FIN”) No. 48, “Accounting for Uncertainty in Income Taxes—an interpretation of FASB Statement No. 109”. FIN No. 48 clarifies the accounting for uncertainty in income taxes recognized in financial statements in accordance with SFAS No. 109. FIN No. 48 prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. FIN No. 48 also provides guidance on de-recognition, classification, interest and penalties, accounting in interim periods, disclosure, and transition. In addition, FIN No. 48 states that income taxes should not be accounted for under provisions of SFAS No. 5, “Accounting for Contingencies”. The adoption of FIN No. 48 resulted in a cumulative effect adjustment increasing the opening balance of retained earnings as of January 1, 2007, by approximately 316 million Rubles. As of March 31, 2007, an asset for a position expected to be taken of 410 million Rubles was recorded, and included in other current and non-current assets in the amount of 152 million Rubles and 258 million Rubles, respectively.

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 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.

The rate so determined is based on the currently enacted tax rate of 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.

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Notes to Condensed Consolidated Financial Statements (continued)

2. Summary of Significant Accounting Policies (continued)

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, deferred revenue, asset retirement obligation, fair value of derivative financial instruments, income tax provision and recoverability of deferred taxes.

Comprehensive Income

SFAS No. 130, "Reporting Comprehensive Income", requires the reporting of comprehensive income in addition to net income. Comprehensive income is defined as net income plus all other changes in net assets from non-owner sources. For the three months ended March 31, 2006, total comprehensive income included, in addition to net income, foreign currency translation adjustment recorded by the Company as a result of the change of functional currency from the US dollar to the Ruble effective January 1, 2006.

	Three months ended March 31,	
	2006	2007
	<i>(In millions of Rubles)</i>	
Net income	3,720	6,137
Foreign currency translation adjustment	(247)	-
Total comprehensive income	3,473	6,137

Comparative Information

Certain prior year amounts have been reclassified to conform to the current year's presentation.

New Accounting Pronouncements

In September 2006, the FASB issued SFAS No. 157, "Fair Value Measurements", which clarifies the definition of fair value, establishes guidelines for measuring fair value, and expands disclosures regarding fair value measurements. SFAS No. 157 does not require any new fair value measurements and eliminates inconsistencies in guidance found in various prior accounting pronouncements. SFAS No. 157 will be effective for the year ending December 31, 2008. The Company is currently evaluating the impact of adopting SFAS No. 157 on its financial statements.

In February 2007, the FASB issued SFAS No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities, Including an Amendment to SFAS No. 115". SFAS No. 159 permits companies to elect to measure many financial instruments and certain other items at

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Notes to Condensed Consolidated Financial Statements (continued)

2. Summary of Significant Accounting Policies (continued)

New Accounting Pronouncements (continued)

fair value. SFAS No. 159 does not affect any existing accounting standards that require certain assets and liabilities to be carried at fair value. SFAS No. 159 is effective for the year ending December 31, 2008. The Company is currently evaluating the impact of adopting SFAS No. 159 on its financial statements.

3. Income Taxes

Income taxes represent the Company's provision for profit tax. Profit tax is calculated at 24% of taxable profit in 2007 and 2006, in accordance with the legislation of the Russian Federation.

The difference between the income tax expense reported in the accompanying condensed consolidated financial statements and the income before taxes for the three months ended March 31, 2007 and 2006, multiplied by the Russian statutory tax rate, is mainly due to expenses which are non-deductible for income tax purposes.

4. Revenues

Revenues for the three months ended March 31 are comprised of:

	2006	2007
	<i>(In millions of Rubles)</i>	
Revenues from local subscribers	18,655	25,098
Roaming charges to other wireless operators	464	476
Revenues from interconnection charges	449	3,560
Connection fees	88	104
Other revenues	64	100
Total revenues	19,720	29,338

5. Cost of Services

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

	2006	2007
	<i>(In millions of Rubles)</i>	
Interconnection charges	2,354	5,124
Cost of SIM-cards	291	199
Roaming expenses	307	408
Other	23	-
Total cost of services	2,975	5,731

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Notes to Condensed Consolidated Financial Statements (continued)

6. Sales and Marketing Expenses

Sales and marketing expenses for the three months ended March 31 are comprised of:

	2006	2007
	<i>(In millions of Rubles)</i>	
Advertising	932	1,368
Commissions to dealers for connection of new subscribers	913	995
Commission to dealers for distribution of prepaid cards and for cash collection from subscribers	439	578
Other	6	31
Total sales and marketing expenses	2,290	2,972

7. Operating Expenses

Operating expenses for the three months ended March 31 are comprised of:

	2006	2007
	<i>(In millions of Rubles)</i>	
Salaries and social charges	1,552	2,103
Rent	819	1,141
Network repairs and maintenance	610	753
Operating taxes	598	781
Materials and supplies	207	140
Office maintenance	188	212
Professional services	131	93
Radio frequency fees	132	349
Insurance	54	72
Other expenses, net	504	714
Total operating expenses	4,795	6,358

8. Commitments and Contingencies

Operating Environment

While there have been improvements in the Russian economy over the past few years, such as an increasing gross domestic product and a reducing rate of inflation, Russia remains in a continuing process of economic reform and development of its legal, tax and regulatory frameworks, all of which are required in order for it to develop a stable market economy.

Further growth and the positive development of the Russian economy are largely dependent on these reforms and developments being implemented and the effectiveness of economic, financial and monetary measures undertaken by the Russian government.

Notes to Condensed Consolidated Financial Statements (continued)

8. Commitments and Contingencies (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 unasserted claims that may arise, 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. In the second quarter of 2007, Russian tax authorities commenced an examination of the Company's tax returns for 2004 through 2006 that is anticipated to be completed by the end of 2007.

Based on tax examinations of other telecommunications companies operating in Russia, 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, tax authorities are claiming additional taxes which are currently being disputed in courts by these Russian telecommunications companies.

Management believes that the Company is 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 some of its subsidiaries have been sued as a result of disputes arising in the ordinary course of their business and operations.

Management believes that the ultimate resolution of the matters mentioned above will not have a material effect on the Company's financial statements.

Other Matters

In April 2007, the results of the tender for the 3G licenses were announced. MegaFon was one of three companies that were granted a federal license allowing them to provide 3G services in Russia. In accordance with the conditions set forth in the tender documentation, the winning companies are required to begin commercial exploitation of a 3G network within the period of two years from the date of granting the license.