

2004 ANNUAL REPORT

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2004 ГОДОВОЙ ОТЧЕТ




Full name – Open Joint Stock Company “MegaFon”  
Short name – OJSC “MegaFon”

30 Kadashevskaya emb., Moscow 115035  
tel. +7 (095) 980 1970  
fax +7 (095) 980 1949  
e-mail: [info@megafon.ru](mailto:info@megafon.ru)  
[www.megafon.ru](http://www.megafon.ru)

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An aerial photograph of a city, likely Tallinn, Estonia. On the left is a tall, ornate Gothic building with a spire. In the foreground, a stone tower with a red-tiled conical roof stands on a hillside. The city extends to the water in the background. The image is overlaid with a blue and green graphic design consisting of curved bands and circles.

Address of the  
Chief Executive  
Officer to the  
Shareholders

About  
the Company

Map  
of licensed  
territory

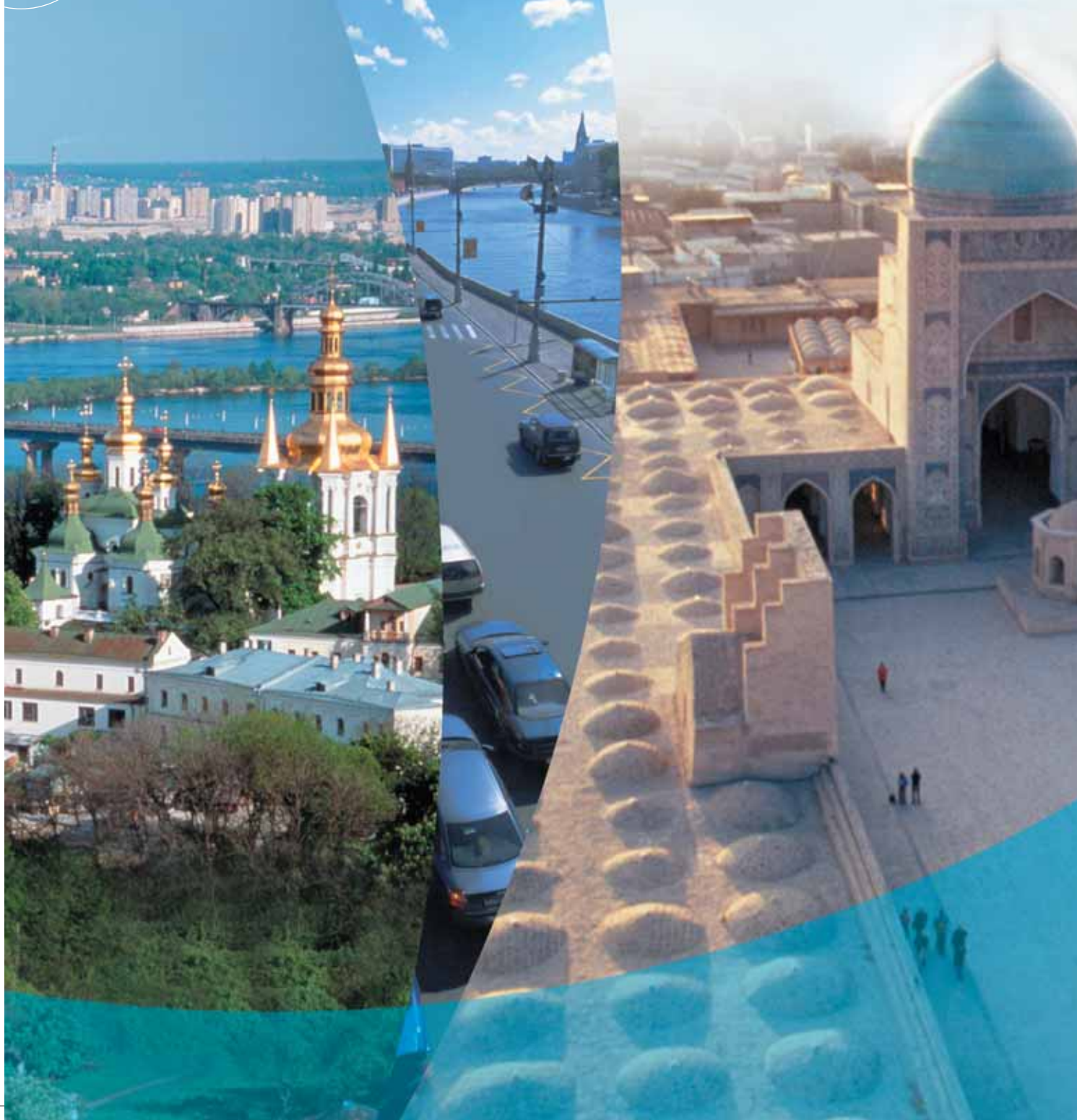
MegaFon 2004  
Key  
Performance  
Indicators

Products  
and  
Services

Results of  
Technical  
Development

Financing

IT-solutions  
in MegaFon  
network



# Address

of the Chief Executive Officer to the Shareholders



**S. V. Soldatenkov**

Chief Executive Officer



Dear Ladies and Gentlemen!

Let me present to you the Annual Report of OJSC “MegaFon” that summarizes the results of the Company’s performance in 2004.

Within 2004 MegaFon business is growing faster than other operators in the “Big III”. During this year the subscriber base of the Company grew from 6.4 mln to 13.6 mln, or 115%.

With such subscriber base growth rates MegaFon managed to keep its market share close to 18%, with significant potential for further growth. While MegaFon’s share in total subscriber base is 18%, its share in total revenue is 20%.

This success has become the result of implementation of the Company’s business-strategy; the main directions of which included strengthening the Company’s position as the all-national operator, expanding the geography of operation and retaining high profitability.

During 2004 the number of RF regions covered by MegaFon network increased to 71. Key events during the first six months of 2004 included entering the Far East market, and covering all licensed territories in the Urals and the Central part of Russia. During the second part of the year MegaFon left no “blank spots” on our footprint map in the Russian Federation from the western boundaries to the Urals inclusive. Network development in the Far East deserves special attention: during the last year MegaFon built and launched networks in five regions of the Far East.

In 2004 OJSC “MegaFon” placed the second tranche of its ruble bonds with total par value of 1.5 billion rubles. At the end of 2004 an important event took place: MegaFon placed its first Eurobond issue. The amount of the issue was US\$375 million, tenor – 5 years, coupon rate - 8.0%. Citigroup and ING were the Joint Lead Arrangers. Market analysts believed the issue to be very successful: the coupon rate proved to be the lowest among Russian telecommunications companies, and the number of requests for buying the bonds exceeded the placement amount more than four times.

Proceeds from the issue were used to finance its previously obtained loans and for general corporate purposes, including the development and expansion of the regional networks.

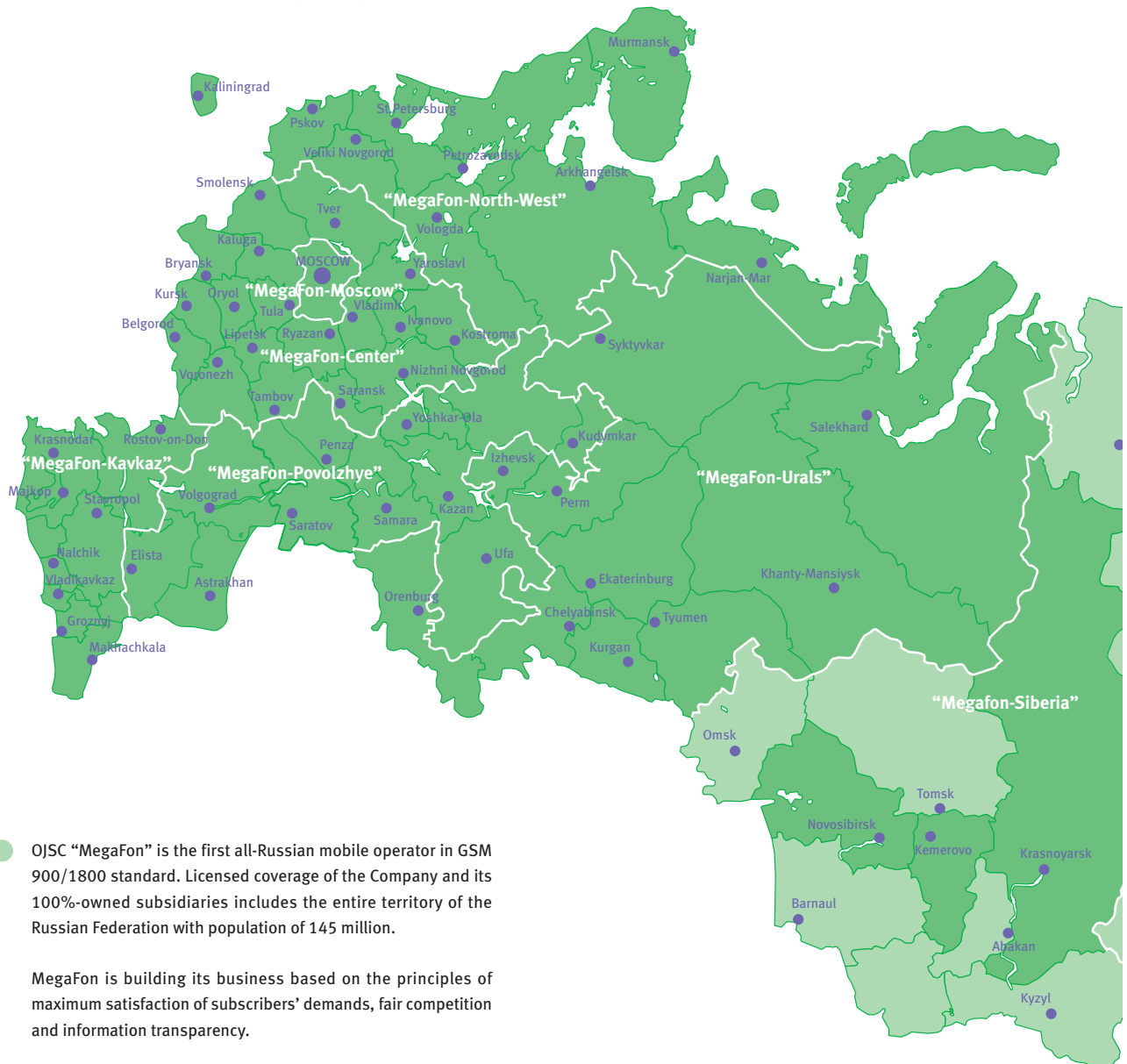
Today Russian telecommunications market is one of the most promising and fast-growing markets in the world, thus investor interest may be easily explained. MegaFon’s successful Eurobond placement is the best evidence of trust that foreign markets demonstrate to our Company with international goodwill that is already solid. International rating agencies Fitch, Moody’s and Standard&Poor’s assigned our debut Eurobond issue BB-, B2 and B+ ratings respectively.

Another positive event was a prestigious “Company of the Year” award which our Company won in the nomination “Telecommunications and New Technologies”. Our victory in this important contest, which was held under support of the RF Ministry of Finance, proved once again MegaFon’s high status in extremely competitive Russian telecommunications market.

I am sure that last year’s achievements will lay a foundation for a profitable and reliable business in the future. Next year we plan to expand our territory of presence in Siberia and the Far East. In the environment of severe competition the most important operator’s features will include ability of flexible response to changes in the market situation, forecast of demand for new services and products as well as their timely implementation. In 2005 MegaFon intends to strengthen its position as the innovative leader in the market. The Company looks forward to obtaining licenses for construction and operation of 3G networks.

In spite of the magnitude of future achievements, I am sure of their successful performance. The Company may rely upon the support from the shareholders and high potential of united team of professionals, and it will continue to expand its business in the future.

# About the Company



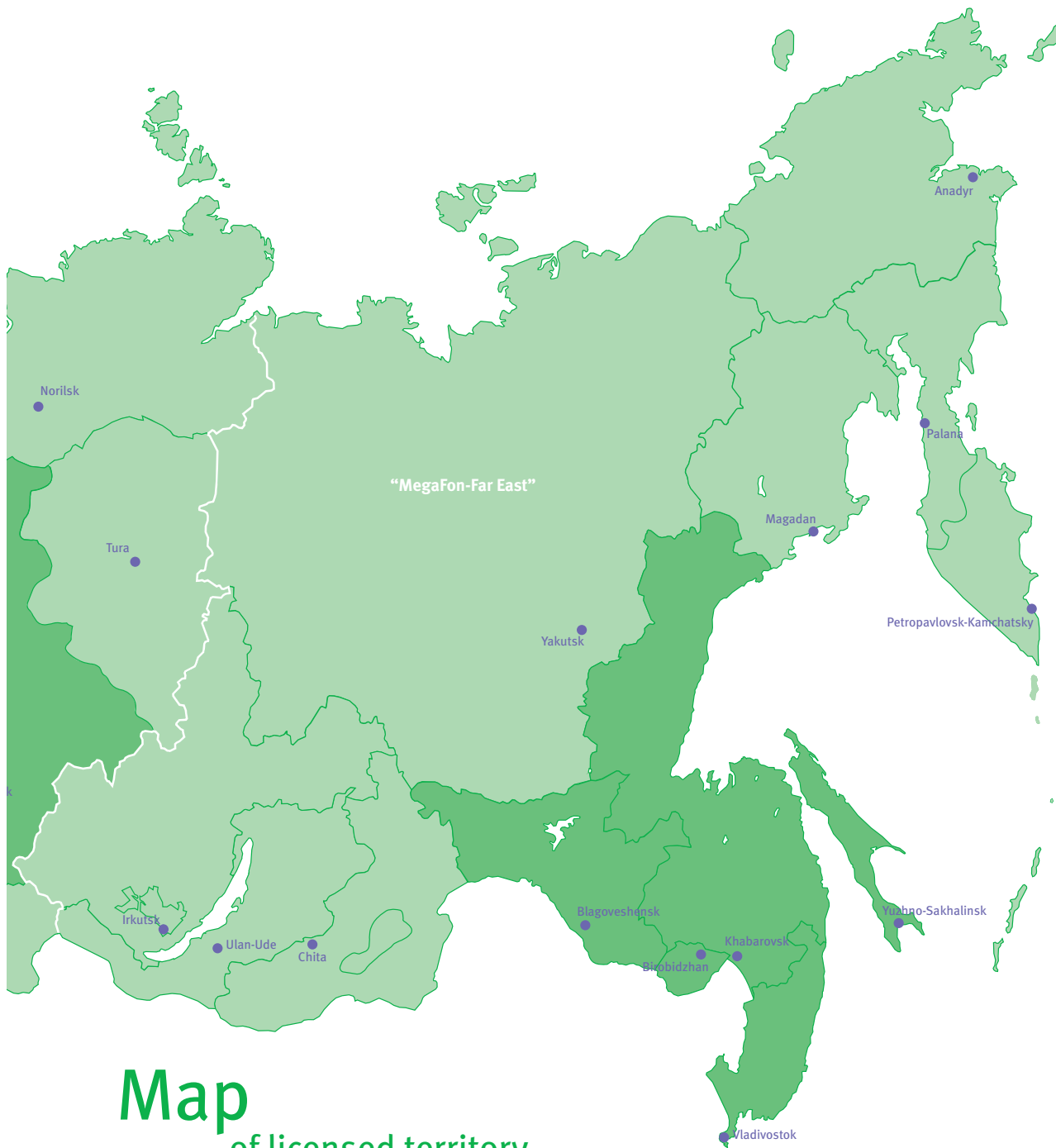
● ● ● OJSC “MegaFon” is the first all-Russian mobile operator in GSM 900/1800 standard. Licensed coverage of the Company and its 100%-owned subsidiaries includes the entire territory of the Russian Federation with population of 145 million.

MegaFon is building its business based on the principles of maximum satisfaction of subscribers’ demands, fair competition and information transparency.

MegaFon’s network uses advanced technology that opens new capabilities of communication and information handling for its subscribers. The spectrum of services that is unique for the Russian telecommunications market is addressed both to mass consumers and to corporate customers.

MegaFon sees its strategic target in creating uniform telecommunication space in Russia and eliminating the concept of “national roaming”.





# Map

of licensed territory

- network territory
- roaming territory

# MegaFon 2004

## Key Performance Indicators

During 2004 subscriber base increased more than two-fold, from 6.35 mln in January 2003 to 13.65 mln in January 2004. In general MegaFon subscriber base increased 115% in 2004.

During 2004 MegaFon's share in the Russian mobile market surged up to 18.4% from 17.5% as of the end and the beginning of 2004 respectively.

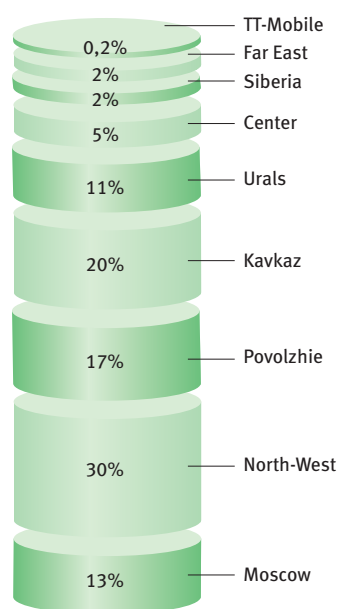
MegaFon business is growing faster than that of other operators in the "Big Three". MegaFon's subscribers base increased 115% in 2004.

### Subscriber Base Growth

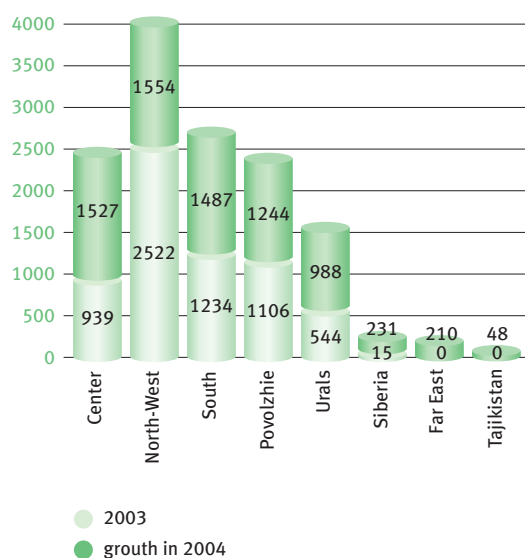
	2004	2003
MegaFon	115%	108%
Entire Market	104%	101%

Therefore we can see that MegaFon is growing faster than the entire market.

### Distribution of MegaFon Subscriber Base between Regions



### Subscriber Base Growth in Regions in 2004



### Subscriber Base Growth in Regions in 2004

Year	Center	North-West	South	Povolzhie	Urals	Siberia	Far East	Tajikistan	Russia
2003	939	2 522	1 234	1 106	544	15	0	0	<b>6 359</b>
2004	2 466	4 076	2 721	2 350	1 532	246	210	48	<b>13 648</b>
Growth	163%	62%	121%	112%	182%	1540%	-	-	<b>115%</b>



## Strengthening of Brand and Development of Communications Channels

2004 was the year of a successful federal image campaign aimed at promotion of MegaFon brand under the slogan “You can do more”. During the year MegaFon held a campaign on advertising and informational support of MegaFon’s intranet roaming capacities, as well as the first federal tariff promotion campaign. Active presence on national TV channels, as well as communication of uniform federal tariff offers strengthened MegaFon’s positioning as the federal operator.

In 2004 the scheme for interaction with the internal content-provider was developed, and the basic principles were established for the new branded product MegaFon PRO.

Last year the corporate web-site [www.megafon.ru](http://www.megafon.ru) was redesigned, and it is also true for the web-sites of six out of eight regional companies. The new version of the web-site has a wider set of features: positioning, information and promotion. The web-design and the site configuration solved the task of positioning MegaFon as the company that offers new possibilities to its subscribers, the most important of which is the possibility of choice.

In October 2004 MegaFon’s corporate newspaper – “Your MegaFon – A Newspaper for Those Who Care” – was first published.

## Sales

Last year the concept of Express-Service Offices for MegaFon’s customers was introduced based on One-Stop-Shopping principle. The new concept includes a number of advantages, such as: faster customer service as compared to “classic” Sales and Customer Care Centers (85% of service procedures do not require customer’s presence, average service time is 5 minutes); processing of customer requests received at the Back-office; universal qualification of employees which makes it possible to execute the entire set of service procedures.

Together with its partner dealers MegaFon opened Brand Salons in a number of regions, which strengthened the presence of MegaFon brand in the market, and created an effect of an addi-

tional own Customer Care Center; volume of sales comparable to volume of sales in MegaFon’s own Customer Care Centers; growth of efficiency of the Brand Salons as compared to regular (multi- and mono-brand) centers due to dealer co-investment; strengthening of partnership with the dealers.

The federal program was launched for Key Corporate Customers operating or represented in more than one Federal Region of the Russian Federation. The federal corporate program includes uniform prices in all regions where MegaFon operates; unique price offer in relation to all out-going long-distance calls and intra-net roaming calls; uniform I&R account.

# Products and Services

Value added services present one of the most profitable sources of revenue for mobile operators – new multimedia technologies, lower equipment prices, which brought about fast spread of mobile terminals with color displays and polyphonic ring tones, allow development of new attractive services. This results, on the one hand, in an increased user interest towards multimedia applications, and on the other hand, in a growing number of content- and services providers involved in the business – therefore, the market of value-added services is expanding.

MegaFon takes all relevant steps to promote and directly organize value added services market – this implies, first of all, creating conditions for market transparency, as well as implementation of promising telecommunication technologies.

In 2004 MegaFon's revenue from VAS was 11.5% of the total revenue, and grew more than 3.5 times as compared to 2003, which amounted to over US\$170 million versus US\$45 million in 2003.

## VAS revenue share in total revenue

Region	2004	2003
Center	17,4%	9,2%
North-West	16,8%	10,5%
Urals	11,8%	6,8%
Siberia	15,2%	-
Far East	17,9%	-
Moscow	13,5%	5,0%
Povolzhie	13,3%	9,6%
Kavkaz	14,6%	7,8%
<b>Total</b>	<b>11,45%</b>	<b>5,4%</b>



In 2004 GPRS networks were rolled out in all Federal Regions of Russia. MegaFon's subscribers obtained access to MMS based on GPRS over the entire territory covered by the network. The "youngest" network segments – in Siberia and the Far East – launched services existing in the federal network, such as MMS, WAP, mobile Internet, SIM-Menu and others.

MegaFon-Far East became the leader among MegaFon regional companies in terms of the "Innovations Index". By the end of 2004 VAS share in the total revenue of CJSC "Mobicom-Khabarovsk" reached 17.9%.

In average, about 55% of total revenue from value added services fell to transmission of P2P SMS – SMS communications between MegaFon's subscribers and between MegaFon's subscribers and

subscribers of other operators. We should note the positive trend of this parameter decrease during last year which implies increase of demand for "intellectual" value added services. For instance, in the North-West Branch of OJSC "MegaFon" only 44% of revenue from VAS comes from P2P SMS, and the other 56% falls on content services.

GPRS-based services enjoyed significant development in 2004. About 15-20% of total revenue from VAS came from GPRS-based services – GPRS-WAP, mobile Internet, and MMS. WAP-sites and WAP-portals are also becoming increasingly popular; the number of providers of such services is going up.

In 2004 the total number of content-providers offering value-added services to MegaFon subscribers reached 200.

# Results

## of Technical Development

- ● ● MegaFon's main technical achievement in 2004 resulted in intensive development of network equipment on the entire territory covered by the Company.

Intensive development in network equipment was based on active growth of existing networks in the Center, Urals, and Volga, together with construction of new networks in Siberia.

### Quantitative growth of equipment during the year

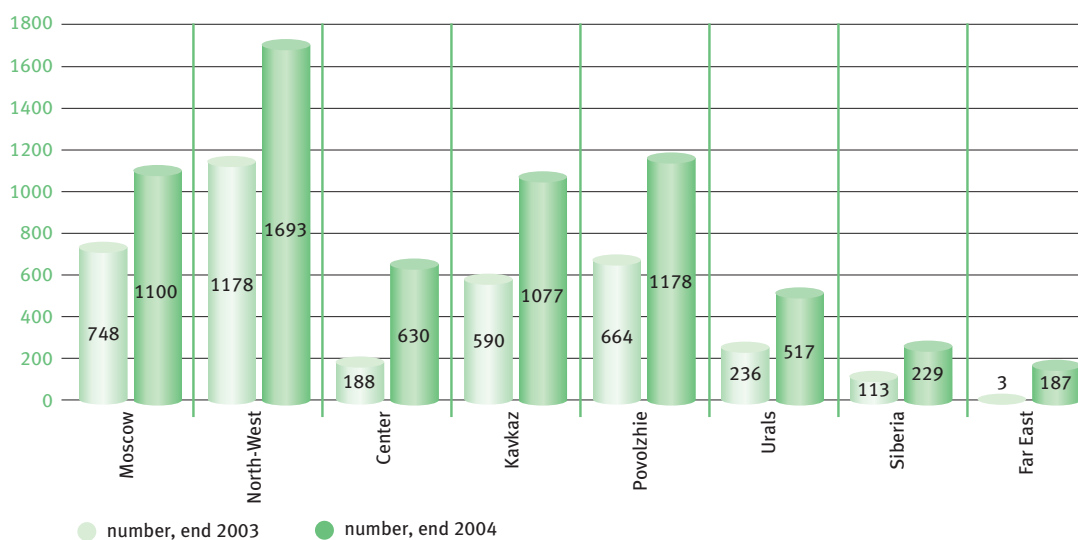
Equipment	Growth
HLR, number	100,0%
HLR, capacity	111,6%
MSC, number	76,2%
MSC, capacity	116,4%
BSC, number	91,1%
BSC, capacity	123,2%
BS sites	77,7%
Sectors	94,7%
TRX 900	97,5%
TRX 1800	124,1%
Total TRX	107,4%

### Dynamics of building sites for base stations

Region	end 2003	end 2004	Growth
Moscow	748	1100	47,1%
North-West	1178	1693	43,7%
Center	188	630	235,1%
Kavkaz	590	1077	82,5%
Povolzhie	664	1178	77,4%
Ural	236	517	119,1%
Siberia	113	229	102,7%
Far East	3	187	6133,3%
<b>OJSC "MegaFon"</b>	<b>3720</b>	<b>6611</b>	<b>77,7%</b>



### Dynamics of building sites for base stations



### Roaming Statistics

	GSM		GPRS		CAMEL
	Agreements (operators/countries)	Commercial partners (operators/countries, incl. satellite services)	Agreements (operators/countries)	Commercial partners (incl. free roaming in testing regime) (operators/countries)	Commercial partners (operators/countries)
End 2003	382 / 151	324 / 146 / 167	123 / 86	10 / 9	1 / 1
End 2004	448 / 166	361 / 169 / 183	251 / 124	52 / 39	44 / 32

In 2004, inter-net incoming roaming grew 11% as compared to 2003, out-going roaming grew 38% due to 63% increase of its international component. Intra-net roaming also increased 65% in spite of considerable reduction of tariffs in 2004 compared to 2003.

During 2004 GPRS networks were launched in all regional networks. In the North-West and Moscow license zones the two-

way GPRS roaming with all regional networks was opened. Commercial GPRS roaming is now available with 45 operators in 40 countries, in the testing mode – with 3 operators in 30 countries.

Out-going CAMEL-based roaming is available with 29 operators in 30 countries; incoming roaming is opened for 18 operators from 15 countries.

# Financing



Well-balanced investment policy of the company is one of the most important factors of MegaFon's dynamic development in 2004.

MegaFon was successful in raising debt financing under its investment program for 2004; the Company continued to use the previously obtained facilities and signed new facility agreements.

In May 2004 OJSC "MegaFon" signed facility agreements with Citibank International Plc ("Citibank") and ING Bank N.V. ("ING") for the total amount of US\$188.5 million to finance purchases of equipment from Ericsson and Nokia.

The loan agreement for US\$30 million jointly arranged by Kazkommerzbank and Moskommerzbank was signed. The facility is due in June 2009.

In October 2004 OJSC "MegaFon" signed the loan agreement for US\$30 million with Nordic Investment Bank due in June 2010.

In September 2004 two loan agreements were signed with IMB for US\$35 million and US\$10 million to be repaid in four years and one year respectively.

In April 2004 OJSC "MegaFon" placed the second tranche of its ruble bonds with total par value of 1.5 billion rubles. At the end of 2004 an important event took place: MegaFon placed its first Eurobond issue. The amount of the issue was US\$375 million, tenor – 5 years, coupon rate - 8.0%. Citigroup and ING were the Joint Lead Arrangers. Market analysts believed the issue to be very successful: the coupon rate proved to be the lowest among Russian telecommunications companies, and the number of requests exceeded the placement amount more than four times.

Proceeds from the issue were used to finance its previously obtained loans and for general corporate purposes, including the development and expansion of the networks.



# IT-solutions

## in MegaFon network



Further to developing the license territory MegaFon pursues the policy of business processes unification, it brings them to uniform standards. In 2004 there were continued activities to implement of the project of Automated System for Enterprise Resource Planning (on the basis of SAP R/3, 1S: Enterprise). CJSC “Sonic Duo” joined the subsidiaries already operating SAP R/3. Commercial testing of the personnel management system on the basis of mySAP R/3 started in all MegaFon subsidiaries. The second version of the uniform 1S configuration was launched. This enabled the Company to switch to the uniform Chart of Accounts, to support parallel accounting in accordance with international standards (US GAAP) and to consolidate its accounting statements (Russian and international (US GAAP) standards). Hyperion Planning was added to automated systems – it provides integration of budgeting, planning and forecasting processes at the level of the entire MegaFon Group.

In 2004 a number of steps were taken for further unification of billing systems produced by “Peter-Service”.

At the same time installation of the convergent billing and information system (CBIS) started, Interconnect – the system for set-offs between operators was launched, Billing and Information Solution was implemented.

Together with Ernst&Young MegaFon launched a project for providing quality of the billing processes (the project has been finalized in Povolzhie) and processes automated via SAP R/3 – Revenue Assurance.

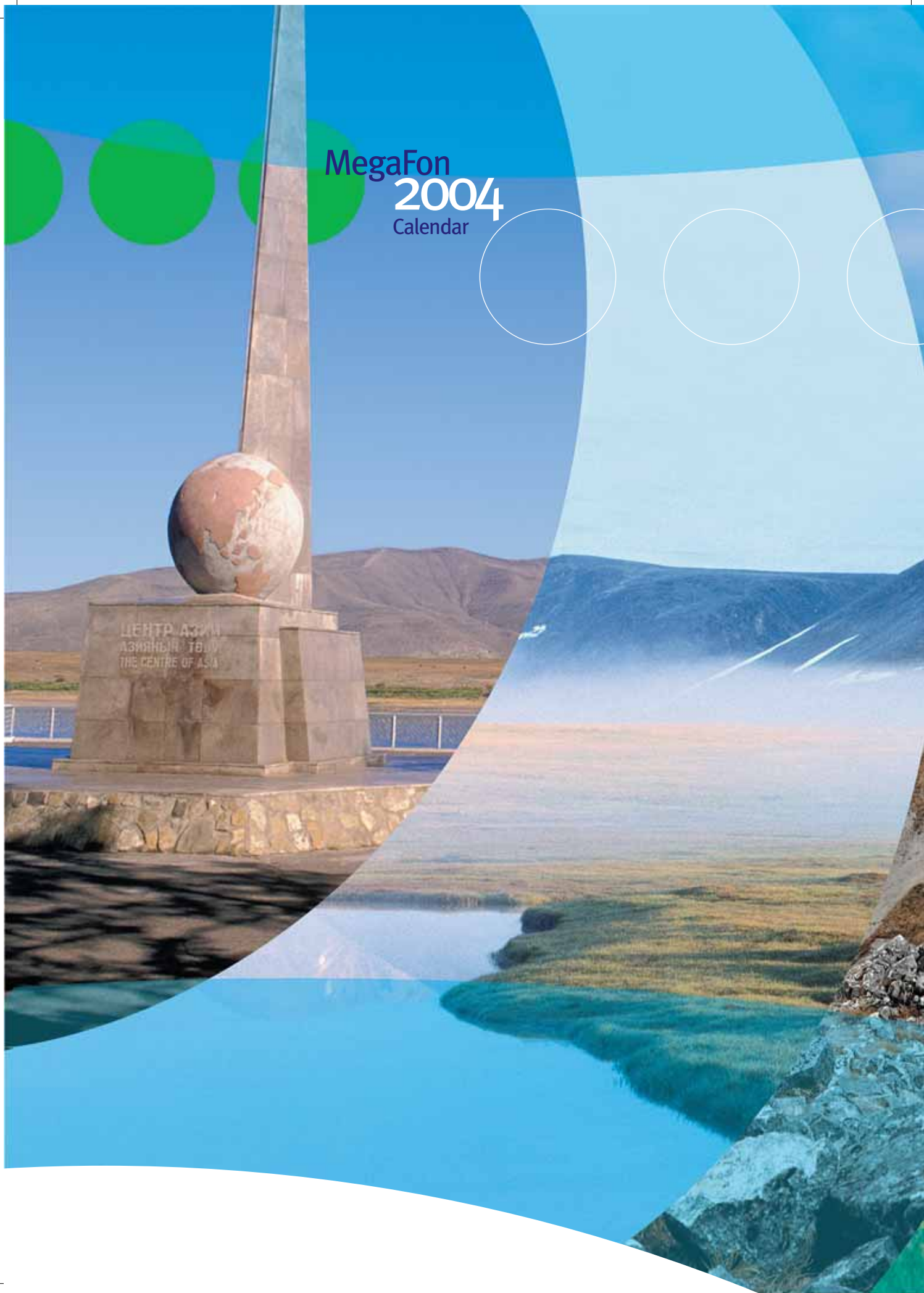
In 2004 the information infrastructure of MegaFon Headquarters was transferred to the new office in Kadashevskaya Embankment, Moscow.

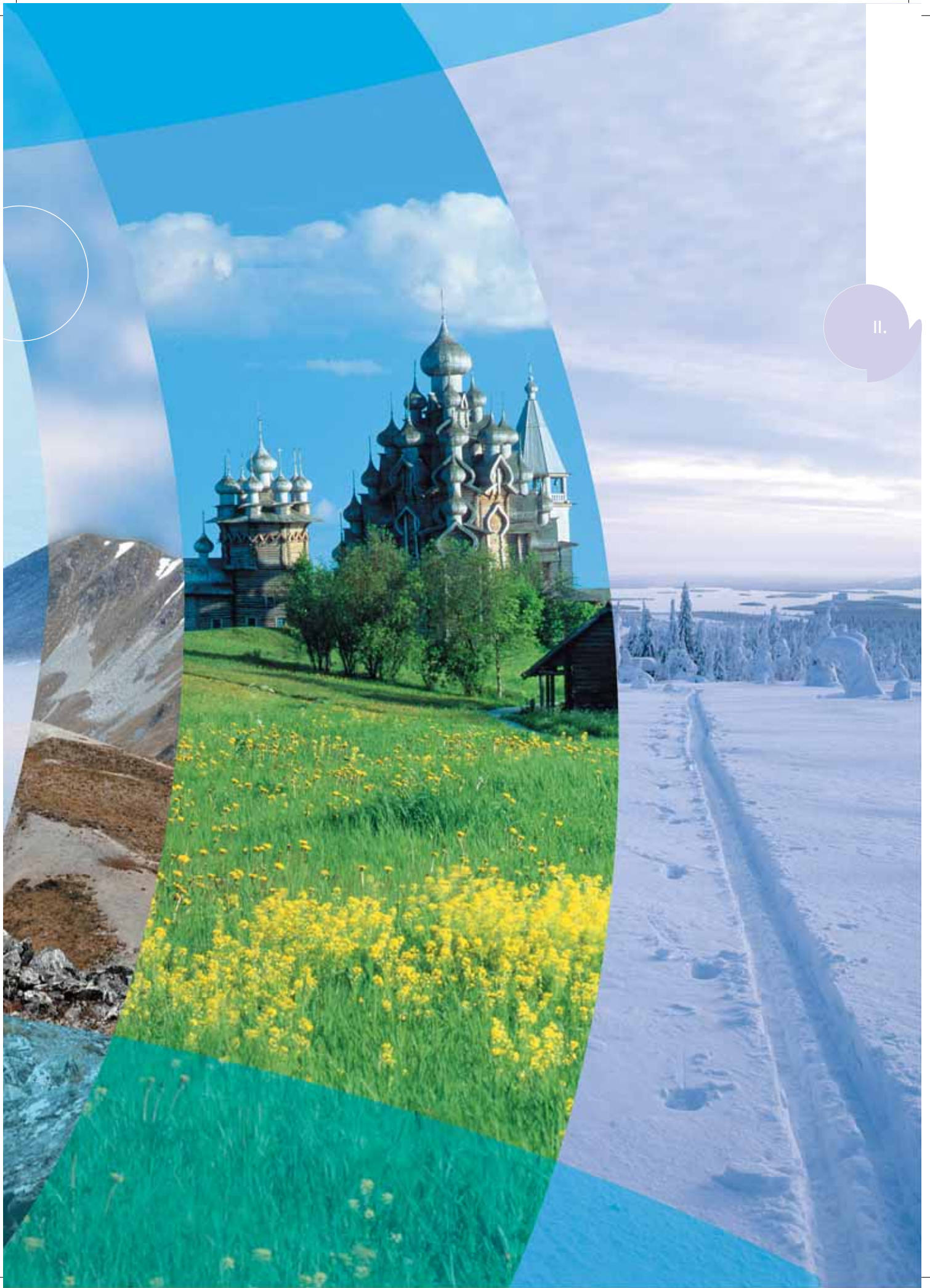
CJSC “Sonic Duo” finalized implementation of the CRM system produced by Amdocs – Clarify CRM.

For further unification of processes and projects, MegaFon signed the Frame Agreement on Software Supplies with Oracle, in addition to the existing agreement with Microsoft.

MegaFon  
2004  
Calendar

ЦЕНТР АЗИИ  
АЗИЯНЫҢ ТӨҮҮ  
THE CENTRE OF ASIA







# MegaFon-2004

Calendar



## January

On January 1 MegaFon subscriber base in the North-West exceeded 2 500 000 subscribers.

MegaFon-Center's subscriber base exceeded 100 000. MegaFon-Povolzhie connected its 50 000th subscriber in the Republic of Mordovia, while MegaFon-North-West connected its 100 000th subscriber in Karelia.

A star named MegaFon appeared in the sky. This name was assigned to a ninth-grade star in the constellation of Capricorn (coordinates 320,65953 -23,83521). The new star was registered in the Catalogue of Celestial Bodies "Rosastro" under number JE123-396.

The following communities were included into MegaFon network coverage territory: Yuzhnouralsk (Chelyabinsk region), Izlutchinsk, Yugorsk and Beloyarsky (Khanty-Mansiysk region), Leninsk-Kuznetsky, Prokopyevsk, Mariinsk, Kiselevsk (Kuznetsk Basin).

The radio sub-system of CJSC "Mobicom-Kirov" was connected to the switch of CJSC "Ural GSM" – thus Kirov region enters the uniform roaming-free space of MegaFon network in the Urals.

MegaFon-Siberia launched a package of tariff plans with per-second billing: "Alfa", "Beta", "Omega. Pryem". Dealer motivation program was launched in MegaFon-Siberia network.

MegaFon-Urals introduced new services into the market – "SMS-Account" and "Last Payment Date".

MegaFon-Urals also opened a Customer Care Center in Izhevsk (the republic of Udmurtia). MegaFon-Volga-Region opened a Customer Care Center in Balakovo (Saratov region).

## February

MegaFon-Urals started connecting subscribers in Kurgan region.

MegaFon-Siberia network registered over 40 000 subscribers, the subscriber base grew 185% since the beginning of 2004.

Subscriber base of MegaFon-Volga-Region in Samara region exceeded 600 000, in Penza region – 30 000 subscribers.

MegaFon-Moscow launched an unusual service that combined new technologies and good old traditions: MegaFon-Moscow subscribers obtained the possibility to send postcards to relatives and friends from their handset.

MegaFon-Siberia introduced the Corporate Customer Program.

MegaFon-Center's Customer Care Center was opened in Kursk.

MegaFon network included the cities of Anzhero-Sudzhinsk, Mariinsk, Belovo, Guriyevsk, Osinniki, Mezhdurechensk of Kemerovo regions, mountain sky centers of Kuzbas, the federal highway Novosibirsk-Kemerovo-Novokuznetsk, towns Alapaevsk (Sverdlovsk region) and Yalutorovsk (Tyumen region).

## March

On March 10 MegaFon started connecting subscribers in the Far East simultaneously in two regions – Khabarovsk and Primorski. On the very first day 1 500 subscribers were connected, and by the end of the month their number totaled 10 000.

Over 60 000 citizens of the Republic of Mordovia are subscribers of MegaFon-Volga-Region. Togliatti branch of MegaFon-Volga-Region has 200 000 registered subscribers.

MegaFon-Center started providing service to subscribers in Yaroslavl region.

The number of subscribers of MegaFon-North-West in Vologda region exceeded 200 000.

The mobile positioning service – "Locator" was launched for trial operation in Saint-Petersburg.

MegaFon-Moscow started offering Location Based Services (LBS).

MegaFon-Urals offered a new service to its subscribers – "Legal Consultations".

MegaFon-Center opened a Customer Care Center in Kaluga, MegaFon-Kavkaz – in Makhachkala.

## April

The number of MegaFon's subscribers in the Moscow licensed territory exceeded the level of million subscribers within 2.5 years, while it took over five years for other Moscow mobile companies to do the same.

MegaFon network was launched into operation in Bryansk region.

MegaFon-Far East started providing mobile service in Yevreyskaya Autonomous region and opened its Customer Care Center in the capital of the region – Birobidjan. MegaFon was the first GSM operator to provide mobile services in the region.

MegaFon-Center's subscriber base exceeded 200 000 subscribers.

During six months of operation in Penza region, MegaFon-Volga-Region connected 50 000 subscribers.

A new service – "Service Guide" was introduced by MegaFon-Volga-Region.

On April 9, the first public Wi-Fi access point was launched in Saint-Petersburg, in the restaurant "Tinkoff" in Kazanskaya St.

MegaFon-Moscow successfully finished the project on expansion of the mobile Internet infrastructure (GPRS). As a result of works executed by the specialists of the Company, the network capacity for data transmission increased two-fold. The quality of mobile Internet, MMS and other advanced services improved significantly while the services became more available.

MegaFon-Urals introduced additional USSD-based services for its subscribers: statement of account, information on the subscriber's tariff plan, recent payments and activation of express payment cards.

MegaFon-Center opened its Customer Care Center in Oryol region.

MegaFon network included: Gus-Khrustalny (Vladimir region), Tobolsk (Tyumen region), Sarapul and Votkinsk (Republic of Udmurtia), Zapadnoe Verkhnesalymskoe exploration site (Khanty-Mansiysk region), Leninsk-Kuznetsky, Berezovsky, Topki, Kiselevsk, Prokopiysk, Myski, Tashtagol, Mezhdurechensk (Western Siberia).

## May

MegaFon-North-West subscriber base exceeded 3 million.

MegaFon-Volga-Region connected its 100 000th subscriber in Ulyanovsk region.

MegaFon-Volga-Region subscriber base in the Republic of Mari-El exceeded 10 000.

The Russian Fund for Customer Rights Protection and its Moscow branch rewarded MegaFon-Moscow with a diploma for its contribution into formation of a civilized customer market in Russia. The decision to award MegaFon-Moscow was taken by the public expert councils "Best in Russia", "Best in Moscow" and "Best in Moscow Region".

At "Svyaz-Expocomm" exhibition MegaFon-Moscow presented advanced developments in mobile communications: Mobile TV, Mobile ICQ, LBS (Location Based Services), Wi-Fi and Confidential

Communications.

MegaFon-Siberia launched GPRS-based services.

In the Central region MegaFon offered a new service - personal account management.

New SMS services for MegaFon-Urals subscribers were introduced: "Weather" and "Currency Exchange Rates", a new program "Profit Plus" for corporate subscribers.

New services were offered to subscribers of MegaFon-Volga-Region: "Service-Guide" and "7Ya".

The service center network in the Central part of Russia was expanded: MegaFon-Center started serving subscribers in Kovrov (Vladimir region) and Obninsk (Kaluga region).

MegaFon network included the following communities: Karkatevyy, Kut-Yakh and Fedorovsky (Khanty-Mansiysk region), Zavodoukovsk (Tyumen region).

## June

The number of MegaFon-Volga-Region subscribers exceeded 1.5 million, in the Republic of Mordovia the number of subscribers reached 80 000.

MegaFon-North-West introduced tariff plans for corporate customers – "Corporate Standard", "Corporate Council" and "Corporate Alliance".

MegaFon-Siberia introduced a new tariff plan for its subscribers – the tariff plan "Summer".

On June 1, the International Child Protection Day, an all-city campaign "Children on the Road!" was launched. Under these campaign free flickers – special light reflectors providing security of pedestrians on roads – were distributed among MegaFon-Moscow subscribers with children of school-age. Experts in traffic safety say that use of such flickers decreases the risk of road accidents 6.5 times.

MegaFon-Center opened its Customer Care Center in Bryansk region.

Mobicom-Center launched USSD-services that made it possible for its subscribers to get account statements and activate express payment cards.

MegaFon-Center started providing services to subscribers in Lyvny (Oryol region) and Murom (Vladimir region).



MegaFon-Urals started connecting subscribers in Kudymkar (Komi-Permyatski region).

MegaFon-Urals introduced the uniform price for long-distance calls to all cities of Russia – 0,25 units/min.

The coverage zone included Berezniki (Perm region) and Kaskara (Tyumen region).

## July

MegaFon-Kavkaz connected its 2 000 000th subscriber. MegaFon-Kavkaz organized a space-bridge between Rostov, Krasnodar and Stavropol, as well as competitions, quiz-shows and a concert in which the pop-groups “SMASH!”, “Dynamite” participated, as did Thomas N’evergreen. “Mega Party” gathered about 30 000 in Rostov, 40 000 in Krasnodar, and 26 000 in Stavropol.

The number of MegaFon-Urals subscribers reached 1 000 000.

MegaFon-Volga-Region’s subscriber base exceeded 700 000 in Samara regions, and 100 000 in Astrakhan region.

The number of MegaFon-North-West subscribers in Murmansk region exceeded 300 000.

MegaFon-North-West launched GPRS services and GPRS-based MMS services in Arkhangelsk and Pskov regions – packet data transmission technology and MMS-processing services were finally launched on the entire territory of the North-West region. MegaFon-North-West finalized works on providing mobile communications in the Saint-Petersburg Metro. All stations were covered.

MegaFon-Moscow started working in the Moscow Metro. Stations in the center of the Russian capital were the first to be covered.

In Moscow the new Customer Care Center in Novinsky Passage was opened via an unusual event: its first guests were met and served by popular TV presenters – the stars of MuzTV channel.

MegaFon-Center continued expanding its dealer network: sales officers were opened in Maloyaroslavets (Kursk region) and Kolchuguino (Vladimir region).

From July 2004 services of MegaFon-Ural are charged in rubles. New tariff plans were launched – “MegaLite”, “MegaHit” and “MegaLux”, and a new service – “Packet SMS”.

New communities were included into the network coverage area – Komsomolsk-on-Amur (Khabarovsk region), Shumikha (Kurgan region), Tchaikovsky (Perm region).

## August

MegaFon-Center started connecting subscribers in Smolensk, Ivanovo and Kostroma regions – the Central region was fully covered.

MegaFon launched into commercial used its network in Orenburg region.

After launch of MegaFon-Volga-region network in the Republic of Chuvashia the Volga region licensed territory was fully covered. During three days of operation in Chuvashia 10 000 subscribers joined the network.

MegaFon-Volga-region subscribers exceeded 100 000 in the Republic of Mordovia and 100 000 in Penza region.

The number of MegaFon-North-West subscribers in Arkhangelsk region exceeded 200 000.

MegaFon-North-West opened international CAMEL-based roaming for LTE subscribers.

MegaFon introduced FIX – a tariff with no subscriber fee.

The first MegaFon-North-West Customer Care Center in the Leningrad region was opened in Vyborg; MegaFon-Center opened a new Customer Care Center in Nizhni Novgorod.

MegaFon-Siberia launched a new system for accepting payments made by MegaFon subscribers from other regions.

MegaFon-Urals introduced a new info service of “SMS-Subscription”.

The coverage area was expanded to Novomoskovsk (Tula region), Suzdal, Raduzhny, Aleksandrov (Vladimir region), Dalmatovo (Kurgan region), Uvildy lake area and Satka (Tchelyabinsk region), Novy Urengoi (Yamalo-Nenetski region), Ussuriysk (Primorski region).

## September

MegaFon-Volga-Region provides service to 200 000 subscribers in Bashkortostan Republic.

50 000 subscribers have been connected to MegaFon-Centre network in Vladimir region.

The first federal tariff plan “First Federal” was introduced in the all-Russian MegaFon network.

MegaFon-Center introduced the "LIGHT" tariff with no monthly fee based on per-second billing starting from the first second. Subscribers received access to the "Favorite Number" service.

MegaFon-Siberia introduced the new line of tariff plans: «MIX», «Jazz», «Pryom. Standard», «Pryom. Lux».

MegaFon-North-West subscribers have an opportunity to exchange MMS-messages with MTS network subscribers in the North-West region of Russia.

MegaFon-Far East presented to its subscribers the new interactive project: infotainment portal «MegaPlay» – a guide to the world of value-added services provided by MegaFon-Far East network.

The service of confidential cellular communications was launched in the Central region.

The number of MegaFon-Moscow base stations exceeded 1000 – the coverage area was significantly expanded in Moscow and numerous towns and communities of the Moscow region.

A new service of the round-the-clock call center available at the short number of 0909 was launched for MegaFon-Urals subscribers.

Test operation of convergent billing system developed by PeterService was started in MegaFon-Center network. A new switch was installed in Ryazan region.

Mobicom-Center together with independent experts tested communications quality of MegaFon network in Bryansk. The average result on the basis of a five-point scale was 4,55.

A test-drive of telecommunications coverage in the South of Russia was held by Mobile Forum (Mforum.ru). Upon its results MegaFon was acknowledged as the company with the best quality of communication in Rostov-on-Don and Krasnodar regions.

A Customer Care Center for MegaFon-Center subscribers was set up in Kurchatov (Kursk region), service for subscribers was launched in Mtsensk (Oryol region).

Coverage area expanded into Kogalym and Langepas (Khanty-Mansiysk region), Ukhhta (Komi Republic), Glazov (the Republic of Udmurtia), Nakhodka (Primorski region).

## October

MegaFon-Far East network was launched in Sakhalin region.

MegaFon-Volga-Region network numbered 2 mln. subscribers,

200 000 of them in Saratov region, over 150 000 – in Ulyanovsk region. The number of MegaFon's subscribers in the Moscow region exceeded one and a half million.

During three months of MegaFon's operation in Orenburg region over 40 000 subscribers were connected to the network.

The number of MegaFon-North-West subscribers in the Republic of Karelia exceeded 200 000.

MegaFon-Center connected the 50 000th subscriber in the Tula region.

MegaFon-Moscow network got the first place upon the results of the first Moscow drive-test held by the experts of Mobile Forum research and information agency in late September.

New tariff plans - MegaLight plus and MegaLux - were offered to MegaFon-Urals subscribers.

As a result of a large-scale expansion, MegaFon-Center started to provide service to subscribers almost in all districts of the Nizhni Novgorod region, the first base station was put into use to provide coverage along the Nizhni Novgorod – Arzamas highway.

A Customer Care Center for MegaFon-Center subscribers was introduced in Zheleznogorsk (Kursk region).

Coverage area expanded into Dzerzhinsk, Balakhna, Zavolzhie, Bor, Kstovo, Bogorodsk, Gorodets, Pavlovo (Nizhni Novgorod region) and Solikamsk (Perm region).

## November

MegaFon-Siberia started connecting subscribers in Krasnoyarsk region. The first express-service center was set up in Krasnoyarsk.

MegaFon-Far East network expanded to Amur region.

The 500 000th subscriber was connected to MegaFon-Center in the Central region.

MegaFon-Volga-Region network numbered 135 000 subscribers in Penza region and 40 000 subscribers in Mari El Republic.

MegaFon-North-West launched an unlimited tariff plan of Lux, with monthly fee of 100 USD net of VAT.

MegaFon-Moscow introduced a new tariff of the FIX family – FixLIGHT with connection fee. Its main advantage was the flat rate for mobile and local calls.



A new tariff plan “Constructor” was introduced for MegaFon-Far East subscribers. It allows subscribers to independently adjust their tariff plan to their individual communications style.

MegaFon-Far East launched a new interactive service of Service Guide on the entire network coverage area (in Khabarovsk, Primorye, Amur, Sakhalin regions and Yevrejskaya Autonomy.) The First North-West branch dealer conference was held in the State Congress Palace (Strelna).

«MegaFon Special Subscribers» campaign started in St. Petersburg. Under these campaign subscribers received discounts for tickets for cultural and sports events held with the support of MegaFon.

MegaFon-North-West together with the St. Petersburg Metro started works to provide services in the metro tunnels.

The SIM-menu portal was launched in all North-West regions, MegaFon uniform payment card was introduced in St. Petersburg.

The project “MegaCom” – joint social project of MegaFon, Siemens and Higher Education Institutions of Samara was introduced in Samara region.

The first express service office was introduced for MegaFon-Volga-Region subscribers in Bashkortostan Republic. MegaFon-Urals introduced a Customer Care Center for corporate and VIP subscribers in Surgut. MegaFon dealer network continues to grow in Kaluga region. As of the end of October 2004 subscribers were served in Sukhinich, Koselsk, Babyn, Dzerzhinsk, Maloyaroslavets, Zhykovsky and Taruss regions. MegaFon subscribers were also served in Efremov (Tula region).

MegaFon launched the switch in Oryol region.

Coverage area expanded into Novye Lyady (Perm region), Yar and Alnashy (the Republic of Udmirtia), Kataysk (Kurgan region).

## December

The number of MegaFon-North-West subscribers exceeded 4 million.

The subscriber base of MegaFon-Far East exceeded 200 000.

As of the New Year Day the number of MegaFon subscribers in Orenburg region comprised 60 000, the number of subscribers in Penza region exceeded 150 000, MegaFon subscriber base in Bashkortostan Republic exceeded 250 000, in Samara region - 800 000, in Ulyanovsk region – 170 000.

MegaFon-North-West launched automatic settings for GPRS and MMS services for handsets. The service of two-way MMS-messages was launched in the Central region.

MegaFon-Siberia introduced the new services of Mobile ICQ and MMS to its subscribers.

MegaFon-Far East started providing GPRS and MMS services in the entire coverage area in Far East Federal District.

MegaFon-Far East launched a new service - SIM-menu.

MegaFon subscribers in the Central region are provided with the service “GRPS-Internet”.

MegaFon-Urals introduced a new service – “Office Number” - for the corporate subscribers. All MegaFon-Urals network subscribers have an opportunity to pay for telecommunication services via the e-port system.

MegaFon Customer Care Centers in St. Petersburg and the Leningrad region started “PROdivinity Telephone” (Advanced Handset) action under which all subscribers could purchase modern popular models of GPRS and MMS-featured handsets with settings already made for high-tech services.

MegaFon-Volga-Region is the participant of a social campaign aimed at providing war-veterans with telecommunications.

MegaFon-Volga-Region network covered all 22 regions of Mordovia and all area centers of Ulyanovsk region.

Two-way roaming in the testing mode (non-billable) was launched between the networks of CJSC «Mobicom-Centre», the North-West Branch of OJSC «MegaFon», CJSC «Sonic Duo» and CJSC «Ural GSM».

A new express service center was introduced for MegaFon-Volga-Region subscribers in Saratov region.

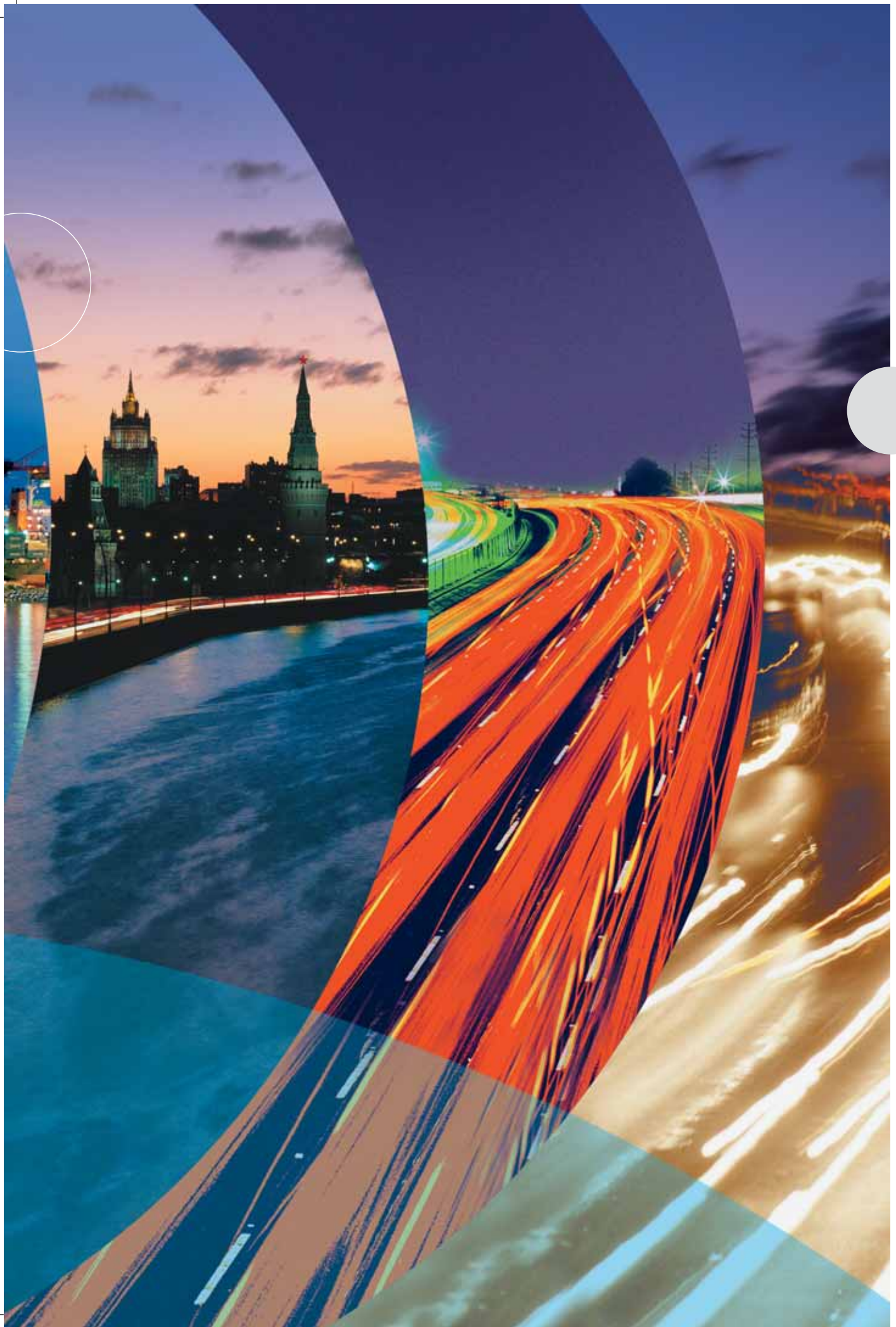
The first test-drive of MegaFon-Centre network was arranged in Nizhni Novgorod region. The test was taken by CJSC “Mobicom-Centre” specialists jointly with independent experts. MegaFon was highly rated upon the test results.

Coverage area expanded into Uzlovanya (Tula region), Salekhard, Vyngapurovsky (Yamalo-Nenetsky region), Nyagan (Khanty-Mansiysk region), Kurtamysh (Kurgan region).



A nighttime photograph of a cityscape reflected in water. On the left, a church with a tall spire is illuminated. On the right, a large port crane is visible. The water reflects the lights from both. The image is overlaid with a large blue curved shape on the right side and three green circles on the left side. The text 'Consolidated Financial Statements' is centered in the upper part of the image.

Consolidated  
Financial Statements



III.

# Consolidated Financial Statements

Years ended December 31, 2004 and 2003

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# Report of Independent Auditors

● ● ● The Board of Directors and Shareholders  
OJSC MegaFon -

We have audited the accompanying consolidated balance sheets of OJSC MegaFon and subsidiaries (“the Company”) as of December 31, 2004 and 2003, and the related consolidated statements of operations, shareholders’ equity and cash flows for the years then ended. These financial statements are the responsibility of the Company’s management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. We were not engaged to perform an audit of the Company’s internal control over financial reporting. Our audit included consideration of internal control over financial reporting as a basis for designing audit procedures that are

appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company’s internal control over financial reporting. Accordingly we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of OJSC MegaFon and subsidiaries as of December 31, 2004 and 2003, and the consolidated results of their operations and their cash flows for the years then ended in conformity with accounting principles generally accepted in the United States.

Ernst & Young LLC  
Moscow, Russia  
May 31, 2005

# Consolidated Balance Sheets

(In thousands of US dollars, except share amounts)

	Note*	December 31, 2004	December 31, 2003
<b>Assets</b>			
Current assets:			
Cash and cash equivalents	4	331,762	59,976
Short-term investments	5	–	56,784
Accounts receivable, net of allowance for doubtful accounts of \$1,768 in 2004 and \$1,492 in 2003	6	37,159	20,407
Accounts receivable, related parties	23	3,129	1,511
Inventories	2	27,728	14,863
VAT receivable	2	110,530	92,687
Deferred tax asset	21	25,042	17,613
Prepayments and other current assets	7	50,756	40,423
<b>Total current assets</b>		<b>586,406</b>	<b>304,264</b>
Property, plant and equipment, net	8	1,625,376	842,638
Intangible assets, net	9	512,850	574,338
Other non-current assets	10	66,351	11,910
<b>Total assets</b>		<b>2,790,683</b>	<b>1,733,150</b>
<b>Liabilities and shareholders' equity</b>			
Current liabilities:			
Accounts payable	11	68,819	38,898
Accounts payable and accruals to equipment suppliers		212,636	145,140
Accounts payable, related parties	23	15,971	4,350
Subscribers prepayments	2	112,422	66,058
Deferred revenue, current portion	2	12,947	7,778
Accrued liabilities	12	59,281	30,245
Capital lease obligations, current portion	8	14,425	12,674
Short-term debt	13	3,364	1,653
Short-term loans from shareholders	14	4,483	54,953
Debt, current portion	13	107,399	66,469
<b>Total current liabilities</b>		<b>611,747</b>	<b>428,218</b>
Debt, net of current portion	13	988,897	353,806
Loans from shareholders, net of current portion	14	103,300	44,496
Capital lease obligations, net of current portion	8	4,198	17,421
Deferred revenue, net of current portion	2	2,078	3,233
Derivative financial instruments (C-loans)	15	106,500	81,650
Other non-current liabilities		12,119	1,470
Deferred tax liability	21	103,237	116,684
<b>Total liabilities</b>		<b>1,932,076</b>	<b>1,046,978</b>
Commitments and contingencies	25	–	–
Minority interest		914	449
Shareholders' equity:			
Common stock (par value of 10 Rubles, 6,200,002 and 6,715,466 shares authorized as of December 31, 2004 and 2003, respectively; 6,200,002 shares issued and outstanding as of December 31, 2004 and 2003)	16	18,281	18,281
Reserve fund		541	541
Additional paid-in capital		436,606	436,606
Retained earnings		402,265	230,295
<b>Total shareholders' equity</b>		<b>857,693</b>	<b>685,723</b>
<b>Total liabilities and shareholders' equity</b>		<b>2,790,683</b>	<b>1,733,150</b>

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

# Consolidated Statements of Operations

(In thousands of US dollars)

	Note*	December 31, 2004	December 31, 2003
<b>Revenues</b>	17, 23	<b>1,480,071</b>	<b>814,610</b>
Cost of services, excluding depreciation and amortization (including related party amounts of \$52,247 in 2004 and \$46,965 in 2003)	18, 23	262,282	142,498
<b>Gross margin</b>		<b>1,217,789</b>	<b>672,112</b>
Sales and marketing expenses	19	252,405	125,984
Operating expenses (including related party amounts of \$14,450 in 2004 and \$12,788 in 2003)	20, 23	344,123	183,980
Depreciation and amortization	8, 9	257,438	145,767
<b>Operating income</b>		<b>363,823</b>	<b>216,381</b>
Other income and expenses:			
Interest expense		52,323	28,236
Change in fair value of derivative financial instruments (C-loans)	15	24,850	33,208
Other income, net		(2,575)	(1,961)
Net foreign exchange loss	2	25,234	4,444
Total other expenses, net		99,832	63,927
<b>Income before taxes and minority interest</b>		<b>263,991</b>	<b>152,454</b>
Provision for income taxes	21	91,556	53,077
Minority interest in earnings of subsidiaries	2	465	385
<b>Net income</b>		<b>171,970</b>	<b>98,992</b>

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

# Consolidated Statements of Cash Flows

(In thousands of US dollars)

	December 31, 2004	December 31, 2003
<b>Cash flow from operating activities:</b>		
<b>Net income</b>	<b>171,970</b>	<b>98,992</b>
Adjustments to reconcile net income to net cash provided by operating activities		
Depreciation and amortization	257,438	145,767
Net foreign exchange loss	25,234	4,444
Minority interest in earnings of subsidiaries	465	385
Provision for deferred income taxes	(20,876)	(18,216)
Change in fair value of derivative financial instruments (C-loans)	24,850	33,208
Loss from other non-cash items, including on disposal of tangible and intangible assets	18,332	12,024
Decrease/(increase) in:		
Accounts receivable	(16,147)	(7,888)
Accounts receivable, related party	(1,583)	(449)
Inventory	(12,865)	(7,874)
VAT receivable	(24,762)	(28,391)
Prepayments and other current assets	(7,536)	(23,812)
Increase/(decrease) in:		
Accounts payable	18,666	18,132
Accounts payable, related party	6,117	(3,005)
Deferred revenue	4,014	2,798
Subscribers prepayments	44,316	27,177
Accrued liabilities	26,571	16,460
<b>Net cash provided by operating activities</b>	<b>514,204</b>	<b>269,752</b>
<b>Cash flows from investing activities:</b>		
Purchases of property, plant and equipment and intangible assets	(654,668)	(364,801)
Proceeds from sale of property, plant and equipment	1,523	158
Cash paid for acquisitions	-	(12,000)
Decrease/(increase) short-term investments	58,763	(56,784)
Other non-current assets	(10,558)	(5,406)
<b>Net cash used in investing activities</b>	<b>(604,940)</b>	<b>(438,833)</b>
<b>Cash flows from financing activities:</b>		
Proceeds from long-term debt	710,965	274,408
Repayments of long-term debt	(326,892)	(87,790)
Proceeds from short-term loans from shareholders	-	49,763
Increase/(decrease) in short-term debt, net	1,635	(7,699)
Deferred finance charges paid	(13,909)	(1,622)
Capital lease principal repayments	(13,323)	(16,989)
<b>Net cash provided by financing activities</b>	<b>358,476</b>	<b>210,071</b>
Effect of exchange rate on cash and cash equivalents	4,046	2,607
<b>Net increase in cash and cash equivalents</b>	<b>271,786</b>	<b>43,597</b>
Cash and cash equivalents at the beginning of the year	59,976	16,379
<b>Cash and cash equivalents at the end of the year</b>	<b>331,762</b>	<b>59,976</b>
<b>Supplemental cash flow information:</b>		
Cash paid during the year for income taxes	111,867	76,505
Cash paid during the year for interest	50,983	16,620
Non-cash financing and investing activities:		
Equity contribution from discount on interest-free loans	-	1,323
Equipment received under capital leases (See Note 8)	682	20,007
Equipment purchased under credit (See Note 13)	248,238	33,116
Deferred finance charges deducted from loan proceeds	18,891	-

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



# Consolidated Statements of Shareholders' Equity

(In thousands of US dollars, except share amounts)

	Common stock		Reserve fund	Additional paid-in capital	Retained earnings	Total
	Shares	Amount				
<b>Balances as of</b>						
<b>December 31, 2002</b>	6,200,002	18,281	541	435,283	131,303	585,408
Net income	-	-	-	-	98,992	98,992
Discount on interest free loans from shareholders (Note 14)	-	-	-	1,323	-	1,323
<b>Balances as of</b>						
<b>December 31, 2003</b>	6,200,002	18,281	541	436,606	230,295	685,723
Net income	-	-	-	-	171,970	171,970
<b>Balances as of</b>						
<b>December 31, 2004</b>	6,200,002	18,281	541	436,606	402,265	857,693

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

# Notes to Consolidated Financial Statements

(Amounts presented are in thousands of US dollars, unless otherwise indicated)

## 1. Description of Business

Open joint stock company (or "OJSC") MegaFon (the "Company" or "MegaFon") is a provider of a broad range of wireless telecommunications services to businesses, other telecommunications service providers and retail subscribers. MegaFon, formerly North-West GSM, was originally registered in St. Petersburg, Russia in June 1993 as a closed joint stock company and began operations in 1994.

The Company and its subsidiaries have operating licenses for all Federal Districts of the Russian Federation, covering 100% of its population. MegaFon is building a nationwide mobile communications network that operates on the dual band GSM-900/1800 standard.

As of December 31, 2004 and 2003 MegaFon included the following operating entities:

Company	Ownership interest	Region / License area	Date operations started
<b>MegaFon:</b> (NW GSM branch)	N/A	St. Petersburg and St. Petersburg region	December 1994
<b>Subsidiaries:</b>			
Sonic Duo	100%	Moscow and Moscow Region	November 2001
MCS Povolzhie	100%	Volzhsky Federal District	August 1999
Mobicom Kirov	100%	Kirov Region	February 2001
Mobicom Center	100%	Central Federal District	December 2002
Volzhsky GSM	100%	Mordovia Republic	December 1999
Ural GSM	100%	Urals Federal District	June 2002
Mobicom Caucasus	100%	Southern Federal District	January 2001
Mobicom Novosibirsk	100%	Siberian Federal District	December 2003
Mobicom Khabarovsk	100%	Far East Federal District	March 2004
TT-Mobile	75%	Republic of Tajikistan	October 2001

The Company had a working capital deficit of \$25.6 million at December 31, 2004, which decreased from \$124.0 million at December 31, 2003. The decrease in the working capital deficit is primarily attributable to:

- Issuance of five-year \$375.0 million Eurobonds in December 2004 (see Note 13(4));
- Approximately \$50 million of short-term shareholders loans shown as a current liability in 2003 which were restructured into long-term loans in 2004 (see Note 14); and
- Refinancing of certain of short-term indebtedness by long-term loans (see Note 13).

As further discussed in Note 13, in 2005, the Company has entered into a number of long-term credit agreements or issued bonds totaling approximately \$203 million that are intended for the purchase of equipment or general corporate purposes. Also in 2005, the Company is negotiating to close new financings which aggregate approximately \$900 million.

The Company can defer capital expenditures if necessary in order to meet short-term liquidity requirements. Accordingly, management believes that cash flows from operating activities will be sufficient for the Company to meet its obligations as they become due.

## 2. Summary of Significant Accounting Policies

The principal accounting policies adopted for the preparation of the accompanying consolidated financial statements are set out below.

### Basis of Presentation

The statutory accounting records of the Company and its subsidiaries, except for TT-Mobile, are maintained in Russian Rubles in accordance with Russian law and are prepared in accordance with the accounting requirements provided for under Russian law and accounting practices. The accounting records of TT-Mobile are maintained in the local currency of Tajikistan (the Somoni) and in accordance with legal and accounting practices of the Republic of Tajikistan. The financial statements have been prepared in order to present the consolidated financial position, results of operations and cash flows in accordance with accounting principles generally accepted in the United States of America ("US GAAP") and are expressed in terms of US dollars (see "Foreign Currency Translation Methodology" below). The accompanying financial statements differ from the statutory financial statements used in Russia and the Republic of Tajikistan because they reflect certain adjustments, recorded in the entities' accounts, which are necessary to present the financial position, results of operations and cash flows in accordance with US GAAP. The principal adjustments are related to revenue recognition, foreign currency translation, deferred taxation, consolidation, accounting for derivatives, and valuation and depreciation of property, plant and equipment and intangible assets.

### Basis of Consolidation

All significant intra-group balances and transactions are eliminated in consolidation.

### Minority Interest

Minority interests in the net assets and earnings of consolidated subsidiaries are shown under "Minority interest" in the accompanying balance sheets and statements of operations.

### 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 consolidated financial statements relate to the useful lives of tangible and intangible assets, fair value of derivative financial instruments and recoverability of deferred taxes, as discussed in Notes 2, 8, 9, 15 and 21.

### Foreign Currency Translation Methodology

The Company's functional currency is the US dollar because the largest proportion of its revenues, capital expenditures, operating and borrowing costs are either denominated in US dollars or linked to the US dollar exchange rate. Accordingly, transactions and balances not already measured in US dollars (primarily transactions involving Russian Rubles and Euros) have been re-measured into US dollars in accordance with the relevant provisions of Statement of Financial Accounting Standards ("SFAS") No. 52, "Foreign Currency Translation". The objective of this re-measurement process is to produce largely the same results that would have been reported if the accounting records had been kept in US dollars.

Cash, receivables, payables and loans are considered monetary assets and liabilities and have been translated using the exchange rate as of the balance sheet dates. Non-monetary assets and liabilities, including non-current assets and shareholders' equity, are stated at their actual dollar cost or are restated from their historic cost, by applying the historical exchange rate as at the date of the original transactions. Income and expenses are restated by applying the monthly average exchange rates to underlying transactions. Items in the statement of cash flows are translated at exchange rates applicable as of the dates of transactions or with the monthly or quarterly average exchange rates.

Translation differences arising from the use of these different rates are credited or charged to the statement of operations.

Effective January 1, 2003, international accounting and financial reporting bodies have determined that Russia no longer meets the test for being classified as a highly inflationary economy for purposes of applying SFAS No. 52. The change in inflationary status did not have any impact on the results of operations or financial position of the Company and its subsidiaries as the US dollar is the Company's functional currency.

The Russian Ruble is not a convertible currency outside the territory of Russia. Official exchange rates are determined daily by the Central Bank of Russia ("CBR") and are generally considered to be a reasonable approximation of market rates. The translation of Ruble-denominated assets and liabilities into US dollars for the purpose of these financial statements does not indicate that the Company could realize or settle in US dollars the reported values of the assets and liabilities. Likewise, it does not indicate that the Company could return or distribute the reported US dollar values of capital and retained earnings to its shareholders.

The official exchange rates as of December 31, 2004 and 2003, for one US dollar were 27.75 Rubles and 29.45 Rubles, respectively.

## Cash and Cash Equivalents

Cash represents cash on hand and in the Company's bank accounts. Cash equivalents represent short-term cash deposits held at banks with an original maturity of three months or less. Cash equivalents are carried at cost, which approximates fair value.

Restricted cash, included in Prepayments and Other Current Assets, is primarily related to either (i) cash held in escrow at financial institutions as collateral for debt obligations for certain of the Company's subsidiaries; or (ii) non-interest bearing cash reserves that are placed with CBR as required by Russian legislation for internationally-sourced loans with a tenor of three years or less.

## Short-Term Investments

Short-term investments represent investments in notes receivable and time deposits, which have original maturities in excess of three months but less than twelve months. These investments are accounted for at cost, which approximates fair value. The carrying amount of short-term investments is reduced to recognize an other than temporary decline in the value, if any.

## Accounts Receivable

Accounts receivable are stated net of an allowance for accounts identified as doubtful. The Company provides an allowance for doubtful accounts based on management's periodic review of accounts receivable, including an assessment of the delinquency of these account balances.

## Inventories

Inventories are stated at the lower of cost or market value. Cost is determined using the first in – first out ("FIFO") method. Inventories are mainly comprised of SIM-cards, prepaid cards, phone sets and spare parts.

## Value-Added Tax

Value-added taxes ("VAT") related to revenues are generally payable to the tax authorities on an accrual basis when invoices are issued to customers and dealers. VAT incurred for purchases may be reclaimed or offset, subject to certain restrictions, against VAT related to revenues. VAT related to purchase transactions, which are not currently reclaimable as of the balance sheet dates, are recognized in the balance sheets on a gross basis as VAT receivable.

VAT receivable, representing amounts payable or paid to suppliers, is recoverable from the tax authorities via an offset against VAT payable to the tax authorities on MegaFon's revenue or direct cash receipts from the tax authorities. Management periodically reviews the recoverability of the balance of VAT receivable and believes that the amounts reflected in the financial statements are fully recoverable within one year with the exception of \$30,613 and \$5,136, which are classified as non-current assets at December 31, 2004 and December 31, 2003, respectively.

## Deferred Finance Charges

Arrangement, commission, commitment and related legal fees paid to secure a firm commitment from lenders and other direct debt issuance costs incurred in connection with new borrowings are deferred and amortized over the terms of the related loans, using the effective interest method.

## Intangible Assets

Intangible assets represent numbering capacity, capitalized licenses and other intangible assets.

License costs represent either an allocation of the purchase price to licenses acquired in business combinations or as payments made to government organizations to receive the licenses. License costs are capitalized and amortized on a straight-line basis over their expected useful lives of ten to twelve years from the date operations commenced in the license area.

Numbering capacity represents payments made to acquire access to telephone numbers and the use of telephone lines. Numbering capacity costs are amortized over six years using the straight-line method.

Other intangible assets are amortized on a straight-line basis over their estimated useful lives, generally from two to ten years.

All intangible assets are subject to periodic review for indications of impairment.

## Property, Plant and Equipment

In January 2004, the Company changed the estimated useful life of billing systems and office equipment from 5 to 3 years. The change decreased net income for 2004 by approximately \$7.0 million.

Property, plant and equipment are carried at cost less accumulated depreciation. Cost includes all costs directly attributable to bringing the asset to working condition for its intended use. Interest expense incurred during the construction phase of a project is capitalized as part of property, plant and equipment until the project is completed and the asset is placed into service. Depreciation is recorded on a straight-line basis so as to amortize the cost of the assets over their expected useful lives. The expected useful lives are as follows:

Buildings and structures	7 to 20 years
Switching equipment, including billing systems	3 to 7 years
Base stations, including software	7 years
Other network equipment	5 to 7 years
Vehicles and office equipment	3 to 5 years

Leasehold improvements are amortized over the shorter of the lease term or the estimated useful lives of the assets. The lease term includes renewals when such renewals are reasonably assured.

The cost of maintenance, repairs, and replacement of minor items of property, plant and equipment are expensed. Renewals and betterments are capitalized. Upon sale or retirement of property, plant and equipment, the cost and related accumulated depreciation are removed from the accounts. Any resulting gains or losses are included in the determination of operating results.

The Company accounts for asset retirement obligations in accordance with SFAS No. 143, "Accounting for Asset Retirement Obligations." SFAS No. 143 requires entities to record the fair value of a legal liability for an asset retirement obligation in the period it is incurred. This cost is initially capitalized and amortized over the remaining useful life of the asset. Once the obligation is ultimately settled, any difference between the final cost and the recorded liability is recognized as a gain or loss on disposition. The Company has certain legal obligations related to rented sites for base stations and masts, which fall within the scope of SFAS No. 143. These legal obligations include requirements to restore real estate upon which base stations and masts are located. The adoption of SFAS No. 143 as of January 1, 2003 did not have a material impact on the accompanying financial statements.

## Impairment of Long-Lived Assets

The Company periodically evaluates the recoverability of the carrying amount of its long-lived assets in accordance with SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets". Whenever events or changes in circumstances indicate that the carrying amounts of those assets may not be recoverable, the Company compares the undiscounted net cash flows estimated to be generated by those assets to the carrying amount of those assets.

When these undiscounted cash flows are less than the carrying amounts of the assets, the Company will record impairment losses to write the asset down to fair value, measured by the discounted estimated net future cash flows expected to be generated from the assets. During the years ended December 31, 2004 and 2003, no such impairments have occurred, except for a \$4.6 million write-off relating to certain billing system and telecommunications equipment recognized in 2004.

## Capital Leases

At the inception of the lease, the Company recognizes capital leases as imputed assets and imputed liabilities on the balance sheet at amounts equal to the present value of the minimum lease payments or, if lower, the fair value of the leased property.

A finance charge is attributed to the imputed liability over the term of the lease by applying a constant rate of interest on the outstanding balance of this liability for each period. Lease payments are applied against the finance charges and as a reduction of the outstanding imputed liability. Because the Company will acquire the title to leased property at the end of the lease term, these leased assets are depreciated consistently with similar depreciable assets that are owned.

## Subscribers Prepayments

Amounts received from subscribers in advance of services being provided are deferred and recognized as revenues when the services are provided.

## Interest Free Loans from Shareholders

The Company accounts for interest free loans from non-controlling shareholders in accordance with Accounting Principles Board Opinion No. 21 "Interest on Receivables and Payables". Accordingly, these loans are recorded at their estimated present values based on the Company's incremental borrowing rate. The related imputed interest is recorded as additional paid-in capital in the statement of shareholders' equity. The accretion of imputed interest is included as interest expense in the accompanying statements of operations.

## Revenue Recognition

Revenues are categorized as follows:

- Revenue from local subscribers, including subscription fees, usage charges, fees for value-added services and the fees charged to local subscribers for roaming outside MegaFon's network;
- Roaming fees charged to other wireless operators for guest roamers utilizing MegaFon's network;
- Connection fees;
- Sales of handsets and accessories; and
- Other: rentals of telecommunication channels to other operators and technical support.

## Subscription Fees

The Company recognizes monthly subscription fees as revenue in the month when the service is provided.

## Usage Charges and Value Added Services Fees

Usage charges consist of fees based on airtime or data services used by the subscriber. The Company recognizes revenues related to usage charges and value-added services in the period when the services are rendered.

For prepaid subscribers, the Company recognizes revenues for services provided to subscribers with negative (i.e., debit) account balances only upon subsequent collection of the cash from such subscribers.

The Company presents revenue from some value-added services (e.g., content services) on a gross basis when the Company is responsible for providing the content and on a net basis when the content service provider is responsible for providing the content.

## Prepaid Phone Cards

Prepaid phone cards allow subscribers to make a predetermined monetary amount of wireless phone calls and/or take advantage of other services, such as short messages and sending or receiving of faxes. At the time that the prepaid phone card is purchased, the receipt of cash is recorded as a subscriber prepayment. Revenues are recognized in the period when services are actually rendered. Unused value relating to phone cards is recognized as revenue when the prepaid phone card expires.

## Roaming Fees

The Company charges roaming fees (generally on a per-minute basis) to other wireless operators for "guest" roamers utilizing MegaFon's network.

## Connection Fees

Connection fees consist of non-refundable charges received from subscribers at the time of service initiation.

The Company defers revenue from initial connection fees and recognizes them as revenue over the estimated average subscriber lives. These estimated average subscriber lives differ by region and by type of tariff plans. In 2003-2004, these estimated average subscriber lives ranged from one to three years.

The Company periodically evaluates its estimated average subscriber lives at each subsidiary. In 2003, one of the Company's subsidiaries changed the estimate of average subscriber life from three years to one year. This change increased net income for the year ended December 31, 2003 by approximately \$2,534. This change occurred due a change in the competitive environment in its market.

## Sales of Handsets and Accessories

The Company sells a relatively small quantity of handsets and

accessories. The Company recognizes revenues from the sale of handsets and accessories upon the transfer of handsets and accessories to a customer.

## Rent of Telecommunication Channels and Technical Support

The Company rents telecommunication channels and provides technical support to the other telecommunication operators in Russia. The Company recognizes income from the rent of telecommunication channels and technical support in the month when the services are rendered.

## Arrangements with Multiple Deliverables

Certain of the Company's commercial arrangements constitute a contractual arrangement with multiple deliverables. In accordance with the Emerging Issues Task Force Consensus No. 00-21, "Revenue Arrangements with Multiple Deliverables", the Company allocates the consideration received from a subscriber to the separate units of accounting inherent in the contract based on their relative fair values.

## Discounts and Commissions to Dealers

Dealers purchase service contracts and prepaid phone cards from the Company at a discount and resell them to subscribers at prices set by the Company. Also, dealers collect payments for services from subscribers and remit them to the Company. In turn, the Company pays dealers a commission which is determined as a percentage of amounts collected. The respective discounts and commissions are recorded as a part of sales and marketing expense.

Also, the Company pays dealers a commission for each subscriber connected, depending on region, class or type of subscriber connected and other factors, including average revenue per subscriber for certain time periods. The Company recognizes the entire estimated commission payable when the subscriber is connected by dealer.

## Advertising Costs

Advertising costs are expensed as incurred. These costs totaled \$94,828 and \$60,872 for the years ended December 31, 2004 and 2003, respectively.

## Retirement Benefit Obligations

Both the Company and its subsidiaries are legally obliged to make defined contributions to the National Pension Fund, managed by the Russian Federation Social Security (a defined contribution plan). The Company has no legal or constructive obligation to pay future benefits under this plan. Its only obligation is to pay contributions as they fall due. The Company's contributions relating to defined contribution plans are expensed in the year to which they relate. Contributions to the National Pension Fund for the years ended December 31, 2004 and 2003, were \$16,567 and \$7,596, respectively.

Additionally, the Company has a noncontributory defined benefit pension plan that covers all employees at one location. The net pension benefit obligation and the related periodic net pension cost are based on, among other things, assumptions of the discount rate, estimated return on plan assets, salary increases and the mortality of participants. Actuarial gains and losses are deferred and amortized over future periods.

## Income Taxes

Provision is made in the financial statements for taxation of profits in accordance with Russian legislation currently in force. The Company accounts for income taxes under the liability method in accordance with SFAS No. 109, "Accounting for Income Taxes". Under the liability method, deferred income taxes reflect the future tax consequences of temporary differences between the tax and financial statement basis of assets and liabilities and are measured using enacted tax rates applied to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in the tax rates is recognized in income in the period that includes the enactment date. A valuation allowance is provided when it is more likely than not that some or all of the deferred tax assets will not be realized in the future. These evaluations are based on the expectations of future taxable income, reversals of the various taxable temporary differences and tax-planning strategies.

The Company does not recognize deferred tax liabilities or assets for those differences relating to assets and liabilities that, under SFAS No. 52, "Foreign Currency Translation", are re-measured from the local currency into the functional currency using historical exchange rates and that result from changes in exchange rates or indexing for tax purposes.

## Concentration of Credit Risk

The Company deposits available cash with various banks, including Telecombank, Svyazbank, and Russian Industrial Bank, which are related parties (see Notes 4, 5, 7, 13 and 23). Deposit insurance is either not offered or only offered in de minimis amounts in respect of bank deposits within Russia. To manage the credit risk, MegaFon allocates its available cash to a variety of Russian and foreign banks. Some of these Russian banks are state owned. Management periodically reviews the credit worthiness of the banks in which it deposits cash.

The Company extends credit to certain counterparties, principally international and national telecom operators, for roaming services, and to certain dealers, and establishes an allowance for doubtful accounts for specific accounts that it believes represent a potentially significant credit risk. The Company generally requires its subscribers to prepay for services, except for corporate subscribers that it deems reliable.

## 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 years ended December 31, 2004 and 2003, comprehensive income equaled net income.

## Comparative Information

Certain prior year amounts and disclosures have been reclassified to conform to the 2004 presentation.

## New Accounting Pronouncements

In December 2003, the Financial Accounting Standards Board ("FASB") issued Interpretation ("FIN") No. 46R, "Consolidation of Variable Interest Entities". FIN 46R addresses consolidation by business enterprises of variable interest entities and requires existing unconsolidated variable interest entities to be consolidated by their primary beneficiaries if the entities do not effectively disperse risks among parties involved. The Company adopted FIN 46R as of January 1, 2004 for variable interest entities created after December 31, 2003 and will adopt it as of January 1, 2005 for variable interest entities created before January 1, 2004. The Company did not identify any previously formed variable interest entities. Therefore the adoption of FIN 46R did not have any impact on the Company's financial statements.

In 2004, the FASB issued SFAS No. 123R, "Share Based Payment" and SFAS No. 153, "Exchanges of Non-monetary Assets". The provisions of these pronouncements are effective for periods beginning after June 15, 2005. The Company does not expect the above pronouncements will have a material impact on its financial statements.

### 3. Acquisitions

In February and April 2003, the Company acquired the outstanding minority interests in Mobicom Novosibirsk and Mobicom Khabarovsk increasing its ownership interest to 100%. The acquisitions were recorded using the purchase method of accounting. The

total purchase price was \$14,840 and was paid in cash.

Allocation of the purchase price was based on the estimated fair value of net assets acquired and was allocated as follows:

Licenses	19,526
Deferred income taxes	(4,686)
<b>Total</b>	<b>14,840</b>

### 4. Cash and Cash Equivalents

Cash and cash equivalents are comprised of:

	December 31, 2004	December 31, 2003
Bank deposits and cash on hand	137,882	34,751
Time deposits	193,880	25,225
<b>Total cash and cash equivalents</b>	<b>331,762</b>	<b>59,976</b>

Time deposits as of December 31, 2004 yield interest from 2.35% to 6.5% and have an original maturity of 90 days or less. These deposits can be withdrawn before maturity dates without penalties.

As of December 31, 2004 and 2003, \$24,426 and \$15,347 of cash and cash equivalents were on deposits with related parties, including \$2,961 and \$15,347 with Telecombank and \$21,465 and nil with Svyazbank, respectively (See Notes 2, 13(8) and 23).

### 5. Short-Term Investments

As of December 31, 2003, \$54,713 of time deposits were with Telecombank, a related party.

### 6. Accounts Receivable, Net

Accounts receivable are comprised of:

	December 31, 2004	December 31, 2003
Subscriber accounts receivable	9,144	3,982
Accounts receivable for roaming services	14,068	10,591
Receivables from dealers	14,012	5,874
Other	1,703	1,452
Less allowance for doubtful accounts	(1,768)	(1,492)
<b>Total accounts receivable, net</b>	<b>37,159</b>	<b>20,407</b>

The following summarizes the changes in the allowance for doubtful accounts for the years ended December 31, 2004 and 2003:

	2004	2003
Balance at beginning of year	1,492	1,236
Provision for bad debts	1,018	869
Accounts receivable written off	(742)	(613)
<b>Balance at end of year</b>	<b>1,768</b>	<b>1,492</b>



## 7. Prepayments and Other Current Assets

Prepayments and other current assets are comprised of:

	December 31, 2004	December 31, 2003
Prepaid taxes	11,628	14,171
Advances for advertising	4,818	2,072
Advances for other services	20,699	16,367
Other current assets	8,237	4,963
Restricted cash	5,374	2,850
<b>Total prepayments and other current assets</b>	<b>50,756</b>	<b>40,423</b>

Advances for other services mainly relate to interconnection, network maintenance and advances to dealers. Prepaid taxes mainly relate to prepaid income taxes, which amounted to \$10,924 and \$11,233 as of December 31, 2004 and 2003, respectively.

As of December 31, 2003, restricted cash of \$2,850 was deposited with Telecombank, a related party, earning interest of 6.75%. This

deposit was provided as a guarantee for a \$2,500 loan facility Telecombank provided to TT-Mobile in November 2001 (see Note 13 (8)). During 2004, the amount of the deposit was reduced to \$1,650 (See Note 13(8)). Also, in connection with a short-term credit line agreement with Citibank N.A. and ING Bank N.V., the Company made a non-interest bearing deposit of \$3,724 with the CBR. This deposit will be released in September 2005.

## 8. Property, Plant and Equipment

Property, plant and equipment are comprised of:

	Buildings, structures and leasehold improvements	Telecom- munications network	Vehicles, computers, office and other equipment	Construction in progress	Total
<b>Cost:</b>					
At December 31, 2003	29,013	639,023	64,091	286,236	1,018,363
Additions	–	–	–	966,340	966,340
Transfers	33,656	752,408	56,687	(842,751)	–
Disposals	(659)	(21,027)	(1,660)	(878)	(24,224)
<b>At December 31, 2004</b>	<b>62,010</b>	<b>1,370,404</b>	<b>119,118</b>	<b>408,947</b>	<b>1,960,479</b>
<b>Accumulated depreciation:</b>					
At December 31, 2003	5,914	147,455	22,356	–	175,725
Charge	3,204	153,394	22,122	–	178,720
Disposals	(161)	(17,989)	(1,192)	–	(19,342)
<b>At December 31, 2004</b>	<b>8,957</b>	<b>282,860</b>	<b>43,286</b>	<b>–</b>	<b>335,103</b>
<b>Net book value at December 31, 2004</b>	<b>53,053</b>	<b>1,087,544</b>	<b>75,832</b>	<b>408,947</b>	<b>1,625,376</b>
<b>Net book value at December 31, 2003</b>	<b>23,099</b>	<b>491,568</b>	<b>41,735</b>	<b>286,236</b>	<b>842,638</b>

Included in construction in progress are advances to suppliers of network equipment of \$46,965 and \$38,380 as of December 31, 2004 and 2003, respectively.

Software and licenses for base stations and billing systems are included in the balances of telecommunications network assets. The net book value is \$112,094 and \$63,336 as of December 31, 2004 and 2003, respectively.

Interest capitalized was \$23,450 and \$11,586 for the years

ended December 31, 2004 and 2003, respectively.

The Company also has entered into a number of lease agreements for telecommunications equipment, vehicles, computers and structures for periods ranging from one to ten years. The Company will acquire title to the leased property at the end of the lease term.

The following is an analysis of assets under capital leases as of December 31, 2004:

	Buildings, structures and leasehold improvements	Telecom- munications network	Vehicles, computers, office and other equipment	Construction in progress	Total
Cost at					
December 31, 2004	4,624	39,363	2,345	7	46,339
Accumulated depreciation	(1,194)	(10,575)	(655)	-	(12,424)
<b>Net book value at</b>					
<b>December 31, 2004</b>	<b>3,430</b>	<b>28,788</b>	<b>1,690</b>	<b>7</b>	<b>33,915</b>

The Company leases certain telecommunications network assets from a related party, RTC-Leasing. As of December 31, 2004 and 2003, the net book value of assets recorded under capital leases with RTC-Leasing was \$26,715 and \$28,944 and the capital lease obligations were \$15,347 and \$24,900, respectively.

The following is a summary of the total future minimum lease payments (excluding VAT) to be made after December 31, 2004 under capital leases:

Year	
2005	17,838
2006	4,675
After 2006	17
Total minimum lease payments	22,530
Less amount representing interest	(3,907)
Present value of minimum lease payments	18,623
Less current portion	(14,425)
<b>Long-term lease obligations</b>	<b>4,198</b>

The following table describes all changes to the Company's asset retirement obligations liability:

	2004	2003
Asset retirement obligations at beginning of year	1,421	-
Liability recognized in transition	-	793
Liability recognized during the year	3,449	509
Revision in estimated cash flows	4,620	-
Accretion expense	212	119
Asset retirement obligations at end of year	9,702	1,421

## 9. Intangible Assets

Intangible assets are comprised of:

	Operating licenses	Numbering capacity	Other intangible assets	Total
<b>Cost:</b>				
At December 31, 2003	595,693	60,809	60,799	717,301
Additions	-	7,725	9,706	17,431
Disposals	-	(32)	(601)	(633)
<b>At December 31, 2004</b>	<b>595,693</b>	<b>68,502</b>	<b>69,904</b>	<b>734,099</b>
<b>Accumulated amortization:</b>				
At December 31, 2003	87,221	22,193	33,549	142,963
Charge	51,240	11,930	15,548	78,718
Disposals	-	(29)	(403)	(432)
<b>At December 31, 2004</b>	<b>138,461</b>	<b>34,094</b>	<b>48,694</b>	<b>221,249</b>
<b>Net book value at</b>				
<b>December 31, 2004</b>	<b>457,232</b>	<b>34,408</b>	<b>21,210</b>	<b>512,850</b>
<b>Net book value at</b>				
December 31, 2003	508,472	38,616	27,250	574,338

Amortization expense for the succeeding five years is expected to be as follows: 2005 - \$70,230, 2006 - \$66,065, 2007 - \$58,944, 2008 - \$56,280, and 2009 - \$54,094.

Management believes that all existing operating licenses can be renewed in the future without substantial cost. The licenses expire between 2008 and 2011.

The Company and its subsidiaries have numerous operating licenses granted by the Ministry of Telecommunications and Information of the Russian Federation.

## 10. Other Non-Current Assets

Other non-current assets are comprised of:

	December 31, 2004	December 31, 2003
VAT receivable	30,613	5,136
Deferred finance charges	35,270	6,498
Other	468	276
<b>Total other non-current assets</b>	<b>66,351</b>	<b>11,910</b>

## 11. Accounts Payable

Accounts payable are comprised of:

	December 31, 2004	December 31, 2003
Roaming	7,663	6,069
Interconnection	22,520	7,498
Dealers	11,758	9,528
Other accounts payable	26,878	15,803
<b>Total accounts payable</b>	<b>68,819</b>	<b>38,898</b>

## 12. Accrued Liabilities

Accrued liabilities are comprised of:

	December 31, 2004	December 31, 2003
Accrued taxes	21,461	15,198
Salary and social contributions	9,560	4,408
Accrued interest	6,273	3,320
Other accrued liabilities	21,987	7,319
<b>Total accrued liabilities</b>	<b>59,281</b>	<b>30,245</b>

## 13. Short and Long-Term Loans

### Short-Term Loans

Short-term loans are comprised of:

	December 31, 2004	December 31, 2003
International Moscow Bank (IMB) loan	2,500	–
Sberbank overdraft	864	1,653
<b>Total short-term loans</b>	<b>3,364</b>	<b>1,653</b>

In September 2004, the Company entered into an unsecured loan agreement with IMB for \$10,000, of which \$7,500 remains undrawn. The loan matures in 2005 and bears interest at LIBOR plus 3.85%. In April 2005, the interest rate was reset to LIBOR plus 2.75%.

## Long-Term Loans

Long-term loans are comprised of:

	December 31, 2004	December 31, 2003
EBRD and IFC loans (1)	–	68,000
Nordea and Bayerische Hypo- und Vereinsbank AG loan (1)	50,782	55,595
International Moscow Bank loans (2)	2,500	40,036
Ruble Bonds (3)	109,420	53,016
Eurobonds (4)	375,000	–
Sberbank loans (5)	205,433	157,962
Citibank International plc., ING BHF-Bank Aktiengesellschaft, and ING Bank N.V. loans (6)	264,656	–
Siemens AG (6)	–	27,625
Kazkommerzbank and Moskommerzbank loan (7)	30,000	–
Other loans (8)	58,505	18,041
<b>Total long-term loans</b>	<b>1,096,296</b>	<b>420,275</b>
Less current portion	107,399	66,469
<b>Non-current portion</b>	<b>988,897</b>	<b>353,806</b>

Loan repayments over the five-year period beginning on January 1, 2005 are as follows:

	2005	2006	2007	2008	2009	After 2009	Total
<b>Total</b>	107,399	172,461	205,576	151,870	432,227	26,763	1,096,269

### (1) European Bank for Reconstruction and Development (EBRD), International Finance Corporation (IFC), Nordea and Bayerische Hypo- und Vereinsbank AG (Nordea/HVB)

In 2002, Sonic Duo borrowed a total of \$68,000 in “A” and “B” loans from EBRD and IFC, and entered into an export credit facility with Nordea/HVB. The “A”-Loan from the EBRD and IFC was for \$48,000 with interest at LIBOR plus 5.4% and the “B”-Loan was for \$20,000 with interest at LIBOR plus 5.15%. The loan from Nordea/HVB was for \$58,000 with interest at LIBOR plus 0.30% - 1.85%.

In October 2004, Sonic Duo repaid the “A”- and “B”-Loans to the EBRD and IFC using some of the proceeds from the Company’s \$150,000 short-term credit facility with Citibank N.A. and ING Bank N.V. (see Note 13(8)) and recorded a charge to interest expense of \$687 to write-off the associated deferred finance charges.

In November 2004, Sonic Duo repaid the outstanding principal of the Nordea/HVB loan which then amounted to \$50,035. At the same time, the Company entered into a new unsecured loan agreement with Nordea/HVB for \$50,782. The loan is guaranteed

by EKN, a Swedish export credit agency. The new loan bears interest at LIBOR plus 0.8% and matures in 2005 - 2008. The loan agreement places various restrictions on the Company related to incurrence of debt, guarantees, negative pledges, acquisitions and changes in the business without prior consent from Nordea/HVB. The loan also requires the Company to meet various financial and non-financial covenants. Deferred financing costs of \$1,417 were capitalized in connection with this loan.

### (2) International Moscow Bank

In 2002 and 2003, the Company entered into two loan agreements with IMB for \$36,000 and \$15,000 with interest at LIBOR plus 6% and LIBOR plus 4.3%, respectively. These loans were repaid in September 2004.

In September 2004, the Company entered into an unsecured loan agreement with IMB for \$35,000. As of December 31, 2004, \$32,500 was available to be drawn under the loan agreement. The loan matures in 2007 - 2008 and bears interest at LIBOR plus 5.25%. In April 2005, the interest rate was reset at LIBOR plus 3.75%.

**(3) Ruble Bonds**

In June 2003, MegaFon Finance, a wholly-owned subsidiary, issued 1.5 billion of Ruble bonds (\$49,426 at the exchange rate as of June 30, 2003). The bonds were issued at a premium of 75.6 million Rubles (\$2,491 at the exchange rate as of June 30, 2003). The effective interest rate is 9.75%. The bonds mature in June 2006.

In April 2004, the Company issued 1.5 billion of Ruble bonds (\$52,429 at the exchange rate as of April 15, 2004). The bonds were issued at face value with nominal interest at 9.28%. The bonds mature in April 2007.

**(4) Eurobonds**

In December 2004, MegaFon S.A., issued \$375 million loan participation notes (the Eurobonds) at face value with interest at 8% payable semi-annually in June and December. The Eurobonds mature in December 2009. The proceeds from the Eurobonds were used to finance a loan from MegaFon S.A. to the Company on substantially the same terms and conditions as the Eurobonds. The Eurobonds are guaranteed by all of the Company's operating subsidiaries (except TT-Mobile). The loan agreement places various restrictions on the Company and its subsidiaries related to incurrence of debt, certain assets sales and disposals, transactions with affiliates, making restricted payments such as dividends, mergers and acquisitions, and negative pledges. The loan also requires the Company to meet various financial and non-financial covenants. In connection with the Eurobonds offering the Company incurred \$6,394 of costs directly attributable to the borrowing which were capitalized as deferred finance charges.

**(5) Sberbank**

The Company and certain of its subsidiaries have entered into several credit line agreements with Sberbank denominated in different currencies. As of December 31, 2004, the US dollars denominated portion of the loans (\$72,263) bears interest at 10.0% to 11.5% and the Ruble denominated portion (\$133,170) bears interest at 12.0%. The loans are repayable at various dates from 2005 to 2009. In connection with these loans the Company pledged telecommunications equipment with a net book value of approximately \$97,940 as of December 31, 2004.

**(6) Citibank International plc. and ING BHF-Bank Aktiengesellschaft and Siemens AG ("Hermes Credit"); Citibank International plc. and ING Bank N.V. and Ericsson AB ("EKN Credit"); Citibank International plc. and ING Bank N.V. and Nokia Corporation ("Finnvera Credit")**

In July – December 2003, the Company entered into interest-free equipment supply agreements with Siemens AG and Nokia Corporation for 83.9 million Euros and 300.0 million Euros, respectively, and an open-ended line with Ericsson AB for the amount of actual purchases. The Company paid 15% of the purchase price upfront and the remainder was due within 180 days after delivery of the equipment.

In October 2003, the Company entered into the Hermes Credit for 75.4 million Euros (\$102,683 at the exchange rate as of December 31, 2004) with interest at approximately 4%. This credit line can only be used for purchases of Siemens AG equipment. The loan is guaranteed by Hermes, a German export credit agency. A payment of 4.8 million Euros (\$6,009 at the exchange rate as of date of payment) was required to obtain this guarantee and has been capitalized as deferred finance charges. In February 2004, the Company satisfied all conditions precedent to draw the funds under the facility. As the Company intended to repay amounts owed to Siemens AG using proceeds from the Hermes Credit, at December 31, 2003, the amounts owed to Siemens AG were classified as long-term based on the maturity of Hermes Credit line. As of December 31, 2004, the Company had drawn the entire amount available under the credit line. The Hermes Credit is repayable in semi-annual payments from September 2004 through March 2011. In connection with this loan the Company pledged telecommunications equipment with a net book value of approximately \$101,186 as of December 31, 2004.

In May 2004, the Company entered into the EKN Credit and the Finnvera Credit for \$53,448 and \$135,000, respectively, with interest at approximately 4%. The EKN and Finnvera credit lines can only be used for purchases of Ericsson and Nokia equipment, respectively. The loans are guaranteed by EKN, a Swedish export credit agency, and Finnvera, a Finnish export credit agency, respectively. A payment of \$13,998 was made to obtain these guarantees, which has been capitalized as deferred finance charges. As of December 31, 2004, the Company had drawn the entire amounts available under these credit lines. These Credits are repayable in semi-annual payments from November 2004 through May 2009. In connection with these loans the Company pledged telecommunications equipment with a net book value of approximately \$189,890 as of December 31, 2004.

The Hermes, EKN and Finnvera credit agreements place various restrictions on the Company related to incurrence of debt, guarantees, negative pledges, mergers and acquisitions, and changes in the business without prior consent from the lenders. The agreements also require the Company to meet various financial and non-financial covenants.

**(7) Kazkommertsbank and Moskommertsbank**

In May 2004, the Company entered into an unsecured credit facility with Kazkommertsbank and Moskommertsbank for \$30,000 at 10.25%. The loan matures in June 2009 with the lenders having options to require prepayment in May of each year. The Company plans to repay the entire amount in June 2005.

**(8) Other**

The Company has entered into other credit agreements as follows - Telecombank, a related party, for \$2,500 with interest at 14%; NEC Neva for \$24,961 with interest at LIBOR plus 4%; Transcontinental Mobile Investment Ltd., a related party (see Note 23), for \$2,008 with interest at 6%; Vneshtorgbank for \$16,956 with interest at LIBOR plus 5%; Promstroybank for \$1,221 at 6%; RK Telecom for \$5,916 with interest at an effective rate of 10.47%; and Huawei Technologies for \$922 interest free. These loans mature in 2005 – 2010.

During 2004 the Company maintained a deposit of 45.8 million Rubles as collateral with Telecombank, a related party, on which Telecombank paid interest at 6.75%. As of December 31, 2004, the deposit had been reduced to \$1,650. In February 2005 the deposit was fully repaid. The Company also pledged to NEC Neva all telecommunications equipment supplied by that vendor as security for vendor term financing. As of December 31, 2004, the net book value of telecommunications equipment pledged to NEC Neva is approximately \$24,824. Also, as of December 31, 2004, the Company has pledged telecommunications equipment with a net book value of approximately \$23,261 to Vneshtorgbank, \$1,025 to Promstroybank and \$692 to Huawei Technologies.

In September 2004, the Company entered into a short-term credit agreement with Citibank N.A. and ING Bank N.V. for \$150,000 at approximately 4.5%. A substantial amount of the proceeds from this credit were used to repay the "A"- and "B"- Loans from EBRD and IFC (see Note 13(1)). In December 2004, the Company repaid this facility using the proceeds from Eurobonds (see Note 13(4)).

In October 2004, the Company entered into an unsecured credit agreement with Nordic Investment Bank for \$30,000. The loan matures in 2007 – 2010 and bears interest at LIBOR plus 3.45%. As of December 31, 2004, no amounts were outstanding under the credit agreement.

#### Loan Agreements Concluded after December 31, 2004

In January 2005, the Company entered into a five-year credit line facility with Sberbank for the Ruble equivalent of \$75,000 with interest at 12%. As of the date of the report, the facility remains undrawn.

In January and April 2005, Mobicom Khabarovsk and Mobicom Novosibirsk entered into credit facility agreements with Vneshtorgbank in amounts of \$8,982 and \$7,014, respectively, each at an interest rate of LIBOR plus 5%. The loans are repayable from 2005 to 2011. In connection with these loans the Company pledged telecommunications equipment supplied by Huawei Technologies.

In February 2005, Telecombank transferred to Svyazbank, both related parties, its rights under the loan agreement between Telecombank and TT-Mobile (See Note 13(8)). This loan was subsequently restructured into a ruble-denominated loan and the principal amount was fixed at 42.2 million Rubles (\$1,521 as of December 31, 2004). The interest rate was decreased to 12% and the maturity was extended to February 2010. As part of this restructuring, the collateral on deposit of \$1,650 originally pledged to Telecombank was released. The loan from Telecombank is classified as long-term as of December 31, 2004 based on maturity of the new Svyazbank loan.

In April 2005, TT-Mobile entered into a credit line facility with Svyazbank, a related party, for 140 million Rubles (\$5,045 as of December 31, 2004). The loan matures in 2010 and bears interest at 12%.

In April 2005, the Company issued 3 billion of Ruble bonds (\$107,828 as of April 19, 2005). The bonds were issued at face value with nominal interest at 9.25%. The bonds mature in April 2008.

The Company is in the process of negotiating several long-term facilities aggregating approximately \$900 million. Subject to customary closing conditions, these facilities are expected to be available to the Company in the second or third quarter of 2005.

#### Covenant Violations and Waivers

In February - March 2004, the Company was not in compliance with two non-financial covenants stipulated in the Hermes Credit. In May 2004, the Company obtained a waiver for these violations. As of June 30, 2004, the Company also was not in compliance with one financial covenant under the Hermes Credit. In October 2004, the Company obtained waiver for the violation of this financial covenant. Since the inception of the Hermes, EKN and Finnvera Credits, and since the execution of the loan agreements with Nordea/HVB and Nordic Investment Bank, in each case through March 2005, the Company was not in compliance with a covenant which is identical in all these agreements. In March 2005, the Company obtained waivers for this violation and has amended these loan agreements with all of these lenders. As a result of the amendments, the Company expects to be able to remain in compliance with the revised covenant.

## 14. Loans from Shareholders

As of December 31, 2003, the Company had the following short-term loans from shareholders outstanding:

Short-term loans:	December 31, 2003
TeliaSonera	18,071
Telecominvest	15,651
IPOC	16,041
Accrued interest	2,215
	51,978
Current portion of long-term debt	2,975
<b>Total short-term loans from shareholders</b>	<b>54,953</b>

These loans were extended and amended in November 2004 as discussed below.

Long-term loans from shareholders are comprised of:

Long-term loans:	Interest bearing loans	Non-interest bearing loans			December 31, 2004	December 31, 2003
		Principal amount	Unamortized discount	Amortized cost	Total long-term loans from shareholders	Total long-term loans from shareholders
Telecominvest (1)	29,647	6,005	1,522	4,483	34,130	16,069
TeliaSonera (2)	43,158	-	-	-	43,158	23,734
IPOC (3)	16,041	-	-	-	16,041	-
CT Mobile (4)	-	22,490	13,789	8,701	8,701	6,740
Accrued interest	5,753	-	-	-	5,753	928
<b>Total long-term loans</b>	<b>94,599</b>	<b>28,495</b>	<b>15,311</b>	<b>13,184</b>	<b>107,783</b>	<b>47,471</b>
Less current portion					4,483	2,975
Non-current portion					103,300	44,496

Shareholder loan repayments over the five-year period beginning on January 1, 2005 are as follows:

	2005	2006	2007	2008	2009	After 2009	Total
Telecominvest (1)	6,005	-	-	-	-	29,647	35,652
TeliaSonera (2)	-	-	-	-	-	43,158	43,158
IPOC (3)	-	-	-	-	-	16,041	16,041
CT Mobile (4)	-	-	-	-	18,982	3,508	22,490
Accrued interest	-	-	-	-	-	5,753	5,753
<b>Total</b>	<b>6,005</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>18,982</b>	<b>98,107</b>	<b>123,094</b>



In November 2004, the Company signed an amendment to existing loan agreements with Telecominvest (except with respect to the interest-free loans noted below), TeliaSonera and IPOC which capitalized the accrued but unpaid interest on certain loans and extended the maturity of all of these loans to the earlier of September 30, 2011 or a date ninety days after the payment in full of the Hermes, EKN and Finnvera Credits (see Note 13(6)). Also, the repayment of these shareholder loans is subordinated to the Hermes, EKN and Finnvera Credits and also to the Eurobonds (see Note 13(4)). Effective September 2004, the interest rate on these loans was changed to the 6-month LIBOR rate plus 4%. Interest accruing after September 2004 will not be capitalized but will be payable together with principal at maturity.

#### **(1) Telecominvest**

In 2001, the Company assumed the loan agreement between Sonic Duo and Telecominvest for \$10,000 with interest at 10%. Interest in excess of \$555 per annum is capitalized and payable together with principal. The original maturity of the loan was in 2008. The loan was extended and amended in November 2004 as discussed above.

In 2002, the Company entered into a loan agreement with Telecominvest for \$2,504 with interest at 6%. The original maturity of the loan was in July 2009. The interest was due in one installment together with the principal. The loan was extended and amended in November 2004 as discussed above.

In 2003, the Company entered into a further loan agreement with Telecominvest for \$15,651 with interest at 6%, that had an original maturity in August 2004. The loan was extended and amended in November 2004 as discussed above.

In 2001, several subsidiaries of the Company entered into a number of Ruble denominated interest-free loan agreements with Telecominvest for a total of \$6,005 (at the exchange rate as of December 31, 2004). As of December 31, 2004, the amortized cost of these loans was \$4,483. Initially, these loans were planned to be repaid not earlier than 2005 – 2009. In 2003, certain of the interest-free loans from Telecominvest were amended to extend the maturity date. In connection with these amendments the Company remeasured the fair value of these loans and recorded \$1,323 as additional paid-in capital. In 2004, the Company and Telecominvest agreed that these loans will be repaid in September 2005. Accordingly, all these loans are classified as short-term as of December 31, 2004.

#### **(2) TeliaSonera**

In 2001 and 2002, Sonic Duo entered into several non-interest bearing loan agreements with TeliaSonera affiliated entities for \$11,630. The loans had an original maturity of 2008. The loans were extended and amended in November 2004 as discussed above.

In 2001, Sonic Duo entered into a further loan agreement with TeliaSonera affiliated entities for \$12,500 with interest at 10%. Interest in excess of \$695 per annum is capitalized and payable together with principal. The loan had an original maturity of 2008. The loan was extended and amended in November 2004 as discussed above.

In 2002, the Company entered into further loan agreements with TeliaSonera affiliated entities for \$2,848 with interest at 6%. The loans had an original maturity of 2009. The interest on the loan was due in one installment together with the principal. The loan was extended and amended in November 2004 as discussed above.

In 2003, the Company received a loan from a TeliaSonera affiliated entity of \$18,071 with interest at 6% that had an original maturity of September 2004. The loan was extended and amended in November 2004 as discussed above.

#### **(3) IPOC**

In 2003, the Company received a loan from IPOC of \$16,041 with interest at 6% that had an original maturity of July 2004. The loan was extended and amended in November 2004 as discussed above.

#### **(4) CT Mobile**

In 2001, Sonic Duo entered into three Ruble denominated interest-free loan agreements with CT Mobile for 624 million Rubles (\$22,490 as of December 31, 2004). The first two loans with an aggregate principal of \$18,982 mature in 2009 and the third loan matures in 2031.

## 15. Derivative Financial Instruments (C-loans)

Under the C-loan agreements each of EBRD and IFC agreed to advance \$6,000 (\$12,000 in the aggregate) to Sonic Duo. In connection with the acquisition of Sonic Duo in February 2002, the Company assumed the liability under these C-loan agreements with the EBRD and IFC. The C-loan agreements were also amended to provide that the repayment amount of the loans would be equal in the aggregate to 3.5528% of the fair value of MegaFon at the applicable repayment date (or 1.7764% in the case of each of the lenders). Following this Sonic Duo received the \$12,000 to be advanced under the C-loan agreements.

Under the amended agreements the loans must be repaid no later than December 31, 2009. Repayment of the loans is also required upon the occurrence of any of the following events: an initial public offering of MegaFon, a sale of more than 25% of Sonic Duo, a sale by MegaFon of more than 15% of its assets, dilution of the current shareholders of MegaFon by more than 25%, or a demand made either by EBRD or IFC, or both, at any time after December 31, 2007. In case of an initial public offering, the C-loans may be repaid in the form of MegaFon shares if certain conditions are met; in all other cases, the C-loans has to be repaid in cash. In addition, either lender can require prepayment if it becomes illegal for the lender to hold the loan.

In addition to the foregoing, at any time after December 31, 2004, at either the Company's or at either of the lenders' option, each

C-loan may be repaid by being exchanged for a 1.7764% interest in MegaFon.

Also, in the event any MegaFon shareholders sell part or all of its interest, either lender can require the buyer to purchase their interest under the C-loan agreements for a price equal to 1.7764% of the fair value of MegaFon.

There is no requirement that the lenders act in concert; either lender can elect independently with respect to the exercise of any right it may have under its C-loan agreement.

The Company accounts for the C-loans in accordance with SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities". In 2002, a liability equal to the excess of the fair value of the C-loans over \$12,000 was included in the purchase price allocation. Subsequent changes in the fair value of the C-loans are recorded in the statement of operations. During 2004 and 2003, the fair value of the C-loans increased by \$24,850 and \$33,208, respectively.

While the Company accounts for the value of the C-loans at their estimated fair value, the actual settlement of the obligation is based upon the terms of the agreement and will involve matters that are subjective in nature. Therefore, the actual amount of settlement may differ from the periodic estimates of fair values made by the Company.

## 16. Shareholders' Equity

The reserve fund, an element of Russian corporate law, represents a portion of the Company's earnings designated to create a reserve to cover future losses. The balance of the reserve fund is not available for dividends.

In accordance with Russian legislation, dividends may only be declared to the shareholders of the Company from accumulated undistributed and unreserved earnings as shown in the Company's Russian statutory financial statements. OJSC MegaFon had approximately \$481.2 million and \$343.4 million of undistributed and unreserved earnings as at December 31, 2004

and 2003, respectively. In addition, the Company's share in the undistributed and unreserved earnings of the OJSC MegaFon's subsidiaries was approximately \$276.4 million and \$93.2 million as at December 31, 2004 and 2003, respectively.

In March 2003, the shareholders authorized the issuance of 515,464 additional common shares with a par value of 10 Rubles. The registration of these shares expired as the shares were not issued by September 16, 2004. Accordingly, the number of shares authorized for issuance decreased from 6,715,466 to 6,200,002.

## 17. Revenues

Revenues for the years ended December 31 are comprised of:

	2004	2003
Revenue from local subscribers	1,380,478	725,698
Roaming charges to other wireless operators	62,932	72,110
Connection fees	20,983	10,184
Sales of handsets and accessories	1,252	1,578
Other revenues	14,426	5,040
<b>Total revenues</b>	<b>1,480,071</b>	<b>814,610</b>

## 18. Cost of Services

Cost of services for the years ended December 31 are comprised of:

	2004	2003
Interconnection charges	175,924	92,557
Cost of SIM-cards	43,237	22,149
Roaming expenses	42,395	26,498
Other	726	1,294
<b>Total cost of services</b>	<b>262,282</b>	<b>142,498</b>

## 19. Sales and Marketing Expenses

Sales and marketing expenses for the years ended December 31 are comprised of:

	2004	2003
Advertising	94,828	60,872
Commissions to dealers	156,488	61,401
Other	1,089	3,711
<b>Total sales and marketing expenses</b>	<b>252,405</b>	<b>125,984</b>

## 20. Operating Expenses

Operating expenses for the years ended December 31 are comprised of:

	2004	2003
Network repair and maintenance	44,785	19,344
Professional services	13,069	12,823
Materials and supplies	21,865	9,643
Salaries and social charges	114,768	61,638
Operating taxes	27,357	12,596
Rent*	48,924	24,410
Other expenses, net	73,355	43,526
<b>Total operating expenses</b>	<b>344,123</b>	<b>183,980</b>

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

## 21. Income Taxes

Provision for income taxes for the years ended December 31 are comprised of:

	2004	2003
Current income taxes	112,432	71,293
Less deferred income tax benefit	20,876	18,216
<b>Total income taxes</b>	<b>91,556</b>	<b>53,077</b>

Income taxes represent the Company's provision for profit tax. Profit tax is calculated at 24% of taxable profit in 2004 and 2003, in accordance with the laws of the Russian Federation.

The reconciliation between the income tax expense reported in the financial statements versus the income tax expense computed by applying the Russian enacted statutory tax rate to the income before taxes and minority interest is as follows:

	2004	2003
Income tax expense computed on income before taxes and minority interest at statutory rate	63,358	36,589
Tax effect of permanent differences:		
Change in the fair value of derivative financial instruments (see Note 15)	5,964	7,970
Non-deductible expenses	7,821	5,908
Foreign exchange loss	9,072	4,556
Other permanent differences	5,341	(1,913)
Change in valuation allowance	-	(33)
Income tax expense reported in the financial statements	91,556	53,077

The deferred tax balances were calculated by applying the presently enacted statutory tax rate of 24% applicable to the periods in which the temporary differences between the tax basis of assets and liabilities and the amounts reported in the

accompanying consolidated financial statements are expected to reverse. Deferred taxes in the accompanying consolidated financial statements as of December 31 are comprised of the following:

	2004	2003
Deferred tax assets:		
Revenue recognition	15,036	9,078
Difference in fixed assets depreciation	2,168	6,115
Loss carry-forwards	19,676	14,427
Other	11,449	3,980
Total deferred tax assets	48,329	33,600
Deferred tax liabilities:		
Deferred finance charges	7,456	2,061
Licenses and customer base	108,575	123,340
Other	10,493	7,270
Total deferred tax liability	126,524	132,671
Net deferred tax liability	78,195	99,071
Add current deferred tax assets	25,042	17,613
<b>Total long-term net deferred tax liability</b>	<b>103,237</b>	<b>116,684</b>

For Russian income tax purposes, certain subsidiaries of the Company have accumulated tax losses incurred in 2001 – 2004 which may be carried forward for ten years to use against their future income. Their use is restricted to a maximum of 30% of taxable income of the respective subsidiary each year in future years. The US dollar value of such tax loss carry-forwards may change as the value of the Ruble vs. the US dollar changes. As of December 31, 2004, for Russian income tax purposes, the Company's subsidiaries had tax losses available for carry-forward

of approximately \$81,986 (related tax benefit is \$19,676) expiring in 2011 - \$73, 2012 - \$607, 2013 - \$3,339 and in 2014 - \$15,657.

Management believes that no valuation allowance for loss carry forward is required based on an analysis of profitability trends of the Company's subsidiaries and planned legal merger of the Company and its subsidiaries into one company that would allow the Company to use the loss carry forwards of subsidiaries against income of MegaFon.

## 22. Defined Benefit Pension Plan

The Company has a defined benefit plan which covers approximately 22% of its employees as of December 31, 2004. Pensions are accrued on the basis of a formula which is dependent on the relative pay of participants and their length of service. The plan provides retirement and disability benefits. Retired employees are eligible for benefits when they reach 60 and 55 years for men and women, respectively.

The Company uses a December 31 measurement date for its defined benefit pension plan.

The following tables summarize the benefit obligations, plan assets, funded status, benefit costs and rate assumptions associated with pension plan:

<b>Change in benefit obligation</b>	<b>2004</b>	<b>2003</b>
Projected Benefit Obligation at beginning of year	2,234	1,586
Service cost	649	432
Interest cost	180	216
Actuarial loss	36	-
<b>Projected Benefit Obligation at end of year</b>	<b>3,099</b>	<b>2,234</b>
<b>Change in plan assets</b>	<b>2004</b>	<b>2003</b>
Fair value of plan assets at beginning of year	324	216
Employer contributions	288	108
<b>Fair value of plan assets at end of year</b>	<b>612</b>	<b>324</b>
<b>Funded status at year end</b>	<b>2004</b>	<b>2003</b>
Funded status	(2,487)	(1,910)
Unrecognised net actuarial loss	36	-
<b>Net amount accrued cost</b>	<b>(2,451)</b>	<b>(1,910)</b>
<b>Components of net periodic benefit cost</b>	<b>2004</b>	<b>2003</b>
Service cost	649	432
Interest cost	180	216
Expected return on assets	(36)	(36)
<b>Net periodic benefit cost</b>	<b>793</b>	<b>612</b>
<b>Key assumptions</b>	<b>2004</b>	<b>2003</b>
Discount rate	9,2%	9,2%
Expected return on plan assets	9,3%	9,3%
Rate of compensation increase	1,0%	1,0%

As of December 31, 2004 and December 31, 2003, accumulated benefit obligation was \$2,739 and \$1,946.

The following benefit payments, which reflect expected future service, as appropriate, are expected to be paid:

The assets portfolio consists of 5% equities and 95% other investments (mainly fixed income).

Year	
2005	108
2006	360
2007	36
2008	108
2009	216
2010-2014	3,388

## 23. Related Party Transactions

The Company has entered into certain transactions with its shareholders and their affiliates. The outstanding receivable/(payable) balances and the annual revenues and expenses

as of and for the years ended December 31, 2004 and 2003 are comprised of the following:

Accounts receivable, related parties	December 31, 2004	December 31, 2003
TeliaSonera (1)	1,138	847
Other	1,991	664
<b>Total accounts receivable, related parties</b>	<b>3,129</b>	<b>1,511</b>
<b>Accounts payable, related parties</b>		
Petersburg Transit Telecom (4)	1,641	1,828
Peterservice (6)	7,754	80
Mezhregion Transit Telecom (12)	3,829	861
Other	2,747	1,581
<b>Total accounts payable, related parties</b>	<b>15,971</b>	<b>4,350</b>
<b>Revenues</b>	<b>2004</b>	<b>2003</b>
TeliaSonera (1)	5,475	4,758
Turkcell Iletisim (3)	1,300	1,070
Mezhregion Transit Telecom (12)	2,944	760
Other	2,144	970
<b>Total revenues, related parties</b>	<b>11,863</b>	<b>7,558</b>

<b>Cost of services</b>	<b>2004</b>	<b>2003</b>
TeliaSonera (1)	1,406	826
Cubio Communications (10)	1,705	1,143
Turkcell Iletisim (3)	1,862	870
Globus Telecom (11)	2,488	188
Petersburg Transit Telecom (4)	17,255	22,795
Peterstar (4)	1,004	639
Web Plus (7)	56	1,315
North-West Telecom (8)	NA	3,118
SPIK (9)	824	1,097
Mezregion Transit Telecom (12)	23,910	11,755
Other	1,737	3,219
<b>Total cost of services, related parties</b>	<b>52,247</b>	<b>46,965</b>
<b>Operating expenses</b>		
Telecominvest (2)	5,885	6,079
J.P. Galmond & Co (5)	932	746
Peterservice (6)	2,566	907
Mezon Invest (13)	1,929	197
SPIK (9)	1,143	144
Other	1,995	4,715
<b>Total operating expenses, related parties</b>	<b>14,450</b>	<b>12,788</b>

- (1) **TeliaSonera** - primarily, settlements on roaming services (included in revenues and cost of services) and consulting services related to planning and development of the network (included in operating expenses).
- (2) **Telecominvest** - payments for consulting services and for delivery of invoices to customers.
- (3) **Turkcell Iletisim** - primarily, settlements on roaming services (included in revenues and cost of services). Turkcell Iletisim is an affiliate of TeliaSonera.
- (4) **Petersburg Transit Telecom and Peterstar** - primarily, purchase of numbering capacity (included in intangible assets), fees for interconnection and rent of digital channels (included in cost of services). Telecominvest has a 29% equity interest in Peterstar. Petersburg Transit Telecom is a wholly owned subsidiary of Telecominvest.
- (5) **J. P. Galmond & Co** - payments for legal services. The legal firm is affiliated (through its principal) with Telecominvest and IPOC.
- (6) **Peterservice** - primarily, installation and maintenance of information and billing systems. Purchase of billing systems from Peterservice in the amount of \$3,989 and \$19,861 in 2003 and 2004, respectively. Telecominvest has a 51% equity interest in Peterservice.
- (7) **Web Plus** - primarily, payments for internet access services. Web Plus is a wholly-owned subsidiary of Telecominvest.
- (8) **North-West Telecom** - payment for interconnection and rent of channels (included into cost of services), rent of premises and plots for base stations and consulting services (both included in operating expenses). North-West Telecom has a 15% equity interest in Telecominvest. During 2003, the Chief Executive Officer of the Company served on the Board of Directors of North-West Telecom. During 2004, the Chief Executive Officer of the Company left the Board of Directors of North-West Telecom.
- (9) **SPIK** - payments for subscriber information services outsourced to this company. Telecominvest has a 60% equity interest in SPIK.
- (10) **Cubio Communications** - payments for telecommunications services. Cubio Communications is an affiliate of Telecominvest and IPOC.
- (11) **Globus Telecom** - payments for telecommunications services. Globus Telecom was an affiliate of Telecominvest and IPOC. In 2005, Globus Telecom was sold to a third party.
- (12) **Mezregion Transit Telecom** - payments for telecommunications services. Mezregion Transit Telecom is an affiliate of Telecominvest and IPOC.
- (13) **Mezon Invest** - payments for rent. Mezon Invest is an affiliate of Telecominvest and IPOC.

Telecominvest and IPOC are also affiliated with the ultimate parent of some of the shareholders of Telecombank, Svyazbank and Russian Industrial Bank (see Notes 2, 4, 5, 7 and 13).

As described in Note 14, the Company has loans from the following shareholders: Telecominvest, TeliaSonera, IPOC and CT Mobile. The Company also has a loan from Transcontinental Mobile Investment Ltd., which is believed to have been an affiliate of CT Mobile in 2003, but which CT Mobile confirmed is not an affiliate in 2004 (see Note 13 (8)).

In connection with loans from shareholders the Company recognized interest expense of \$9,857 and \$6,253 during the years ended December 31, 2004 and 2003, respectively.

The Company leases certain assets from RTC-Leasing (see Note 8). Telecominvest and IPOC are affiliated with the ultimate parent of some of the shareholders of RTC-Leasing. In connection with leases from RTC-Leasing the Company recognized interest expense of \$5,614 and \$7,763 during the years ended December 31, 2004 and 2003, respectively.

## 24. Guarantees

In August 2002, the Company issued a guarantee to Sberbank for a credit line to RTC-Leasing through August 2006. The amount available under the credit is \$30,267. The Company will be required to perform under the guarantee within 7 days in case if RTC-Leasing does not repay the principal, interest, and any other payment specified in the loan agreement. As of December 31, 2004, the outstanding amount of principal and interest was \$13,938. As of December 31, 2004, the maximum potential amount of future payments under this guarantee is \$15,244 (including \$13,920 of principal and \$1,324 of interest).

The Company issued guarantees to several banks for loans to certain employees through August 2009. As of December 31, 2004, the amount outstanding under these loans is \$3,356. In connection with these guarantees the Company pledged office equipment with a net book value of approximately \$300 at December 31, 2004. The Company would be required to perform under the guarantee if any of the employees does not repay the principal, interest, or make any other payment specified in his or her loan agreements. Management believes that the fair value of these guarantees and related potential liability is de minimis.

## 25. Commitments and Contingencies

### Operating Environment

The Russian economy while deemed to be of market status continues to display certain characteristics consistent with that of an emerging market in transition. These characteristics include, but are not limited to, relatively high inflation and the existence of currency controls which cause the national currency to be illiquid outside of Russia. The stability of the Russian economy will be significantly impacted by the government's policies and actions with regards to supervisory, legal, and economic reforms.

### Taxation

Russian tax, currency and customs legislation is 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 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 be challenged. As such, 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 three calendar years preceding the year of review. Under certain circumstances reviews may cover longer periods.

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 our 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 described above will not have a material effect on the Company's financial statements.

### Changes in Laws

The new Telecommunications Law introduces the concept of the Universal Service Fund (the "USF"). All telecommunications companies are expected to contribute to the USF which is designed to support the development of telecommunications infrastructure in areas which are deemed to be economically unviable but socially necessary. It is expected that the amount of the universal service charge paid to the USF will not exceed 1.2% of certain revenues of telecommunications companies. It is expected that the first payments to the USF will be made in the second half of 2005; however, the Ministry of Telecommunications and Information has not indicated the exact date for such implementation, due to the lack of supporting regulations to be issued by the Russian government.



## Minimum Lease Payment under Operating Leases

Future minimum lease payments under non-cancelable operating leases with terms of one year or more, as of December 31, 2004, are as follows: 2005 - \$7,246, 2006 - \$6,153, 2007 - \$2,631, 2008 - \$2,631, 2009 - \$1,754.

## 26. Fair Value of Financial Instruments and Risk Management

The following methods and assumptions were used to estimate the fair value of each class of financial instruments for which it is practicable to estimate fair value:

### Cash and Short-Term Investments

The carrying amount approximates their fair value because of short maturity of those items.

### Long-Term Debt

The fair value of long-term debt is estimated based on market interest rates for the same or similar issues or on the current rates offered to the Company for debt of the same remaining maturities.

### Derivative Financial Instruments

The fair values of the derivative financial instruments are determined using estimated discounted cash flows.

The estimated fair values of the Company's financial instruments are as follows:

	2004		2003	
	Carrying amount	Fair value	Carrying amount	Fair value
Cash and short-term investments	331,762	331,762	116,760	116,760
Long-term debt	1,204,079	1,205,445	467,746	467,746
Derivative financial instruments	106,500	106,500	81,650	81,650

The Company, using available market information and appropriate valuation methodologies, where they exist, has determined the estimated fair values of financial instruments. However, judgment is necessarily required to interpret market data to determine the estimated fair value. Accordingly, the estimates presented herein are not necessarily indicative of the amounts the Company could realize in a current market exchange. While management has used available market information in estimating the fair value of financial instruments, the market information may not be fully reflective of the value that could be realized in the current circumstances.

The Company, in connection with its current activities, is exposed to various financial risks, such as foreign currency risks, interest rate risks and credit risks. The Company manages these risks and monitors their exposure on a regular basis. The Company does not use derivative financial instruments to hedge such risks.