



MTS Annual Review 2004



Leading

wireless operator in Russia and the CIS





MTS thanks the employees who participated in the photography for this year's annual report for their time and efforts.

Some of the information in this document may contain projections or other forward-looking statements regarding future events or the future financial performance of MTS, as defined in the safe harbor provisions of the U.S. Private Securities Litigation Reform Act of 1995. You can identify forward-looking statements by terms such as “expect”, “believe”, “anticipate”, “estimate”, “intend”, “will”, “could”, “may” or “might” the negative of such terms or other similar expressions. We wish to caution you that these statements are only predictions and that actual events or results may differ materially. We do not intend to update these statements to reflect events and circumstances occurring after the date hereof or to reflect the occurrence of unanticipated events. We refer you to the documents MTS files from time to time with the U.S. Securities and Exchange Commission, specifically, the Company’s most recent Form 20-F. These documents contain and identify important factors, including those contained in the section captioned “Risk Factors”, that could cause the actual results to differ materially from those contained in our projections or forward-looking statements, including, among others, potential fluctuations in quarterly results, our competitive environment, dependence on new service development and tariff structures, rapid technological and market change, acquisition strategy, risks associated with telecommunications infrastructure, risks associated with operating in Russia, volatility of stock price, financial risk management, and future growth subject to risks.



Mobile TeleSystems (MTS) is the largest mobile phone operator in Russia, Ukraine, Belarus and Uzbekistan in terms of subscribers. The Company, together with its subsidiaries, provides services to over 42.4 million customers*, covering a population under its GSM licenses of 226 million people.

MTS is committed to providing the highest level of service to its customers by offering extensive network coverage, a variety of individual and business tariff plans, a wide range of value-added services, a broad choice of payment methods, and the very latest technology.

MTS' shares have been listed on the New York Stock Exchange since June 2000 under the ticker symbol "MBT". The Company's shares are also traded on the Moscow Interbank Currency Exchange (MICEX).

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* As of May 31, 2005.



MTS' network

Operational areas

Belarus
Ukraine
Uzbekistan

Operational regions in Russia

Moscow and the
Moscow region
St. Petersburg and the
Leningrad region
Adygeya Republic
Aginski-Buryatski
Autonomous District
Altai Republic
Altaisk territory
Amur region
Arkhangelsk region
Astrahansk region
Bashkortostan Republic
Belgorod region
Bryansk region
Buryatiya Republic
Chelyabinsk region
Chita region
Chuvashia Republic
Irkutsk region
Ivanovo region
Kaliningrad region
Kalmykia Republic
Kaluga region
Kamchatka region

Karelia Republic
Kemerov region
Khabarovsk territory
Khakassiya Republic
Khanty Mansiysk
Autonomous District
Kirov region
Komi Republic
Komi-Permyatsk
Autonomous District
Kostroma region
Krasnodar territory
Krasnoyarsk territory
Kurgan region
Kursk region
Lipetsk region
Magadan region
Mari-El Republic
Mordovia Republic
Murmansk region
Nenetsk Autonomous District
Nizhny Novgorod region
Novgorod region
Novosibirsk region
Omsk region
Orel region
Orenburg region
Perm region
Primorsky territory
Pskov region
Rostov region

Ryazan region
Sakha Republic (Yakutia)
Sakhalin region
Samara region
Saratov region
Severnaya Osetia-Alania Republic
Smolensk region
Stavropol territory
Sverdlovsk region
Taimyr Autonomous District
Tambov region
Tatarstan Republic
Tomsk region
Tula region
Tver region
Tyumen region
Tyva Republic
Udmurt Republic
Ulyanovsk region
Ust-Ordynski Buriatsk
Autonomous District
Vladimir region
Volgograd region
Vologda region
Voronezh region
Yamalo-Nenetsk
Autonomous District
Yaroslavl region

Non-operational areas in Russia

Chukotsk Autonomous District
Dagestan Republic
Evenkia Autonomous District
Ingushetia Republic
Jewish Autonomous region
Kabardino-Balkar Republic
Karachaevo-Cherkesia Republic
Koryakski Autonomous District



Company history

1993

MTS receives first license to provide mobile phone services using the GSM standard.

1994

MTS begins offering mobile phone services in Moscow and the surrounding region.

1997

MTS starts expansion into Russian regions.

2000

Initial Public Offering of MTS' securities on the New York Stock Exchange.

2001

MTS launches operations in Russia's second largest city, St. Petersburg.

2002

MTS introduces prepaid "JEANS" brand and begins expansion into neighboring CIS countries by launching joint venture in Belarus.

2003

MTS acquires UMC, a leading mobile phone operator in Ukraine.

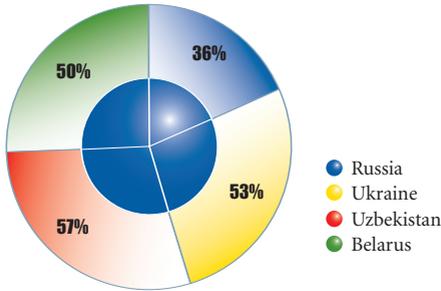
2004

MTS receives additional licenses in Russia to extend its license coverage to 87 out of 89 regions of the country and enters Uzbekistan through the acquisition of a majority shareholding in Uzdunrobita, the country's largest mobile phone operator.

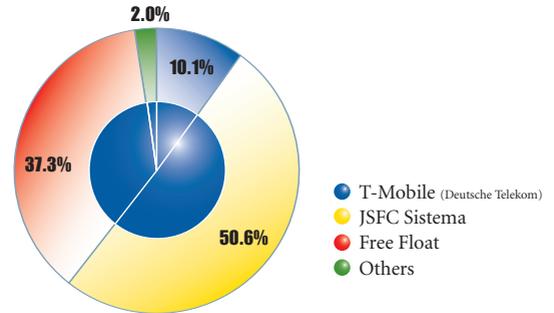


MTS at a glance

Market share of subscribers as of December 2004



MTS' ownership structure as of December 2004



Consolidated statement of operations data

U.S.\$ million	2004	2003	2002
Revenues	3,887.0	2,546.2	1,361.8
Operating income	1,419.1	922.6	464.4
Operating income margin	37%	36%	34%
Net income	987.9	517.2	277.1
Net income margin	25%	20%	20%
Net income per share (U.S.\$)	0.50	0.26	0.14
Net income per ADS (U.S.\$)	0.10	0.05	0.03

Consolidated cash flow data

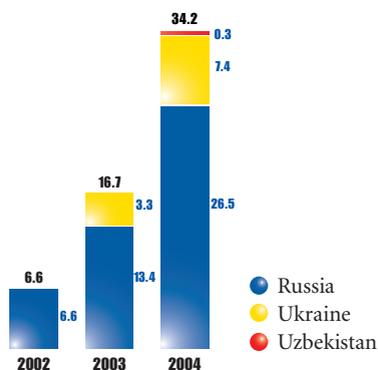
U.S.\$ million	2004	2003	2002
Cash provided by operating activities	1,711.6	966.0	412.8
Cash used in investing activities (of which capital expenditures)	(1,543.2)	(1,910.1)	(697.9)
Cash provided by financing activities	10.8	997.5	100.8

Consolidated balance sheet data (end of period)

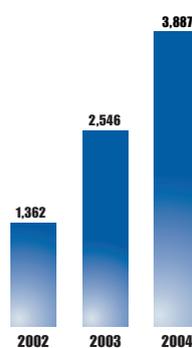
U.S.\$ million	2004	2003	2002
Cash, cash equivalents and short-term investments	347.5	335.4	64.7
Property and equipment, net	3,234.2	2,256.1	1,344.6
Intangible assets, net	1,208.1	1,015.8	525.0
Total assets	5,581.2	4,225.4	2,265.0
Total debt including current portion	1,937.1	1,660.3	454.5
Total liabilities	2,995.8	2,453.8	897.5
Total shareholders' equity	2,523.2	1,723.9	1,302.0

Each ADS is equivalent to one-fifth of one share of MTS' common stock. On January 3, 2005, MTS changed the ratio of its ADSs traded on The New York Stock Exchange from 20 ADSs per one common share to five ADSs per one common share. MTS' ADS holders on record at the close of business on December 27, 2004 received three additional ADSs for every ADS held. All share information presented herein reflects the change in the ratio. There were no changes to the Company's underlying common shares.

Consolidated subscribers at close of year



Year-on-year revenue growth (U.S.\$ million)



Subscribers at close of year (millions)

	2004	2003	2002
Total consolidated subscribers at close of year	34.22	16.72	6.64
Russia	26.54	13.37	6.64
Moscow and the Moscow region	7.52	4.94	3.54
St. Petersburg and the Leningrad region	1.82	1.18	0.83
Other Russian regions	17.20	7.25	2.27
Ukraine	7.37	3.35	–
Uzbekistan	0.31	–	–
Belarus joint venture	1.21	0.46	0.04

ARPU (U.S.\$)

	2004	2003	2002
Russia	12	17	23
Ukraine	13	15	–

SAC (U.S.\$)

	2004	2003	2002
Russia	21	26	35
Ukraine	19	32	–

MOU (minutes)

	2004	2003	2002
Russia	157	144	159
Ukraine	144	97	–

CHURN

	2004	2003	2002
Russia	27.5%	47.3%	33.9%
Ukraine	15.8%	23.8%	–

	2004	2003	2002
Total number of employees at close of year	23,385	19,555	11,042





Letter to the shareholders and partners

We are pleased to present MTS' Annual Review & Financial Statements for the 12 months ended December 31, 2004. 2004 was a year of record success across the board. MTS maintained its number one position in the Russian and Ukrainian markets. The Company also expanded into Uzbekistan and achieved market leadership in Belarus.

We more than doubled our total subscriber base to 34.2 million, with 17.5 million net new consolidated subscribers added during the year. We made investments that will generate future growth and, at the same time, prudently managed our costs. Our strong subscriber base expansion has continued in 2005, with our consolidated subscriber base amounting to 42.3 million at the close of May.

Mobile phone penetration in Russia grew from 25% to 51%¹ in 2004, while penetration in Ukraine increased from 13% to 29%. Capitalizing on this positive market development, we were able to achieve our best ever results in 2004, both operationally and financially. The continued economic expansion and rising levels of disposable income and consumer spending in the countries where we operate, as well as increasing demand for mobile communications services throughout the region, will help MTS to continue the expansion of its subscriber base. At the same time, we are focusing our efforts on increasing customer loyalty and retention by offering a range of attractive tariff structures, and providing a powerful suite of value-added services that will enhance our long-term relationships with our customers.

We are dedicated to sustaining MTS' leading position in Russia and in the other countries in which we operate. This means maintaining leadership in terms of our share of market revenues. It means outpacing our competitors through a superior offering and innovative marketing strategies. It means ensuring that MTS is the most recognized and well perceived brand for mobile communications in all of our markets.

We are also focused on expanding our geographic footprint in order to capture the full potential of newer high-growth markets, both within Russia and throughout the Commonwealth of Independent States (CIS). Along these lines, MTS purchased controlling stakes in three local mobile operators in Russia during 2004. Additionally, we expanded our reach into Uzbekistan, a country with a population of 26.5 million people, by acquiring a controlling shareholding in Uzdurobita, which is the country's largest mobile phone operator.

The Board of Directors and executive management team are committed to ensuring that the benefits of MTS' continued operational and financial growth are returned to our shareholders. The Group's consolidated revenues increased by 53% in 2004, our OIBDA² rose by 57% and we achieved an all-time high annual OIBDA margin of 54%. Consolidated net income nearly doubled year-on-year, increasing to \$987.9 million. Our share price appreciated by 77% in 2004, which we believe reflects the Company's substantial progress throughout the year. The Board of Directors has recommended that the Annual General Meeting of shareholders approve a dividend payment of RUR 5.75 per share (\$1.03 per ADS), which is equivalent to 41% of the Company's 2004 net earnings under US GAAP. The payment of dividends totaling some RUR 11.47 billion (approximately \$410 million)

¹ Unless otherwise mentioned, market and market share statistics in the Annual Review are based on information from independent research firm AC&M Consulting.

² See pages 93 and 94 for definitions and reconciliation of OIBDA and OIBDA margin to their most directly comparable US GAAP financial measures.



Letter to the shareholders and partners

is the largest in the history of the Russian telecommunications industry, and continues our policy of returning value to our shareholders, following last year's payment of RUR 6.38 billion (\$220 million).

Maintaining MTS' leading position in corporate governance and corporate social responsibility is also one of our most important strategic objectives.

As one of Russia's largest companies by market capitalization, we are a prominent corporate citizen in Russia and the other countries in which we operate, and have a significant impact and influence upon these markets.

MTS also greatly values its more than 23,000 employees and makes significant investments in enriching their lives by providing them with opportunities for further education and training. We have also taken care to design and implement supportive workplace conditions that cater for employees' career development and self-improvement.

Looking ahead, 2005 is expected to be yet another successful year for MTS and its partners. With a license area covering a population of 226 million people, there is still tremendous potential for the growth and development of our business. We will seek to continue to drive penetration in our existing markets by capitalizing on our many years of

delivering

MTS is committed to adding value to society at large – not only by making peoples' lives more convenient and secure through our services, but by investing in our communities. In line with these objectives, MTS and its subsidiaries sponsor and support a range of organizations that operate in the areas of cultural development, education, international relations, sports and charity.

experience in developing and managing mobile businesses in the region – strengthening our leading position. We will be introducing value-added services such as DoCoMo's i-mode service and Blackberry in an effort to grow average revenues per user (ARPU) and improve customer loyalty and retention. In addition to generating organic growth within our existing territories, we will continue to aggressively pursue our strategy of

geographical expansion, looking for opportunities to acquire leading positions in markets with low mobile phone penetration rates and high-growth economies. We are optimistic about the business prospects for MTS moving forward and are grateful for your continued support.

A handwritten signature in black ink, appearing to read 'Vlagutin'.

Vladimir Lagutin
Chairman of the Board of Directors

A handwritten signature in black ink, appearing to read 'Vassily Sidorov'.

Vassily Sidorov
President and CEO



From left **ALEXEI BUYANOV, HELMUT REUSCHENBACH, ALEXANDER GONCHARUK, VLADIMIR LAGUTIN, VASSILY SIDOROV, FRIDBERT GERLACH, MICHAEL GUENTHER**



Board of directors

VLADIMIR LAGUTIN

CHAIRMAN OF THE BOARD – NON-EXECUTIVE DIRECTOR

b. 1947, Chairman of MTS' Board of Directors since October 2003. Mr. Lagutin holds a Doctorate in Technical Sciences from the National Electrotechnical Communications University. In 1992 he graduated from the Fuqua Business School at the Duke University (USA). From 1967, he worked at Moscow City Telephone Network, where he rose through a number of engineering and managerial roles, including Chief Telephone Exchange Engineer, Chief of Telephone Exchange, and Deputy General Director for Economics. From 1994, Mr. Lagutin served as General Director of MGTS. In July 2003, Mr. Lagutin was appointed as the General Director of Sistema Telekom. He is the author of more than 100 published works, including four monographs.

MICHAEL GUENTHER

DEPUTY CHAIRMAN OF THE BOARD – NON-EXECUTIVE DIRECTOR – MEMBER OF THE AUDIT COMMITTEE

b. 1944, MTS Board member since October 2000. Mr. Guenther is also a member of the Board of Management of T-Mobile International AG, where he has been responsible for joint venture management since September 2001. Before this, he was Chief Financial Officer of T-Mobile International from February 2000. After completing a business traineeship with Osram in Berlin, Mr. Guenther studied Business Administration at the Universities of Berlin and Hamburg. He began his professional career in 1971 with Philips as Chief Financial Officer in various fields until 1993. Between 1987 and 1993, he was a member of the Board of Management of Philips Kommunikations Industrie in Nuremberg, responsible for controlling, finance, accounting and information technology. In 1994, Michael Guenther moved to DeTeSystems in Frankfurt to become Chief Financial Officer. He joined Deutsche Telekom in 1996 as Head of Finance and Controlling in the business customers division before moving to T-Mobile. Between September 1997 and August 2000, Mr. Guenther was Chief Financial Officer of T-Mobile's German subsidiary, T-Mobile Deutschland.

ALEXEI BUYANOV

NON-EXECUTIVE DIRECTOR – MEMBER OF THE AUDIT COMMITTEE

b. 1969, elected to MTS' Board of Directors in June 2003. Mr. Buyanov graduated from the Moscow Physical-Technical Institute (MFTI) in 1992 with a Degree in Applied Physics and Mathematics. Mr. Buyanov worked at Sistema from 1994 to 1995 in property management. In 1995, he was appointed Head of Department of Sistema-Invest and then became Vice-President of Sistema-Invest. Mr. Buyanov served as Vice-President of MTS from 1998 to 2002. In July 2002, Mr. Buyanov was appointed Vice-President of Sistema to run the department for financial restructuring. Since September 2002, Mr. Buyanov has served as Senior Vice-President of Sistema, heading the company's financial and investment group.

FRIDBERT GERLACH

NON-EXECUTIVE DIRECTOR

b. 1957, elected to MTS' Board of Directors in June 2004. Mr. Gerlach is a Member of the Supervisory Board of Polska Telefonia Cyfrowa Sp.z.o.o. (PTC), which is affiliated with T-Mobile and Zeta GmbH. He graduated from the Aachen Institut of Technology (RWTH Aachen) with a Master's Degree in

Communications Engineering and Industrial Engineering in 1987. He started his professional career at Alcatel SEL in Stuttgart in 1987, where he held various senior management functions in the marketing sector. He began his employment with Deutsche Telekom Group (Detemobil GmbH) in 1997, responsible for CIS projects. In 1999 he moved to Deutsche Telekom Headquarters. Between 2001 and 2003, he was Head of Deutsche Telekom's Region Central and Eastern Europe, Middle East, responsible for the management and co-ordination of mergers and acquisitions as well as integration projects in the region. Since June 2003, Mr. Gerlach has served as Executive Vice-President Joint Venture Management of T-Mobile International AG and COKG.

ALEXANDER GONCHARUK

NON-EXECUTIVE DIRECTOR

b. 1956, served as Chairman of the Board of Directors of MTS in 1998 and from June 2002 to October 2003. Mr. Goncharuk also served as Deputy Chairman of the Board in 1997, and from January to June 1999, and Chairman of the Board of Directors of MTS in 1998. From 1998, Mr. Goncharuk held the post of President of Sistema Telekom. From July 2003, he was appointed General Director of Sistema's Scientific Center – KNTs. Since 2000, Mr. Goncharuk has served as a Board member of Sistema.

HELMUT REUSCHENBACH

NON-EXECUTIVE INDEPENDENT DIRECTOR – CHAIRMAN OF THE AUDIT COMMITTEE

b. 1948, elected to MTS' Board of Directors in November 2004 as an independent director. Helmut Reuschenbach is an Independent Financial Advisor and was a director at Lazard & Co. Frankfurt until the end of 2004. Mr. Reuschenbach joined Lazard, the global investment bank, in January 2001 from Deutsche Telekom where he served as Treasurer and Senior Executive Vice-President for Finance for six years. He led the project to privatize Deutsche Telekom – one of the largest German IPOs of the 1990s – and was responsible for a number of capital markets transactions within the group, such as the IPOs of several subsidiaries and a number of global multi-currency bond issues. Prior to 1994, he was the Chief Financial Officer and a member of the Board at Mercedes-Benz S.A. in Belgium, while heading Daimler-Benz Co-ordination Center and Daimler-Benz Financial Company S.A. as the Chief Executive Officer. From 1989 to 1993, Mr. Reuschenbach was Vice-President for Finance at Daimler-Benz S.A. in Stuttgart. Previously, he was Director of Finance at AEG Aktiengesellschaft in Frankfurt, Director of Finance and Administration at AEG Italiana S.p.A. in Milan, and Corporate Finance Manager at AEG-TELEFUNKEN Aktiengesellschaft in Frankfurt. Mr. Reuschenbach is a graduate of Business and Administration from the Fachhochschule des Landes Rheinland-Pfalz in Mainz, and in Macro-Economics from the Johannes-Gutenberg-University in Mainz.

VASSILY SIDOROV

EXECUTIVE DIRECTOR

(Please refer to biography in the executive management section.)



From left

**SERGEY ASLANYAN, VASSILY SIDOROV, YURY GROMAKOV, RAINER HENNIKE, ALEXANDER GORBUNOV, TATIANA
EVTUSHENKOVA, DMITRY PROHORENKO, ANDREY BRAGINSKI, IGOR STOLYAROV, NIKOLAI TSEKHOMSKY**



Executive management

VASSILY SIDOROV

PRESIDENT AND CHIEF EXECUTIVE OFFICER

b. 1971, appointed President and CEO of MTS in October 2003. Vassily Sidorov joined MTS from Sistema Telecom, where he served for three years as First Vice-President for Finance and Investments. In this position, he was responsible for the M&A, corporate finance and investment affairs of the company. Prior to joining Sistema Telecom, Mr. Sidorov served as Deputy General Director/Chief Financial Officer of Svyazinvest Holding from 1997. From 1994 to 1997, he owned and managed several companies specializing in investment and M&A advisory services, as well as equity and fixed-income trading. Mr. Sidorov is a graduate of the Wharton School of Business at the University of Pennsylvania and of the International Law Faculty of the Moscow State International Relations Institute.

YURY GROMAKOV

VICE-PRESIDENT, TECHNOLOGY

b. 1946, joined MTS in 1994. Dr. Gromakov has worked for various industrial military companies in the telecommunications field since 1973. Dr. Gromakov is a graduate of the Moscow Aviation Institute. He is one of the leading experts on mobile communications in Russia and holds a Doctorate in Technical Sciences. He is the author of more than 200 published works, including two monographs.

RAINER HENNIKE

VICE-PRESIDENT, INTERNATIONAL AFFAIRS

b. 1943, joined MTS in 2003. Prior to joining MTS, Dr. Hennike worked at DeTeMobil Deutsche Telekom MobilNet GmbH, which is a subsidiary of Deutsche Telekom AG, as a Managing Director and Head of the Representative Office in Russia. Previously, he held different positions at Deutsche Post, DETECOM and a number of other Deutsche Telekom AG subsidiaries. From 1995 to 2003, he served as an MTS Board member. Dr. Hennike is a graduate of the Transport and Communications Department of the Dresden University.

NIKOLAI TSEKHOMSKY

VICE-PRESIDENT, CHIEF FINANCIAL OFFICER

b. 1974, joined MTS in 2002. Prior to joining MTS, Mr. Tsekhomsky worked as the Finance Director of the investment bank Renaissance Capital. He has also worked at Brunswick UBS. Mr. Tsekhomsky started his career at Ernst & Young, where he worked as auditor on various projects in Russia and the UK. Mr. Tsekhomsky is a graduate of St. Petersburg Academy for Engineering and Economics. He has a PhD in Economics.

TATIANA EVTUSHENKOVA

VICE-PRESIDENT, INVESTMENT AND CORPORATE DEVELOPMENT

b. 1976, joined MTS in October 2002. Prior to joining MTS, Ms. Evtushenkova was the Director of the investment department at Sistema Telecom from December 1999. She is a graduate of the Government of the Russian Federation's Financial Academy and London School of Economics.

SERGEY ASLANYAN

VICE-PRESIDENT, CHIEF INFORMATION OFFICER

b. 1973, joined MTS in 2003. Prior to joining MTS, Mr. Aslanyan worked at TNK-BP Management as the Deputy Director of Information Technology. He worked at PriceWaterhouseCoopers from 1997 to 2001 (from 1997 to 1999 at Coopers&Lybrand). Mr. Aslanyan is a graduate of the Computer Science and Cybernetics Department of the Moscow State University and is a member of Intel Russia's advisory board.

IGOR STOLYAROV

VICE-PRESIDENT, SALES AND CUSTOMER SERVICE

b. 1969, joined MTS in 2004. Prior to joining MTS, Mr. Stolyarov worked at Gillette International as the Regional Director for the CIS and Baltic States. He has also worked for Duracell Russia, Coca-Cola Moscow and Ernst & Young Vneshaudit. Mr. Stolyarov is a graduate of the Moscow State International Relations Institute.

ALEXANDER GORBUNOV

DIRECTOR OF STRATEGY

b. 1967, joined MTS in 2003. Prior to joining MTS, Mr. Gorbunov was a director of the Strategic Analysis and Planning Department at Sistema Telecom. Previously, he spent over five years with Bain & Company in Moscow and Boston. Mr. Gorbunov is a graduate of the Moscow Engineering Physics Institute and has an MBA from Harvard Business School.

DMITRY PROHORENKO

DIRECTOR OF HUMAN RESOURCES

b. 1969, joined MTS in February 2004. Prior to joining MTS, Mr. Prokhorenko worked at M.Video, one of Russia's largest electronics retail chains, as Human Resources Director. Between 1993 and 2002 he held different managerial positions in sales and human resource management at L'Oreal Russia. Mr. Prokhorenko is a graduate of the Nizhni Novgorod State Linguistics University and accomplished a General Management Program at CEDEP in Fontainebleau, France.

ANDREY BRAGINSKI

DIRECTOR OF INVESTOR RELATIONS

b. 1974, joined MTS in 2002 from the leading Russian investment group, Renaissance Capital. At Renaissance Capital, Mr. Braginski worked as a Senior Equity Analyst/Vice-President covering the Russian telecommunications industry. Previously, Mr. Braginski worked as an analyst at RTK Leasing, an investment branch of Rostelecom, at ING Barings, and Skate, an analytical and information agency. Mr. Braginski is a graduate of the Physics Department of the Moscow State University and of the State University, Higher School of Economics.



Inside MTS

Providing regional Russia with a superior mobile phone offering

MTS continued to expand its business across Russia's regions during 2004 by building out and launching networks, as well as through the acquisition of local network operators.

MTS made significant investments in order to expand and improve its network in Russia, increasing the number of base stations from 7,166 in 2003 to 10,693 in 2004. During the year, the Company also unified a number of its subsidiaries under the MTS brand, including Primtelefon, Uraltel, Sibchallenge and MSS.

Customers located in the Russian regions where MTS has acquired the local mobile network operator benefit in a variety of ways from becoming part of the Company's national network. First, they automatically profit from the more than 11 years' experience that MTS has in building and managing mobile phone networks that adhere to strict technical standards. The enhanced quality of service that MTS brings to customers translates into tangible improvements in their mobile communications experience.

Besides the superior quality of MTS' network, regional Russian customers also benefit from MTS' nationwide presence and in-country roaming capabilities. Roaming on another provider's network can prove to be a very costly exercise but, as an MTS subscriber, customers are able to remain on the same network throughout Russia and benefit from far more attractive tariff structures.

As an MTS subscriber, the customer becomes a member of the largest mobile community in Russia and associates themselves with one of the most recognized brands in the country.

MTS subscribers in Russia's regions are able to save money through two unique schemes: first, the price of a long-distance call to an MTS subscriber in another region is the same as a local call; and second, all incoming calls from MTS subscribers are free, regardless of the customer's location. Additionally, regional Russian customers can take advantage of MTS' unified payment system, which allows them to pay for the service through a wide network of supermarkets, banks and retailers (a total of 20,501 points of sale in Russia); or via the Internet and phone. They can also purchase additional services or receive support from MTS' more than 327 sales and customer service centers across Russia.



**CUSTOMERS IN
RUSSIA'S REGIONS
EXPERIENCE MANY
BENEFITS BY
BECOMING PART OF
MTS' NATIONAL
NETWORK, INCLUDING
FAVORABLE TARIFFS
AND A HIGHER
QUALITY OF SERVICE**

Improving



Market trends

Market demand and economic growth continue to drive business

The past year was one of phenomenal mobile penetration growth in MTS' core markets – Russia and Ukraine. The number of cellular users in Russia and Ukraine more than doubled, from 36 million to 74 million and from 6.6 million to 13.8 million respectively.

Penetration in Russia increased from 25% to 51%, and from 13% to 29% in Ukraine. Mobile penetration in the two countries significantly outpaced fixed line penetration, which stood at around 29%³ and 20%⁴, respectively, at the end of the year.

MTS, with its investment in network build-out and subscriber acquisition, has been a major driver of this growth. Mobile penetration in Belarus grew by 13% during the year and reached 24% by the end of the year. The Uzbek market, which MTS entered via its acquisition of Uzdurobita in 2004, is also an under-penetrated market with enormous potential for further development. Mobile penetration was estimated at 2%⁵ of a total population of 26.5 million⁶.

As mobile penetration rates continue to rise, the importance of developing customer loyalty and trust, as well as deepening MTS' relationship with its subscribers, will continue to increase. MTS is well positioned in this respect, with many programs aimed at increasing customer loyalty and a range of value-added, non-voice services that further benefit subscribers.

The Russian economy continued its recovery in 2004, with a number of key indicators helping to drive MTS' business forward. The country's GDP expanded by 7.1%⁷ and per capita income grew by 7.8%⁷ in real terms for the year, with consumption up by 11.3%⁷, stimulating growth and increasing demand for MTS' products and services.

As an indication of the improving health of Russia's capital markets, Russian sovereign debt was promoted to an "Investment Grade" rating by Standard & Poor's (S&P) at the beginning of 2005. S&P was the last of the three major credit rating agencies to promote Russia to this category.

Despite the dramatic political developments in the second half of the year, Ukraine posted economic growth of 12.1%⁸ for 2004. Recovery in Ukraine is now in its fourth successive year, and is being driven by robust growth in personal income, private consumption and the development of small and medium-sized businesses. Domestic household income in Ukraine grew by an encouraging 16%⁸ in 2004.

MTS expects that mobile penetration in its territories will continue to expand in the coming years, fueled by continued economic growth, the increasing demand for voice and non-voice services and the declining prices of these services. In order to exploit this growth, the Company will continue to invest in the development of its infrastructure and the consolidation of its market-leading position.

³ Source: Russian Information Technologies and Communications Ministry (including fixed-lines used by all corporate networks).

⁴ Source: Ukrtelecom (the incumbent fixed-line operator in Ukraine).

⁵ Source: The Uzbek Agency for Communications and Informatization.

⁶ Source: The State Statistics Committee of Uzbekistan.

⁷ Source: Russian Federal Committee on Statistics.

⁸ Source: The State Statistics Committee of Ukraine.



adapting

**IN TANDEM WITH
CONTINUED ECONOMIC
GROWTH IN THE
REGION, MTS HAS
BEEN A MAJOR FORCE
IN DRIVING MOBILE
PENETRATION RATES
IN EACH OF ITS
CORE MARKETS**



Business strategy

MTS' strategy is aimed at preserving and strengthening its position as the leading cellular operator in Russia and the neighboring countries. The Company aims to excel in every aspect of its business – in profitability, in subscriber acquisition and retention, and in geographical presence. In order to achieve these goals, management is focused on executing the following strategic objectives:

INCREASE THE COMPANY'S REVENUES AND MAINTAIN HIGH LEVELS OF PROFITABILITY

Extensive subscriber base growth and entrance into new markets have contributed to the continuous growth in MTS' revenues. While many mobile markets where MTS operates continue to experience rapid expansion, management is exploring ways to drive revenues from customers by providing value-added services in anticipation of eventual market maturation. At the same time, maintaining effective control over the Group's operating costs and capital expenditure is amongst management's major priorities.

EXPAND AND DEVELOP MTS' GEOGRAPHIC PRESENCE

MTS will continue to build networks within the framework of its existing licenses in Russia's regions, as well as expand its existing networks. The Company seeks further expansion opportunities in Russia and neighboring countries, including the acquisition of other cellular operators.

CONSOLIDATE AND INTEGRATE SUBSIDIARIES INTO THE MTS BRAND

In order to have complete operational and financial control over its regional businesses, as well as to streamline management processes, MTS aims to consolidate 100% of all of its subsidiaries through the buying-out of minority stakes. The Company therefore expanded its stakes in a number of its Russian cellular subsidiaries during 2004. MTS is also actively bringing its subsidiaries under the MTS trademark, allowing it to employ the strength

of its national brand and conduct nationwide marketing campaigns more effectively. In addition, MTS' management is focused on harmonizing and integrating the enterprise resource planning (ERP), billing and customer services systems of its acquired regional operators.

FURTHER IMPROVE THE QUALITY OF SERVICE FOR SUBSCRIBERS

The Company's subscribers associate MTS with premium mobile telephony. MTS sees further improvement in the quality of its services as one of its top priorities, and is continually investing to maintain the highest quality standards and widen the spectrum of its non-voice services and payment methods, as well as working to improve its service segmentation. As the Russian cellular market begins to mature, MTS' focus will naturally shift from attracting new clients to keeping existing subscribers, by increasing their loyalty through the provision of exclusive value-added services and increasing their trust in MTS' brands.

CONTINUE TO DEVELOP NON-VOICE SERVICES AND PROVIDE SUBSCRIBERS WITH ACCESS TO PREMIUM SERVICES AND CONTENT

As the Company's GSM subscriber base develops, non-voice services play an ever-growing role in the development of MTS' business. Technologies and services such as SMS, WAP, MMS and GPRS enable MTS' subscribers to access a wide array of information and services from their mobile phones. The Company is committed to developing the most advanced mobile

technologies across its network, in order to continually improve the breadth and quality of its service offering to customers.

FURTHER STRENGTHEN INTERNAL BUSINESS PROCESSES AND STREAMLINE MANAGEMENT PROCEDURES

Over the past year, MTS has implemented a new three-tiered management structure, in order to optimize the running of the Company's regional operations – comprising headquarters, macro-regions and regions. The Company also introduced a new function-based management structure in 2004. MTS plans to focus further on performance enhancing initiatives during 2005 – from implementation to monitoring and the continuous evaluation of the effectiveness of

of their performance. With this in mind, in 2004 MTS began introducing management contracts based on the Company's and individual department KPIs and project implementation.

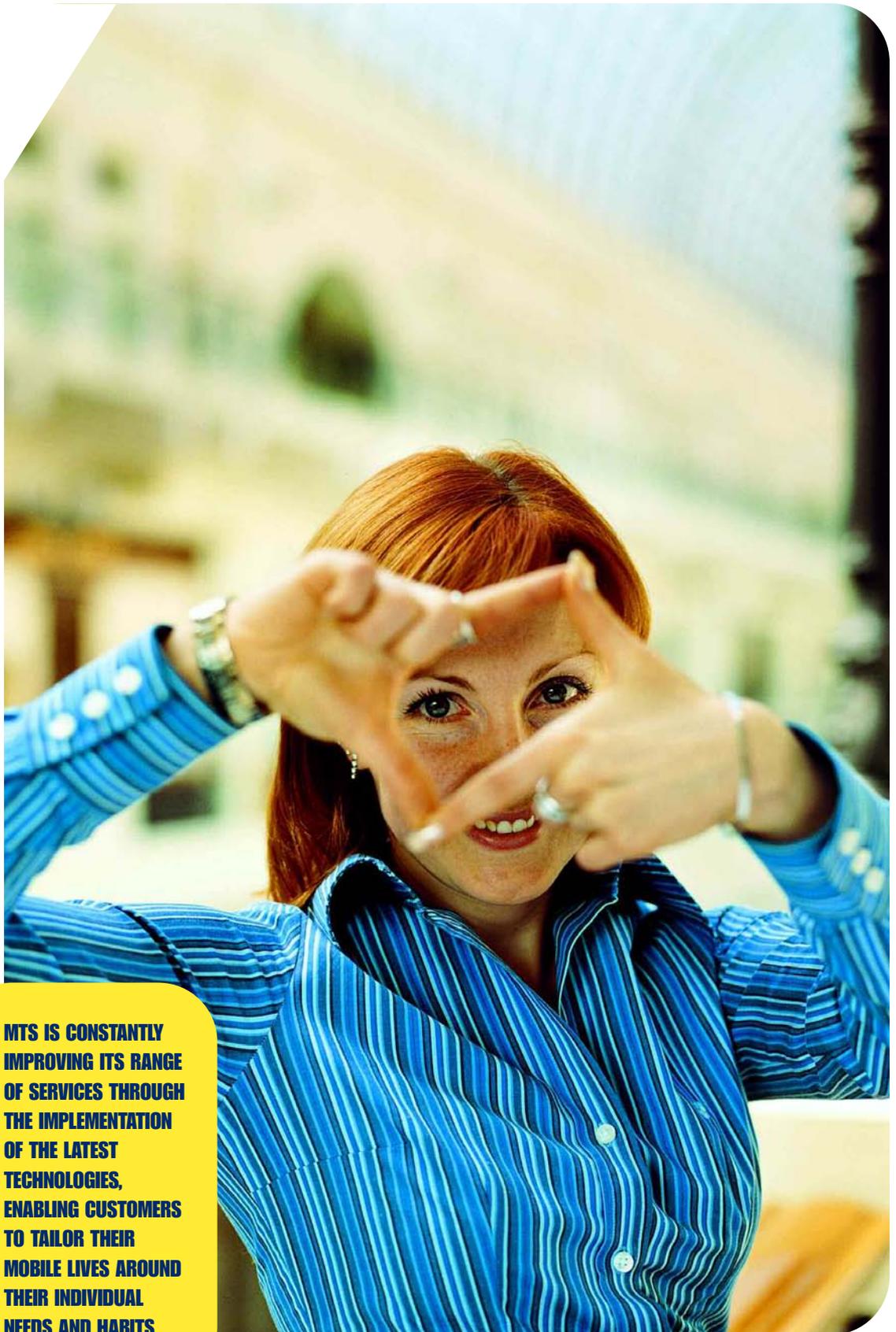
Leadline

MTS' human capital management and business performance, such as the implementation of state-of-the-art ISO 9000 and eTOM-based business process redesign (BPR) systems.

PROMOTE THE PROFESSIONAL DEVELOPMENT OF EMPLOYEES AND A MOTIVATIONAL CULTURE

Preserving and strengthening MTS' leadership position would be impossible without the professionalism and dedication of the Company's staff. MTS' management places a high priority on attracting top professionals by providing for their further training, as well as creating the right conditions for their career development and self-improvement. One of management's key tasks is to continue to improve the ways in which MTS links the evaluation of individual employees and business units with objective indicators





MTS IS CONSTANTLY IMPROVING ITS RANGE OF SERVICES THROUGH THE IMPLEMENTATION OF THE LATEST TECHNOLOGIES, ENABLING CUSTOMERS TO TAILOR THEIR MOBILE LIVES AROUND THEIR INDIVIDUAL NEEDS AND HABITS



Russia

Active expansion of the network, well-structured tariff plans, advanced marketing solutions, quality customer service and a first-class network, all contributed to the record number of new subscribers in Russia during 2004.

customising

MTS retained its position as the leading mobile phone operator in Russia, with 26.5 million subscribers by the end of the year. 13.1 million new customers were added in Russia in 2004, of which 12.6 million were the result of organic growth. MTS also increased its leading market share in the country's key market of Moscow and the surrounding region from 44% to 45%. In the first five months of 2005, MTS' subscriber base in Russia has expanded by a further 6.5 million customers, all of which were added organically, taking the total subscriber base to 33.0 million as of the end of May 2005.

MTS' leadership in the Russian market and the high level of consumer trust in the Company has yielded a premium-quality subscriber mix. The Company is also well positioned within the mass-market segment. As a testament to MTS' leadership in the Russian market and the high level of consumer trust in the Company, MTS was named the most popular Russian cellular operator in 2004 by Narodnaya Marka, the leading independent Russian brand-rating organization.

As GSM licenses in Russia were allocated on a per-regional, or in some cases macro-regional basis, MTS had to extend its license portfolio by

either acquiring local license holders or functioning operators, or through negotiations with the government to obtain new licenses. In February 2004, MTS received GSM licenses to operate in 11 new regions with a total population of 14.3 million. In addition, the Company received 900 MHz extensions to existing GSM1800 licenses in several regions, helping to improve coverage and optimize CAPEX spending. The Company's Moscow and Moscow region 900/1800 MHz license was also renewed until April 2008.

MTS acquired three local market leaders – Sibintertelecom, Gorizont RT, and Telesot-Alania – over the course of 2004, reinforcing the Company's operations in Siberia, the Far Eastern and Southern parts of Russia, as well as enabling the Company to become the number one operator in the respective regional markets.

As the result of the new license allocation and acquisitions, MTS had secured licenses in every region in Russia, with the exception of Penza and Chechnya, by the end of 2004. The Company's license area in Russia covered 142.6 million people at year end, or approximately 98% of the country's population.



Business operating review

In addition, during the year, MTS consolidated its ownership in eight regional companies.

MTS launched a variety of innovative marketing initiatives and promotions aimed at driving new subscriber intake. These programs – including “JEANS-MINUTE”, “JEANS Gift Package”, “JEANS 2005 Bonus Seconds”, special offers on MTS-branded handsets, and a long-distance service offer – helped contribute to dynamic subscriber growth during 2004.

MTS completely restructured the management of its regional operations within Russia during 2004. This enabled the Company to streamline its business processes, resulting in more modern, flexible and efficient management structures. As a result of these efforts, the Russian business is now managed as a single, consolidated operation.

MTS became the first mobile phone operator to offer customers term contracts in Russia. While term contracts are a popular solution for many European and North American operators, they are unique in MTS’ domestic market. Through the offering of term contracts with discounted rates on incoming and outgoing calls, MTS aims to increase subscriber loyalty.

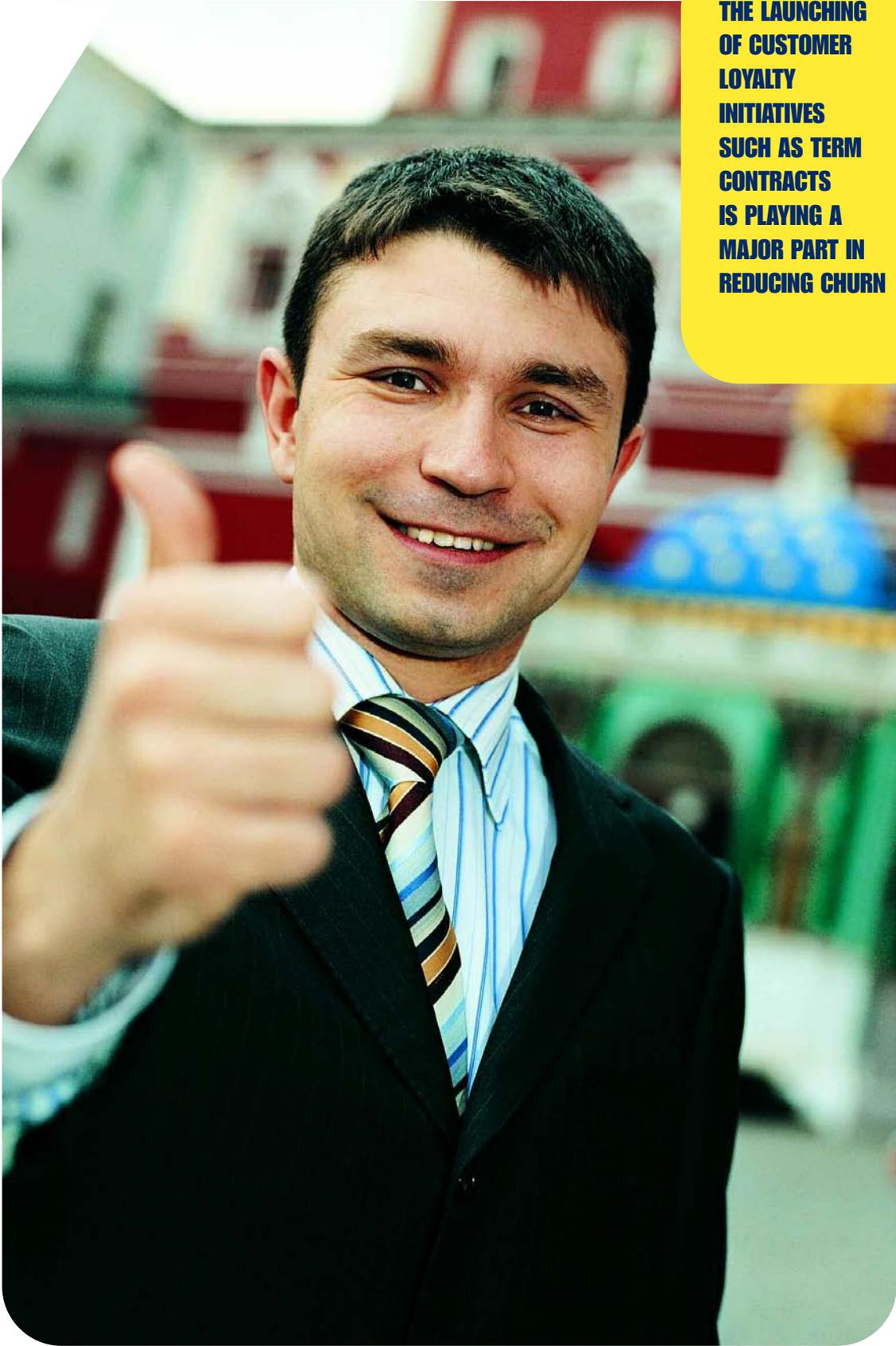
The introduction of term contracts, along with other customer loyalty initiatives such as MTS-branded handsets and “MTS.CARD” bank cards that offer rewards such as monthly bonus minutes for local and mobile calls, contributed to churn reduction in 2004. In 2004, MTS also increased the number of MTS proprietary retail outlets in Russia to 327 operations, which function as both sales and customer service centers.

MTS strives to provide unified market offerings and, to this effect, strengthened its operational efficiency by carrying out targeted investments in its information technology (IT) systems in 2004. New IT projects in the year included the beginning of the migration to a new single billing system for all of MTS’ Russian customers, the introduction of an Oracle e-business suite (ERP system) to streamline the Company’s main business processes and reduce costs, and the implementation of an electronic document management system across the Company’s Russian operations. These measures will aid in the consolidation and streamlining of the many IT systems MTS has inherited as a result of its acquisitions in recent years.

As the Company’s GSM subscriber base continues to develop, MTS strives to anticipate and satisfy customers’ demands for next generation services. MTS is committed to enabling its customers to access new state-of-the-art technologies as they emerge, and to delivering these services to all subscribers through competitively priced and scalable packages.

In line with these strategic objectives, MTS announced the signing of an exclusive agreement with DoCoMo. The Company is planning to launch the i-mode service in the second half of 2005, which will enable customers to have easy access to numerous Internet sites with premium content, as well as specialized services such as e-mail. The service will initially be deployed within the two largest regional markets – Moscow and St. Petersburg – and gradually expand into other regions in Russia, eventually reaching into the other CIS countries in which MTS operates.

MTS also introduced international GPRS roaming to its subscribers in 2004, enabling customers to use various GPRS-based services while traveling abroad.

A man in a dark suit, light blue striped shirt, and striped tie is smiling and giving a thumbs up. The background is a blurred indoor setting with red and white elements.

**THE LAUNCHING
OF CUSTOMER
LOYALTY
INITIATIVES
SUCH AS TERM
CONTRACTS
IS PLAYING A
MAJOR PART IN
REDUCING CHURN**



**MTS' UKRAINIAN
BUSINESS
STRENGTHENED ITS
LEADING POSITION
IN 2004, GROWING
ITS MARKET SHARE
TO 53% AND
ADDING SOME
FOUR MILLION
NEW CUSTOMERS**



UKRAINE

2004 yielded many positive developments for MTS, not only in Russia but also in Ukraine, which comprised approximately 21.4% of the Company's net revenues. In Ukraine, MTS operates through UMC, which is a 100%-owned subsidiary of MTS.

broadening

In 2004, the Company's Ukrainian operations grew faster than its Russian business, both in terms of subscribers and revenues. The number of subscribers in Ukraine increased by 4.0 million to a total of 7.4 million by year end. UMC retained its leading position, improving its market share from 51% to 53%. Since the beginning of 2005, UMC added 1.5 million subscribers, and has grown its total subscriber base to 8.9 million as at the close of May 2005.

During 2004, MTS spearheaded a number of innovative business concepts in Ukraine. UMC launched the "Let's Make Ukraine Mobile" program, which is based on four key elements: expansion of coverage, improvement of quality, affordability and transparent business ethics. UMC also introduced a GPS/GSM-based service under the brand "UMC Navigator", allowing businesses to manage and control their transportation vehicles.



UZBEKISTAN and BELARUS

MTS extended its operations into the Uzbek market in 2004 by acquiring a 74% stake in Uzdurobita, which is the country's leading cellular provider. Last year was also a success for MTS' operations in Belarus, which is yet another example of the Company's ability to leverage its Russian experience and export its proven model to new markets.



UZBEKISTAN

With a population of 26.5 million people, Uzbekistan is the third largest market by population in the CIS after Russia and Ukraine.

Uzbekistan's mobile market is at a very early stage of development, with penetration levels at just 2%. Fixed-line penetration stood at just 6.8%. Similar to MTS' core markets (Russia and Ukraine), Uzbekistan posted significant economic growth for the year, with real GDP growth for the country rising by 7.7%⁹ in 2004.

At the end of 2004, Uzdurobita provided services to 310,000 subscribers. The operator's subscriber base increased to 386,000 as at the close of May 2005.

Since acquiring its stake in Uzdurobita, MTS' growth strategy in Uzbekistan has focused on measures such as the launching of prepaid tariffs by the end of 2005, investments in network build-out, implementation of a new billing platform and the further development of distribution channels.

BELARUS

In 2004, the Company's 49%-owned unconsolidated joint venture, MTS Belarus, added 750,000 new customers, bringing the total number of subscribers to 1.21 million by the year end. MTS Belarus grew its market share to 50% by the year end, securing its position as the number one operator in the country. The joint venture has surpassed its competitors after only two years of operation. As of the end of May 2005, MTS Belarus provided services to some 1.53 million subscribers.

The achievements of MTS' operations outside Russia underscore the rationale for the Company's further expansion plans. In 2005, MTS will continue to look selectively for appropriate acquisition opportunities across the CIS.

⁹ Source: Estimates of Avesta Investment Group Research.



**EXPANSION INTO THE
UZBEK MARKET GIVES
MTS PRIME
POSITIONING IN
THE REGION'S THIRD
MOST POPULATED
COUNTRY, WHERE
MOBILE PHONE
PENETRATION IS
AT JUST 2%**



**MTS IS WORKING
HARD TO MAINTAIN
ITS POSITION AS
ONE OF THE MOST
TRANSPARENT,
ACCOUNTABLE
AND RESPONSIBLE
CORPORATIONS
IN RUSSIA**



As one of Russia's largest corporations by market capitalization and one of the leading communications brands in Russia and the CIS, MTS' Board of Directors and management team recognize the responsibilities the Company has in terms of the economic and social impact MTS has within Russia and its other areas of operation.

implementing

CORPORATE GOVERNANCE

As testimony to the Company's success in maintaining a leading corporate governance policy and transparency in the eyes of the international financial community, MTS retained one of the highest corporate governance ratings in Russia, according to the Standard & Poor's agency. Additionally, in 2004, IR Magazine named MTS as the company with the "Best Corporate Governance in Russia." The election of an independent non-executive director to MTS' Board of Directors in 2004 further strengthened this position. A second independent non-executive director is expected to join the Board in 2005.

SOCIAL RESPONSIBILITY

MTS sponsored and financed numerous projects in 2004 as part of its social responsibility program. The Company's capital was put to work primarily in the areas of cultural development, education, international relations, sports and charity work, including the following initiatives:

Cultural development

MTS supports a regional project of the State

Russian Museum called Virtual Branches of the Russian Museum. The Virtual Branch allows the user to tour the Museum virtually and interactively and is usually installed in regional Universities or Museums.

MTS organized a tour to 50 Russian cities, which was entitled MTS-EXPO. MTS facilitated entertainment in each city, including games, children's clubs, shows, dancing, competitions, concerts, and fireworks.

MTS' 100%-owned Ukrainian subsidiary, UMC, supported the children's music and dance group, Svitanok, which promotes Ukrainian folk culture around the world.

Education

MTS is a sponsor of the Russian chapter of the AIESEC Association, which is the world's largest student organization.

In Ukraine, UMC granted 74 scholarships to top university students from around the country. Furthermore, to mark its five million subscriber milestone, UMC built and inaugurated a playground for children in the center of Kiev.



Corporate governance and social responsibility

International relations

MTS and UMC are both members of the American Chamber of Commerce and sponsor and support a wide range of events. UMC is also a member of the European Business Association, an organization established as a forum for the discussion and resolution of problems facing the private sector in Ukraine.

The Company also supports the activities and projects of the Russo-British Chamber of Commerce, an organization that facilitates trade between Britain and Russia.

Sports

MTS is a sponsor and official cellular services provider to the Kremlin Cup Tennis Tournament. The Company also sponsors the MTS AC Racing car racing team, one of Russia's leading teams in the Touring category.

Charity

MTS donated over \$100,000 to the victims of the Beslan hostage crisis. In addition to MTS' corporate contribution, Company employees donated their own money to the cause as well.

UMC, together with Nokia and Ohmatdit Hospital for Children, launched a unique project called Mobile Consilium, which enables real-time consultations between reconstructive plastic microsurgery specialists, saving valuable time and improving chances of successful surgery.

Each year, MTS receives hundreds of requests for financial contributions from a variety of worthy causes. The Company responds to each based on the merit of the proposal and the relative benefit it will provide to the individual or community involved.

satisfying



Financial and capital markets review

MTS' 2004 financial results demonstrate the success of the Group's strategy to expand its business by increasing the Company's subscriber base through organic growth and strategic acquisitions, as well as management's continuous focus on optimizing underlying business processes and the integration of acquired companies.

2004 was another year of unprecedented growth for the Company, with a 53% year-on-year increase in net revenues to \$3.9 billion and a 57% increase in operating income before depreciation and amortization (OIBDA) to \$2.1 billion. Net income from operations reached \$987.9 million, almost doubling year-on-year.

Compared to the previous year, MTS' OIBDA margin increased from 53% to 54% as a result of increased economies of scale and tough cost control measures, which compensated for the pressure on margins from relatively high inflation levels in both Russia and Ukraine. In addition, the subscriber acquisition cost (SAC) per gross additional subscriber continued to decline in 2004, reflecting the lower cost of attracting mass-market subscribers.

Expansion in the subscriber base during the year resulted in a further dilution of the subscriber mix by mass-market subscribers that, along with certain tariff reductions and promotions, led to a decline in ARPU. Management expects the trend of declining ARPU to continue in 2005.

The Company recorded positive annual cash flow of \$352 million¹⁰ in 2004, excluding acquisitions, and nearly achieved a break-even result with the inclusion of acquisitions.

MTS' full-year cash expenditure on property, plant and equipment amounted to \$1.2 billion, of which \$955 million was invested in Russia, \$246 million in Ukraine, and \$3 million in Uzbekistan. Cash expenditure on intangible assets during the year amounted to \$155 million (\$119 million in Russia and \$36 million in Ukraine).

In line with the Company's strategy to expand the geographical reach of its operations, MTS continued to acquire regional market leaders. The Company spent \$356 million (net of cash in acquired companies) on acquisitions during the year, comprised of \$235 million in the regions of Russia and \$121 million on acquiring the business in Uzbekistan.

Strong operating cash-flow generation resulted in a further decrease in MTS' relative leverage level. As of December 31, 2004, MTS' total debt¹¹ stood at \$1.94 billion, resulting in a ratio of total debt to OIBDA of 0.9 times, compared to 1.2 times in 2003. The Company's cash and cash equivalents amounted to \$274 million at the end of 2004 and net debt amounted to \$1.59 billion.

¹⁰ Please refer to page 93.

¹¹ Total debt is comprised of the current portion of debt, current capital lease obligations, long-term debt and long-term capital lease obligations; net debt is the difference between the total debt and cash and cash equivalents and short-term investments. See pages 93 and 94 for the net debt reconciliation to our consolidated balance sheets.



Financial and capital markets review

MTS' average cost of borrowing decreased from 8.1% at the beginning of the year to 7.4% at the close of 2004. This was due in part to the favorable terms MTS was able to secure for the \$600 million Syndicated Loan that was arranged in July by a number of leading international banks. The loan was a landmark event, as it was the largest ever unsecured loan to be successfully arranged in Russia, and the first of its kind to be arranged outside the oil and gas sector. The proceeds of the loan were used for the repayment of higher interest rate bearing Eurobonds, as well as for general corporate development purposes. Global Finance named MTS as the "Best Telecom Company" as part of its "Best Companies in Russia 2005" awards.

In October 2004, MTS obtained committed credit facilities from HSBC Bank and ING BHF-Bank in an aggregate amount of \$122 million. The funds will be used to expand and enhance the Company's network through the purchase of equipment and software from Siemens and Alcatel.

In December, MTS received a further \$150 million in loan financing from the European Bank for Reconstruction and Development, which will be used to finance investments in the Russian regions outside Moscow and St. Petersburg.

Improved MTS fundamentals resulted in an upgrade of the Company's credit rating by Standard & Poor's in April 2004 from B+ to BB- (outlook stable). The Company's credit rating by Moody's remained unchanged at Ba3 (outlook stable).

+53%

Consolidated revenues

+91%

Consolidated net income

54%

Consolidated OIBDA margin



Share structure and performance

The Company's success is supported by the expertise and strong backing of its core shareholders – Sistema (50.6% owner), which is the largest private sector consumer services company in Russia and the CIS, and T-Mobile (10.1% owner), which is a leading international mobile phone operator.

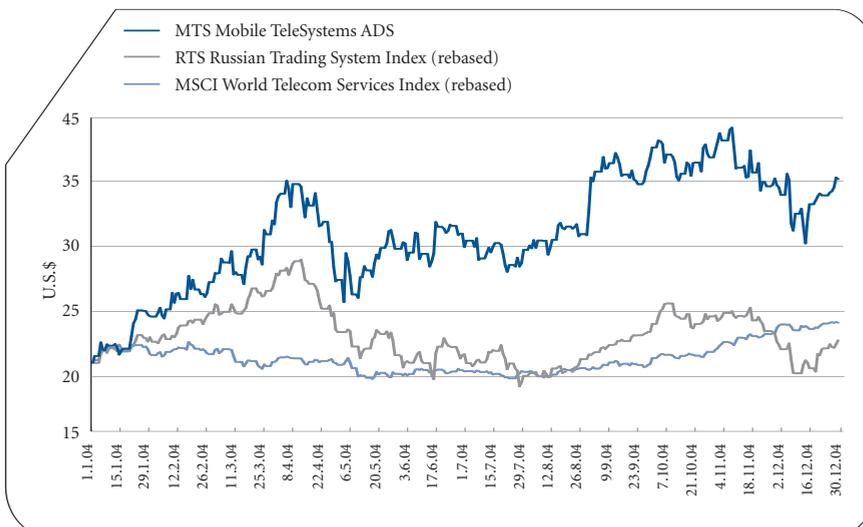
MTS' Level 3 American Depository Shares (ADSs) have been listed on the New York Stock Exchange (NYSE) since June 2000. The Company's Global Depository Receipts (GDRs) are also traded on an over-the-counter basis on various European exchanges. Local shares have been traded on the Moscow Interbank Currency Exchange (MICEX) since November 2003. Local shares and GDRs are transferable into ADSs subject to certain requirements and limitations. The majority of trading volume in the Company's securities occurs on the NYSE.

On December 15, 2004, MTS announced a change to its ADS ratio from one ADS per 20 ordinary shares to one ADS per five ordinary

shares, which became effective on the first day of trading in 2005. The ratio change was carried out because MTS' ADS price has increased more than five times since the Company's IPO in 2000, making its shares more expensive than the majority of companies traded on the NYSE. The new ADS ratio is intended to create a broader appeal to a larger investor audience and increase liquidity in the stock.

The end of 2004 was marked by an important development for the Company as T-Mobile decreased its ownership from 25% to 10%, placing 15% of its MTS shares in the largest-ever Russian corporate equity placement in the market. This transaction increased the Company's free float from 22.2% to 37.3%.

MTS ADS share price performance relative to indices



OJSC MOBILE TELESYSTEMS AND SUBSIDIARIES

Consolidated financial statements

At December 31, 2004 and 2003 and for the years ended December 31, 2004, 2003 and 2002

Consolidated balance sheets

at December 31, 2004 and 2003

	Notes	2004 U.S.\$'000	2003 U.S.\$'000
Current assets			
Cash and cash equivalents	4	274,150	90,376
Short-term investments, including related party amounts of \$73,100 and \$245,000 as of December 31, 2004 and 2003, respectively	5	73,360	245,000
Trade receivables, net	6	162,525	99,951
Accounts receivable, related parties	17	17,768	3,356
Inventory	7	89,518	67,291
Prepaid expenses		79,971	46,679
Deferred tax asset, current portion	14	49,850	44,423
VAT receivable		272,578	209,629
Other current assets		21,235	33,774
Total current assets		1,040,955	840,479
Property, plant and equipment , net of accumulated depreciation of \$901,416 and \$532,268, respectively			
	8	3,234,318	2,256,076
Licenses , net of accumulated amortization of \$417,158 and \$257,024, respectively			
	3, 20	771,271	703,103
Goodwill			
	3, 22	108,329	8,533
Other intangible assets , net of accumulated amortization of \$277,905 and \$148,052, respectively			
		328,533	304,144
Debt issuance costs , net of accumulated amortization of \$9,345 and \$4,586, respectively			
	11	16,546	9,431
Investments in and advances to associates			
	19	81,235	103,585
Total assets		5,581,187	4,225,351

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

Consolidated balance sheets

at December 31, 2004 and 2003

	Notes	2004 U.S.\$'000	2003 U.S.\$'000
Current liabilities			
Accounts payable, related parties	17	17,009	31,904
Trade accounts payable		242,495	168,039
Deferred connection fees, current portion	10	45,083	21,467
Subscriber prepayments and deposits		308,859	191,768
Debt, current portion	11	370,845	103,312
Notes payable, current portion	11	—	597,836
Capital lease obligations, current portion	12, 17	8,561	9,122
Income tax payable		22,567	11,128
Accrued liabilities	13	180,677	143,789
Other payables		33,872	19,604
Total current liabilities		1,229,968	1,297,969
Long-term liabilities			
Notes payable, net of current portion	11	800,000	800,000
Debt, net of current portion	11	753,795	142,418
Capital lease obligations, net of current portion	12, 17	3,947	7,646
Deferred connection fees, net of current portion	10	47,665	25,177
Deferred taxes	14	160,390	180,628
Total long-term liabilities		1,765,797	1,155,869
Total liabilities		2,995,765	2,453,838
Commitments and contingencies	21	—	—
Minority interest		62,099	47,603
Shareholders' equity			
Common stock: (2,096,975,792 shares with a par value of 0.1 rubles authorized and 1,993,326,138 shares issued as of December 31, 2004 and 2003, 432,414,940 of which are in the form of ADS)	1	50,558	50,558
Treasury stock (7,202,108 and 9,929,074 common shares at cost as of December 31, 2004 and 2003, respectively)	6	(7,396)	(10,197)
Additional paid-in capital		564,160	559,911
Unearned compensation	16	(1,780)	(869)
Shareholder receivable	11	(18,237)	(27,610)
Accumulated other comprehensive income	2	22,444	7,595
Retained earnings		1,913,574	1,144,522
Total shareholders' equity		2,523,323	1,723,910
Total liabilities and shareholders' equity		5,581,187	4,225,351

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

Consolidated statements of operations

for the years ended December 31, 2004, 2003 and 2002

	Notes	2004 U.S.\$'000	2003 U.S.\$'000	2002 U.S.\$'000
Net operating review				
Services revenue and connection fees		3,800,271	2,465,089	1,299,141
Sales of handsets and accessories		86,723	81,109	62,615
		3,886,994	2,546,198	1,361,756
Cost of services, excluding of depreciation and amortization shown separately below (including related party amounts of \$56,722, \$37,680 and \$31,607, respectively)		481,097	301,108	196,445
Cost of handsets and accessories		218,590	173,071	90,227
General and administrative expenses (including related party amounts of \$14,557, \$11,002 and 9,602, respectively)	18	575,296	355,230	215,942
Provision for doubtful accounts	16	26,459	32,633	7,047
Other operating expenses		29,777	18,859	6,067
Sales and marketing expenses (including related party amounts of \$59,113, \$23,668 and \$12,140, respectively)		460,983	326,783	171,977
Depreciation and amortization expenses		675,729	415,916	209,680
Net operating income		1,419,063	922,598	464,371
Currency exchange and transaction (gains)/losses		(6,529)	(693)	3,474
Other (income)/expenses (including related party amounts of \$5,303, \$6,161 and \$5,141, respectively):				
Interest income		(21,792)	(18,076)	(8,289)
Interest expense		107,956	106,551	44,389
Other (income)/expenses, net		(33,456)	3,420	(2,454)
Total other expenses, net		52,708	91,895	33,646
Income before provision for income taxes and minority interest		1,372,884	831,396	427,251
Provision for income taxes	14	354,664	242,480	110,417
Minority interest		30,342	71,677	39,711
Net income		987,878	517,239	277,123
Weighted average number of common shares outstanding		1,984,497,348	1,983,374,949	1,983,359,507
Earnings per share, basic and diluted:				
Net income		0.50	0.26	0.14

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

Consolidated statements of shareholders' equity

for the years ended December 31, 2004, 2003 and 2002

	Note	Common stock		Treasury stock		Other comprehensive income	Additional paid-in capital	Unearned compensation	Shareholder receivable	Retained earnings	Total
		Shares	Amount	Shares	Amount						
Balances, December 31, 2001		1,993,326,138	50,558	(9,966,631)	(10,206)	–	555,794	–	(38,958)	461,091	1,018,279
Receivable from Sistema	11	–	–	–	–	–	–	–	–	–	–
Increases for interest		–	–	–	–	–	2,073	–	(2,073)	–	–
Payments from Sistema		–	–	–	–	–	–	–	6,619	–	6,619
Issuance of stock options	16	–	–	–	–	–	235	(235)	–	–	–
Amortization of deferred compensation	16	–	–	–	–	–	–	23	–	–	23
Dividends declared		–	–	–	–	–	–	–	–	–	–
Translation adjustment		–	–	–	–	–	–	–	–	–	–
Net income		–	–	–	–	–	–	–	–	277,123	277,123
Balances, December 31, 2002		1,993,326,138	50,558	(9,966,631)	(10,206)	–	558,102	(212)	(34,412)	738,214	1,302,044
Receivable from Sistema	11	–	–	–	–	–	–	–	–	–	–
Increases for interest		–	–	–	–	–	807	–	(807)	–	–
Payments from Sistema		–	–	–	–	–	–	–	7,609	–	7,609
Issuance of stock options	16	–	–	–	–	–	1,002	(1,002)	–	–	–
Stock options exercised	16	–	–	37,557	9	–	–	–	–	–	9
Amortization of deferred compensation	16	–	–	–	–	–	–	345	–	–	345
Dividends declared	1	–	–	–	–	–	–	–	–	(110,931)	(110,931)
Translation adjustment		–	–	–	–	7,595	–	–	–	–	7,595
Net income		–	–	–	–	–	–	–	–	517,239	517,239
Balances, December 31, 2003		1,993,326,138	50,558	(9,929,074)	(10,197)	7,595	559,911	(869)	(27,610)	1,144,522	1,723,910
Receivable from Sistema	11	–	–	–	–	–	–	–	–	–	–
Increases for interest		–	–	–	–	–	1,190	–	(1,190)	–	–
Payments from Sistema		–	–	–	–	–	–	–	10,563	–	10,563
Issuance of stock options	16	–	–	–	–	–	1,811	(1,811)	–	–	–
Stock options exercised	16	–	–	2,726,966	2,801	–	1,248	–	–	–	4,049
Amortization of deferred compensation	16	–	–	–	–	–	–	900	–	–	900
Dividends declared	1	–	–	–	–	–	–	–	–	(218,826)	(218,826)
Translation adjustment		–	–	–	–	15,361	–	–	–	–	15,361
Change in fair value of interest rate swaps, net of taxes		–	–	–	–	(512)	–	–	–	–	(512)
Net income		–	–	–	–	–	–	–	–	987,878	987,878
Balances, December 31, 2004		1,993,326,138	50,558	(7,202,108)	(7,396)	22,444	564,160	(1,780)	(18,237)	1,913,574	2,523,323

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

Consolidated statements of cash flows

for the years ended December 31, 2004, 2003 and 2002

	2004 U.S.\$'000	2003 U.S.\$'000	2002 U.S.\$'000
Cash flows from operating activities			
Net income	987,878	517,239	277,123
Adjustments to reconcile net income to net cash provided by operating activities			
Minority interest	30,342	71,677	39,475
Depreciation and amortization	675,729	415,916	209,680
Amortization of deferred connection fees	(46,978)	(29,372)	(24,854)
Equity in net income of associates	(24,146)	(2,670)	–
Inventory obsolescence expense	4,610	3,307	5,614
Provision for doubtful accounts	26,459	32,633	7,047
Deferred taxes	(76,023)	(43,001)	(18,989)
Non-cash expenses associated with stock bonus and stock options	900	213	23
Changes in operating assets and liabilities			
Increase in accounts receivable	(101,223)	(64,384)	(20,305)
Increase in inventory	(24,179)	(14,737)	(18,186)
Increase in prepaid expenses and other current assets	(18,571)	(19,151)	(10,056)
Increase in VAT receivable	(55,044)	(50,230)	(64,154)
Increase in trade accounts payable, accrued liabilities and other current liabilities	331,835	148,544	30,354
Net cash provided by operating activities	1,711,589	965,984	412,772
Cash flows from investing activities			
Acquisitions of subsidiaries, net of cash acquired	(355,744)	(667,206)	(143,396)
Purchases of property, plant and equipment	(1,204,400)	(839,165)	(502,054)
Purchases of intangible assets	(154,544)	(119,606)	(72,218)
Purchases of short-term investments	(114,440)	(215,000)	–
Proceeds from sale of short-term investments	286,340	–	55,304
Investments in and advances to associates	(413)	(69,110)	(35,557)
Net cash used in investing activities	(1,543,201)	(1,910,087)	(697,921)

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

Consolidated statements of cash flows

for the years ended December 31, 2004, 2003 and 2002

	Note	2004 U.S.\$'000	2003 U.S.\$'000	2002 U.S.\$'000
Cash flows from financing activities				
Proceeds from stock options exercised		4,049	–	–
Proceeds from issuance of notes		–	1,097,000	50,808
Repayment of notes		(600,000)	–	–
Notes and debt issuance cost		(12,039)	(9,556)	(649)
Capital lease obligation principal paid		(15,274)	(22,646)	(1,804)
Dividends paid including taxes		(232,662)	(110,864)	–
Proceeds from loans		1,177,556	712,716	52,851
Loan principal paid		(320,511)	(677,374)	(7,008)
Payments from Sistema		9,654	8,269	6,619
Net cash provided by financing activities		10,773	997,545	100,817
Effect of exchange rate changes on cash and cash equivalents		4,613	2,273	(636)
Net increase/(decrease) in cash and cash equivalents		183,774	55,715	(184,968)
Cash and cash equivalents beginning of year		90,376	34,661	219,629
Cash and cash equivalents end of year		274,150	90,376	34,661
Supplemental information				
Income taxes paid		430,109	286,016	147,346
Interest paid		142,899	79,824	43,438
Non-cash investing activities				
Additions to network equipment and software under capital lease		2,861	10,928	18,917
Payable related to business acquisition	3	–	27,500	–
Additions to network through Hermes financing		8,800	–	–

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

Notes to consolidated financial statements

for the years ended December 31, 2004, 2003 and 2002

1 Description of business

Business of the Group OJSC Mobile TeleSystems and its subsidiaries (“MTS” or the “Group”) is the leading provider of wireless telecommunication services in the Russian Federation (“RF”), Ukraine and Uzbekistan in terms of the number of subscribers and revenues. The Group has operated primarily in the GSM standard since 1994.

Open Joint-Stock Company Mobile TeleSystems (“MTS OJSC” or the “Company”) was created on March 1, 2000, through the merger of Closed Joint-Stock Company Mobile TeleSystems (“MTS CJSC”) and RTC CJSC, a wholly-owned subsidiary. MTS CJSC was formed in 1993 to design, construct and operate a cellular telecommunications network in Moscow and the Moscow region. The development of the network was achieved through green-field build-out in the regions for which the Company was granted 900 or 1800 MHz (“GSM-900” and “GSM-1800”) cellular licenses or through the acquisition of majority stakes in local GSM operators (see Note 20 “Operating licenses” and Note 3 “Businesses acquired”).

The Company’s shares are traded in the form of American Depositary Shares (“ADS”). Each ADS represents 20 shares of common stock of the Company. The Company issued a total of 17,262,204 ADS, representing 345,244,080 common shares.

Ownership As of December 31, 2004 and December 31, 2003, MTS’ shareholders of record and their respective percentage direct interests were as follows:

	2004	2003
	%	%
Joint-Stock Financial Corporation “Sistema” (“Sistema”)	41.0	41.0
T-Mobile Worldwide Holding GmbH (“T-Mobile”)	10.1	25.4
VAST, Limited Liability Company (“VAST”)	3.1	3.1
Invest-Svyaz-Holding, closed joint-stock company	8.0	8.0
ADS holders	21.7	17.4
GDR holders and others	16.1	5.1
	100.0	100.0

In March 2003, Sistema and T-Mobile (together, “the Shareholders”) entered into a call option agreement, pursuant to which T-Mobile granted Sistema the option to acquire from it 199,332,614 shares of MTS, representing 10.0% of outstanding common stock of MTS. On April 26, 2003, Sistema exercised its option with T-Mobile to purchase an additional 6.0% of the outstanding common stock of MTS and purchased T-Mobile’s 49.0% interest in Invest-Svyaz-Holding, bringing its interest in Invest-Svyaz-Holding to 100.0%. Concurrently with this transaction, T-Mobile sold its holding of 5.0% in MTS on the open market in the form of Global Depositary Receipts (“GDRs”) listed on the London Stock Exchange.

In December 2004 T-Mobile sold its 15.09% stake in MTS on the open market in form of the GDRs.

Sistema owns a 51.0% equity interest in VAST, a limited liability company incorporated under the laws of the Russian Federation; the remaining 49.0% interest is held by ASVT, a Russian open joint-stock company. Sistema’s effective ownership in MTS is 50.6% at December 31, 2004 and December 31, 2003.

Notes to consolidated financial statements

for the years ended December 31, 2004, 2003 and 2002

1 Description of business continued

In April 2003, Sistema issued \$350.0 million 10.25% notes, due in 2008. These notes are collateralized by 193,473,900 shares of common stock of MTS OJSC.

On June 30, 2003, the Group approved cash dividends of \$1.12 per ADS (\$0.056 per share) for a total of \$111.0 million. As of December 31, 2004 dividends were fully paid.

On November 28, 2003, common shares of MTS OJSC were included by the Board of Moscow Interbank Currency Exchange ("MICEX") into the MICEX "B" Quotation List.

On June 24, 2004, MTS' shareholders approved cash dividends totaling \$220.0 million (\$2.2 per ADS), including \$1.1 million related to treasury stock, which were fully paid by December 31, 2004.

2 Summary of significant accounting policies and new accounting pronouncements

Accounting principles MTS maintains its accounting books and records in Russian rubles for its subsidiaries located in the Russian Federation ("RF"), in Ukrainian hryvnias for Ukrainian Mobile Communications ("UMC"), and Uzbek som for Uzdurobita based on respective local accounting and tax legislations. The accompanying consolidated financial statements have been prepared in order to present MTS' financial position and its results of operations and cash flows in accordance with accounting principles generally accepted in the United States ("U.S. GAAP") and expressed in terms of U.S. dollars.

The accompanying consolidated financial statements differ from the financial statements used for statutory purposes in that they reflect various adjustments, not recorded on the entities' books, which are appropriate to present the financial position, results of operations and cash flows in accordance with U.S. GAAP. The principal adjustments are related to revenue recognition, foreign currency translation, deferred taxation, consolidation, acquisition accounting and depreciation and valuation of property and equipment and intangible assets.

Basis of consolidation Wholly-owned subsidiaries and majority-owned subsidiaries where the Company has operating and financial control are consolidated. Those ventures where the Company exercises significant influence, but does not have operating and financial control are accounted for using the equity method. All significant intercompany accounts and transactions are eliminated upon consolidation. The Company's share in net income of unconsolidated affiliates is included in other income in the accompanying consolidated statements of operations and disclosed in Note 19. Results of operations of subsidiaries acquired are included in the consolidated statements of operations from the date of their acquisition.

2 Summary of significant accounting policies and new accounting pronouncements continued

As of December 31, 2004 and 2003, MTS has investments in the following significant legal entities:

	Accounting method	2004	2003
ACC	Consolidated	100.0%	100.0%
Telecom XXI	Consolidated	100.0%	100.0%
Telecom-900	Consolidated	100.0%	100.0%
SCS-900	Consolidated	100.0%	88.5%
FECS-900	Consolidated	100.0%	60.0%
Uraltel	Consolidated	99.8%	99.8%
MTS Finance ¹	Consolidated	100.0%	100.0%
BM Telecom	Consolidated	100.0%	100.0%
Kuban-GSM	Consolidated	100.0%	100.0%
Dontelecom	Consolidated	100.0%	100.0%
MTS-Barnaul	Consolidated	100.0%	100.0%
BIT	Consolidated	100.0%	100.0%
MTS-Capital	Consolidated	100.0%	100.0%
UMC	Consolidated	100.0%	100.0%
Sibchallenge	Consolidated	100.0%	100.0%
TSS	Consolidated	100.0%	100.0%
Volgograd Mobile	Consolidated/equity	100.0%	50.0%
Astrakhan Mobile	Consolidated/equity	100.0%	50.0%
Mar Mobile GSM	Consolidated	100.0%	100.0%
Primtelefon	Consolidated/equity	100.0%	50.0%
MSS	Consolidated	91.0%	83.5%
ReCom	Consolidated	53.9%	53.9%
TAIF Telcom	Consolidated	100.0%	52.7%
UDN-900	Consolidated	100.0%	51.0%
Novitel	Consolidated	100.0%	51.0%
MTS-Kostroma	Consolidated	100.0%	100.0%
MTS-NN	Consolidated	100.0%	65.0%
Uzdunrobita	Consolidated	74.0%	–
Sibintertelecom	Consolidated	93.5%	–
Gorizont-RT	Consolidated	76.0%	–
Telesot Alania	Consolidated	52.5%	–
MTS-Komi Republic	Equity	26.0%	26.0%
MTS Belarus	Equity	49.0%	49.0%
MTS Tver	Equity	26.0%	26.0%

¹Represents beneficial ownership.

Notes to consolidated financial statements

for the years ended December 31, 2004, 2003 and 2002

2 Summary of significant accounting policies and new accounting pronouncements continued

Translation methodology Management uses the U.S. dollar as the functional currency for MTS OJSC and most of its subsidiaries because the majority of their revenues, costs, property, plant and equipment and intangible assets purchases, and debt are either priced, incurred, payable or otherwise measured in U.S. dollars. Each of the legal entities domiciled in Russia, Ukraine, Uzbekistan and Belarus maintains its records and prepares its financial statements in the local currency, either Russian ruble, Ukrainian hryvnia, Uzbek som or Belarusian ruble, in accordance with the requirements of local statutory accounting and tax legislation.

Translation (re-measurement) of financial statements denominated in local currencies into U.S. dollars has been performed in accordance with the provisions of Statement of Financial Accounting Standard (“SFAS”) No. 52 “Foreign currency translation”:

- For subsidiaries of the Group, where functional currency is the U.S. dollar, monetary assets and liabilities have been translated at the period-end exchange rates. Non-monetary assets and liabilities have been translated at historical rates. Revenues, expenses and cash flows have been translated at historical rates. Translation differences resulting from the use of these rates have been accounted for as foreign currency gains and losses in the accompanying consolidated statements of operations.
- For UMC and Kuban-GSM where functional currency is the local currency, Ukrainian hryvnia and Russian ruble, respectively, all year-end balance sheet items have been translated into U.S. dollars at the period-end exchange rate. Revenues and expenses have been translated at period average exchange rate. In addition, a “new cost basis” for all non-monetary assets of Kuban-GSM has been established as of January 1, 2003, when the Russian economy ceased to be considered hyperinflationary. Cumulative translation adjustment, related to the translation of UMC and Kuban-GSM, in the amount of \$22.4 million, net of income taxes, was reported as accumulated other comprehensive income in the accompanying consolidated balance sheet at December 31, 2004.

Management estimates The preparation of consolidated financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Examples of significant estimates include the allowance for doubtful accounts, the recoverability of intangible assets and other long-lived assets, and valuation allowances on deferred tax assets.

Cash and cash equivalents Cash represents cash on hand and in MTS’ bank accounts and short-term investments having original maturities of less than three months.

Short-term investments Short-term investments represent investments in term deposits, which have original maturities in excess of three months but less than 12 months. These investments are being accounted for at cost.

Allowance for doubtful accounts MTS provides an allowance for doubtful accounts based on management’s periodic review for recoverability of accounts receivable from customers and other receivables.

Prepaid expenses Prepaid expenses are primarily comprised of advance payments made for inventory and services to vendors.

2 Summary of significant accounting policies and new accounting pronouncements continued

Inventory Inventory, accounted for at cost, determined by the first-in, first-out, or FIFO method, consists of telephones and accessories held for sale and spare parts to be used for equipment maintenance within next 12 months and other inventory items.

Telephones and accessories held for sale are written down to their market values based on specific periodic reviews and are expensed as cost of equipment sold.

Value-added Tax (“VAT”) Value-added tax related to sales is payable to the tax authorities on an accrual basis based upon invoices issued to the customer. VAT incurred for purchases may be reclaimed from the state, subject to certain restrictions, against VAT related to sales.

Property, plant and equipment Property, plant and equipment, including improvements that extend useful lives, are stated at cost. Property, plant and equipment with a useful life of more than one year is capitalized at historical cost and depreciated on a straight-line basis over its expected useful life as follows:

Network and base station equipment	5 – 12 years
Leasehold improvements	shorter of 8 – 10 years or lease term
Office equipment and computers	5 years
Buildings	50 years
Vehicles	4 years

Construction in progress and equipment held for installation is not depreciated until the constructed or installed asset is ready for its intended use.

Maintenance and repair costs are expensed as incurred, while upgrades and improvements are capitalized.

As a result of recent financial statement restatements by numerous U.S. public companies and publication of a letter by the Chief Accountant of the SEC regarding the interpretation of longstanding lease accounting principles, MTS has corrected its accounting practices for the leasehold improvements in the fourth quarter of 2004. The primary effect of this accounting correction was to accelerate to earlier periods’ depreciation expenses with respect to certain components of previously capitalized leasehold improvements.

These corrections resulted in a cumulative net charge to net income of \$34.9 million in the fourth quarter of 2004, of which \$21.5 million relates to the years 1998 through 2003. The net cumulative charge is comprised of a \$44.5 million increase in depreciation expense related primarily to depreciation of capitalized leasehold improvements expenses for base stations; a decrease of \$1.4 million in the equity net income from MTS-Belarus also related to depreciation of capitalized leasehold improvements expenses for base station positions; and increase of \$11.0 million related to additional deferred tax benefit due to the change in accounting base for property, plant and equipment.

All components of the net charge are non-cash and do not impact historical or future cash flows or the timing of payments under the related leases.

Notes to consolidated financial statements

for the years ended December 31, 2004, 2003 and 2002

2 Summary of significant accounting policies and new accounting pronouncements continued

Asset retirement obligations In accordance with Statement of Financial Accounting Standards, or SFAS, No. 143, "Accounting for asset retirement obligations", the Group calculates an asset retirement obligation and an associated asset retirement cost when the Group has a legal obligation in connection with the retirement of tangible long-lived assets. The Group's obligations under SFAS No. 143 arise from certain of its leases and relate primarily to the cost of removing equipment from such lease sites. As of December 31, 2004 the estimated asset retirement obligations were not significant to the Group's consolidated financial position and results of operations.

License costs License costs are capitalized as a result of (a) purchase price allocated to licenses acquired in business combinations and (b) licenses purchased directly from government organizations, which require license payments.

Current operating licenses of the Group do not provide for automatic renewal upon expiration. As the Group and the industry do not have sufficient experience with the renewal of licenses, license costs are being amortized during the initial license period without consideration of possible future renewals, subject to periodic review for impairment, on a straight-line basis over three to ten years starting from the date such license becomes commercially operational.

Other intangible assets and goodwill Intangible assets represent various purchased software costs, telephone numbering capacity, acquired customer base and rights to use premises. A part of the rights to use premises was contributed by shareholders to the Group's charter capital. Telephone numbering capacity costs with finite contractual life are being amortized over five to ten years and the rights to use premises are being amortized over ten years. Amortization of numbering capacity costs starts immediately upon the purchase of numbering capacity. Telephone numbering capacity with unlimited contractual life is not amortized, but is reviewed, at least annually, for impairment in accordance with the provisions of SFAS No. 142, "Goodwill and other intangible assets. ("SFAS No. 142")

Software costs are amortized over four years. Acquired customer bases are amortized over their estimated average subscriber life from 20 to 76 months. Other intangible assets are being amortized over three to four years. All finite-life intangible assets are being amortized using the straight-line method.

Goodwill represents an excess of the cost of business acquired over the fair market value of identifiable net assets at the date of acquisition.

Goodwill is reviewed for impairment at least annually or whenever it is determined that one or more impairment indicators exist. The Group determines whether an impairment has occurred by assigning goodwill to the reporting unit identified in accordance with SFAS No. 142, and comparing the carrying amount of the reporting unit to the fair value of the reporting unit. If a goodwill impairment has occurred, the Group recognizes a loss for the difference between the carrying amount and the implied fair value of goodwill. To date, no impairment of goodwill has occurred.

2 Summary of significant accounting policies and new accounting pronouncements continued

Leasing arrangements The Group accounts for leases based on the requirements of SFAS No. 13, "Accounting for leases". Certain subsidiaries of the Group lease operating facilities, which include switches, base stations and other cellular network equipment, as well as billing systems. For capital leases, the present value of future minimum lease payments at the inception of the lease is reflected as an asset and a liability in the balance sheet. Amounts due within one year are classified as short-term liabilities and the remaining balance as long-term liabilities.

Subscriber acquisition costs Subscriber acquisition costs represent the direct costs paid for each new subscriber enrolled through MTS' independent dealers. MTS expenses these costs as incurred.

Investments impairment Management periodically assesses the realizability of the carrying values of the investments and if necessary records impairment losses to write the investment down to fair value. For the three years in the period ended December 31, 2004, no such impairment has occurred.

Debt issuance costs Debt issuance costs are amortized using the effective interest method over the terms of the related debt.

Impairment of long-lived assets MTS 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, MTS compares 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, MTS records impairment losses to write the asset down to fair value, measured by the estimated discounted net future cash flows expected to be generated from the use of the assets. No impairment of long-lived assets has occurred during the three years in the period ended December 31, 2004.

Subscriber prepayments MTS requires the majority of its customers to pay in advance for telecommunication services. All amounts received in advance of service provided are recorded as a subscriber prepayment liability and are not recorded as revenues until the related services have been provided to the subscriber.

Revenue recognition Revenues are recognized on an accrual basis, when services are actually provided or title to equipment passes to customer, regardless of when the resulting monetary or financial flow occurs.

MTS categorizes the revenue sources in the statements of operations as follows:

- Service revenue and connection fees: (a) subscription fees, (b) usage charge, (c) value added service fees, (d) roaming fees charged to other operators for guest roamers utilizing MTS' network, (e) connection fees and (f) prepaid phone cards.
- Sales of handsets and accessories.

Subscription fees MTS recognizes revenues related to the monthly network fees in the month that the wireless service is provided to the subscriber.

Notes to consolidated financial statements

for the years ended December 31, 2004, 2003 and 2002

2 Summary of significant accounting policies and new accounting pronouncements continued

Usage charges and value added services fees Usage charges consist of fees based on airtime used by subscriber, the destination of the call and the service utilized.

Value added service fees are based on usage of airtime or volume of data transmitted for value added services, such as short message services, internet usage and data services. MTS recognizes revenues related to usage charges and value added services in the period when services are rendered.

Roaming fees MTS charges roaming-per-minutes fees to other wireless operators for non-MTS subscribers utilizing MTS' network. MTS recognizes such revenues when the services are provided.

Connection fees MTS defers initial connection fees on its prepaid and postpaid tariff plans from the moment of initial signing of the contract with subscribers over the estimated average subscriber life. Prior to December 31, 2003 the Group estimated that the average expected term of the subscriber relationship ranged from 39 to 47 months.

Based on management analysis of the subscriber base in the regions the Group operates, churn periods effective January 1, 2004 have been changed accordingly. Commencing January 1, 2004 the Group calculates an average expected term of the subscriber relationship for each region and amortizes regional connection fees accordingly. Average expected subscriber life ranges from 20 to 76 months. The effect of change in estimate in 2004 was approximately \$8.5 million, net of income tax or \$0.004 per share.

Prepaid phone cards MTS sells prepaid phone cards to subscribers, separately from the handsets. These cards allow subscribers to make a predetermined allotment of wireless phone calls and/or take advantage of other services offered by the Group, such as short messages and sending or receiving faxes.

At the time that the prepaid phone card is purchased by a subscriber, MTS records the receipt of cash as a subscriber prepayment. The Group recognizes revenues from the sale of phone cards in the period when the subscriber uses airtime under the phone card. Unused airtime on sold phone cards is not recognized as revenues until the related services have been provided to the subscriber or the prepaid phone card has expired.

Recently MTS introduced a new line of prepaid service tariff plans, whereby a customer may purchase a package that allows a connection to the MTS network and a predetermined allotment of wireless phone calls and/or other services offered by the Group. Revenues under these plans are allocated between connection fees and service fees based on their relative fair values.

Sales of handsets and accessories MTS sells handsets and accessories to customers who are entering into contracts for service and also as separate distinct transactions. The Group recognizes revenues from the sale of handsets and accessories when a title for product passes to the customer. MTS records estimated returns as a direct reduction of sales at the time the related sales are recorded. The costs of handsets and accessories, whether sold to subscribers through the distribution channel or as part of the service contract, are expensed when title passes to the customer.

In Ukraine, MTS also from time to time sells handsets at prices below cost. MTS recognizes these subsidies in cost of equipment when the sale is recorded.

2 Summary of significant accounting policies and new accounting pronouncements continued

Expense recognition Expenses incurred by MTS in relation to the provision of wireless communication services mainly relate to interconnection and line rental costs, roaming expenses, costs of handsets and other accessories sold, depreciation and amortization and maintenance of the network.

Calls made by subscribers from areas outside of territories covered by the Group licenses are subject to roaming fees charged by the wireless provider in those territories. These fees are recorded as roaming expenses, as MTS acts as the principal in the transaction with subscriber and bears the risk of non-collection from the subscriber. Roaming fees are charged to MTS subscribers based on Group's existing tariffs and are recorded as service revenues.

Any fees paid to dealers as commissions are recorded as a component of sales and marketing expenses.

Taxation Deferred tax assets and liabilities are recognized for the expected future tax consequences of existing differences between financial reporting and tax reporting bases of assets and liabilities, and for the loss or tax credit carry-forwards using enacted tax rates expected to be in effect at the time these differences are realized. Valuation allowances are recorded for deferred tax assets for which it is more likely that these assets will not be realized.

Advertising costs Advertising costs are expensed as incurred. Advertising costs for the years ended December 31, 2004, 2003 and 2002 were \$159,035, \$102,018 and \$48,624, respectively, and are reflected as a component of sales and marketing expenses in the accompanying consolidated statements of operations.

Government pension fund Subsidiaries of the Group contribute to the local state pension fund and social fund, on behalf of all its employees.

In Russia, starting from January 1, 2001 all social contributions, including contributions to the pension fund, were substituted with a unified social tax ("UST") calculated by the application of a regressive rate from 35.6% to 2% of the annual gross remuneration of each employee. UST is allocated to three social funds, including the pension fund, where the rate of contributions to the pension fund vary from 28% to 2%, respectively, depending on the annual gross salary of each employee. The contributions are expensed as incurred.

In Ukraine, the subsidiary of the Group is required to contribute a specified percentage of each employee payroll up to a fixed limit to the Ukrainian pension fund, unemployment fund and social security fund.

The Group does not participate in any pension funds other than described above.

Notes to consolidated financial statements

for the years ended December 31, 2004, 2003 and 2002

2 Summary of significant accounting policies and new accounting pronouncements continued

Earnings per share Basic earnings per share (“EPS”) have been determined using the weighted average number of shares outstanding during the year. Diluted EPS reflect the potential dilution of stock options, granted to employees. There are 3,530,970 stock options outstanding as at December 31, 2004.

The following is the reconciliation of the share component for basic and diluted EPS with respect to the Group’s net income:

	2004	2003	2002
Weighted average number of common share outstanding	1,984,497,348	1,983,374,949	1,983,359,507
Dilutive effect of stock options, as if exercised	1,168,573	1,727,131	405,946
Weighted average number of common shares and potential shares outstanding	1,985,665,921	1,985,102,080	1,983,765,453

Fair value of financial instruments The fair market value of financial instruments, consisting of cash and cash equivalents, accounts receivable and accounts payable, which are included in current assets and liabilities, approximates the carrying value of these items due to the short term nature of these amounts. As of December 31, 2004 the \$400 million Notes due in 2008 have fair value of 105.5% or \$422 million and the \$400 million Notes due in 2010 have fair value of 102.4% or \$410 million. As of December 31, 2004, fair value of other fixed rate debt including capital lease obligation approximated its carrying value. The fair value of variable rate debt approximates carrying value.

Derivative financial instruments and hedging activities From time to time, in its acquisitions the Group uses derivative instruments, consisting of put and call options on all or part of the minority stakes of acquired companies, to defer payment of the purchase price and provide optimal acquisition structuring. In addition, in December 2004, the Group entered into two variable-to-fixed interest rate swap agreements to manage its exposure to changes in fair value of future cash flows of its variable-rate long-term debt, which is caused by interest rate fluctuations. The Group does not use derivatives for trading purposes.

The Group accounts for its derivative financial instruments following the provisions of SFAS No. 133 “Accounting for derivative instruments and hedging activities” and SFAS No. 149, “Amendment of statement 133 on derivative instruments and hedging activities”. All derivatives are recorded as either assets or liabilities in the consolidated balance sheets and measured at their respective fair values. The Group’s interest rate swap agreements are designated as a cash flow hedge and the hedging relationship qualifies for hedge accounting. The effective portion of the change in fair value of interest rate swap agreements is, accordingly, recorded in other comprehensive income and reclassified to interest expense when the hedged debt affects the interest expense. Changes in fair value of other derivative instruments are recognized in net income as those instruments were not designated as hedges.

At the inception of the hedge and on a quarterly basis, the Group performs an analysis to assess whether changes in cash flows of its interest rate swap agreements are deemed highly effective in offsetting changes in cash flows of the hedged debt. If at any time the correlation assessment will indicate that the interest rate swap agreements are no longer effective as a hedge, the Group will discontinue hedge accounting and all subsequent changes in fair value will be recorded in net income.

2 Summary of significant accounting policies and new accounting pronouncements continued

Comprehensive income Comprehensive income is defined as net income plus all other changes in net assets from non-owner sources. The following is the reconciliation of other comprehensive income, net of tax for the years ended December 31, 2004, 2003 and 2002:

	2004 U.S.\$'000	2003 U.S.\$'000	2002 U.S.\$'000
Net income	987,878	517,239	277,123
Translation adjustment	15,361	7,595	—
Change in fair value of interest rate swaps, net of tax of \$123	(512)	—	—
Total comprehensive income	1,002,727	524,834	277,123

Comparative information Certain prior-year amounts have been reclassified to conform to the current period presentation.

Stock-based compensation MTS accounts for stock options issued to employees, non-employee directors and consultants following the requirements of SFAS No. 123, "Accounting for stock-based compensation" and SFAS No. 148, "Accounting for stock based compensation – transition and disclosure, an amendment to FASB Statement No. 123". Under the requirements of these statements, the Company elected to use intrinsic value of options on the measurement date as a method for accounting for compensation to employees and non-employee directors. Compensation to consultants is measured based on the fair value of options on the measurement date as determined using a binomial option-pricing model.

If the Group had elected to recognize compensation costs based on the fair values of options at the date of the grant, net income and earning per share amounts would have been as follows:

	2004 U.S.\$'000	2003 U.S.\$'000	2002 U.S.\$'000
Net income as reported	987,878	517,239	277,123
Pro-forma effect of the application of fair value method of accounting	(1,078)	(727)	(460)
Pro-forma net income	986,800	516,512	276,663
Earnings per share – basic and diluted			
As reported	0.50	0.26	0.14
Pro-forma	0.50	0.26	0.14

Notes to consolidated financial statements

for the years ended December 31, 2004, 2003 and 2002

2 Summary of significant accounting policies and new accounting pronouncements continued

New and recently adopted accounting pronouncements In January 2003, the Financial Accounting Standards Board, or FASB, issued FASB Interpretation No. 46, "Consolidation of variable interest entities – an interpretation of ARB No. 51" ("FIN 46"), to address perceived weaknesses in accounting for entities commonly known as special-purpose or off-balance-sheet. In addition to numerous FASB staff positions written to clarify and improve the application of FIN 46, the FASB announced a deferral for certain entities, and an amendment to FIN 46 entitled FASB Interpretation No. 46R, "Consolidation of variable interest entities" ("FIN 46R"). FIN 46 establishes consolidation criteria for entities for which "control" is not easily discernable under Accounting Research Bulletin No. 51, "Consolidated financial statements," which is based on the premise that holders of the equity of an entity control the entity by virtue of voting rights.

FIN 46 provides guidance for identifying the party with a controlling financial interest resulting from arrangements or financial interests rather than from voting interests. FIN 46 defines the term variable interest entity, or VIE, and is based on the premise that if a business enterprise absorbs a majority of the VIE's expected losses and/or receives a majority of its expected residual returns (measures of risk and reward), that enterprise (the primary beneficiary) has a controlling financial interest in the VIE. Under FIN 46, the assets, liabilities, and results of the activities of the VIE should be included in the consolidated financial statements of the primary beneficiary. The Group was required to apply the provisions of FIN 46R in the first quarter 2004. As the Group did not have any VIEs during the year ended December 31, 2004, the adoption of this new method of accounting for VIEs did not affect its financial condition or results of operations as of December 31, 2004.

In September 2004, EITF issued a final consensus on EITF Issue No. 04-1, "Accounting for pre-existing relationships between the parties to a business combination". In this issue the EITF reached a consensus that a business combination between two parties having a pre-existing relationship is a multiple-element transaction with one element being the business combination and the other element being the settlement of the pre-existing relationship. This Issue requires certain additional disclosures for business combinations between parties with a pre-existing relationship. EITF Issue No. 04-1 is effective for reporting periods beginning after October 13, 2004. The Group does not anticipate that the adoption of EITF Issue No. 04-1 will have a material impact on its financial position or results of operations.

At the September 2004 meeting of the Emerging Issues Task Force, the SEC staff issued an announcement D-108, "Use of the residual method to value acquired assets other than goodwill" stating that companies must use the direct value method to determine the fair value of their intangible assets acquired in business combinations completed after September 29, 2004. The SEC staff also announced that companies that currently apply the residual value approach for valuing intangible assets with indefinite useful lives for purposes of impairment testing, must use the direct value method by no later than the beginning of their first fiscal year after December 15, 2004.

As of December 31, 2004, the Group performed the annual impairment test to measure the fair value of our 900 and 1800 megahertz, or MHz, licenses in its national footprint using the residual value approach. Under this new accounting guidance, the Group performed an impairment test to measure the fair value of our 900 and 1800 MHz licenses as of January 1, 2005 using the direct value method. Based on the assessment no impairment charge as of December 31, 2004 is required.

2 Summary of significant accounting policies and new accounting pronouncements continued

In December 2004, Financial Accounting Standards Board (“FASB”) issued SFAS No. 123R (revised 2004), “Share-based payment”. The statement is a revision of FASB Statement No. 123, “Accounting for stock-based compensation”, and supersedes Accounting Principles Board, or APB, Opinion No. 25, “Accounting for stock issued to employees”. The statement focuses primarily on accounting for transactions in which the Group obtains employee services in share-based payment transactions. This statement requires a public company to measure the cost of employee services received in exchange for an award of equity instruments based on the grant-date fair value of the award. This standard is scheduled to become effective in the first interim reporting period beginning after June 15, 2005. Assuming that the effective date is not delayed, the Group will apply this new standard to its interim reporting period beginning July 1, 2005. The Group has not yet determined the amount of impact on the consolidated statements of operations following adoption and subsequent to 2005 or the transition method the Group will use. The Group does not believe that results of the adoption of SFAS No. 123R will be significant to the consolidated financial position or results of operations.

In March 2005, the U.S. Securities and Exchange Commission, or SEC, released Staff Accounting Bulletin 107, “Share-based payments”, or SAB. 107. The interpretations in SAB. 107 express views of the SEC staff, or staff, regarding the interaction between SFAS No. 123R and certain SEC rules and regulations, and provide the staff’s views regarding the valuation of share-based payment arrangements for public companies. In particular, SAB. 107 provides guidance related to share-based payment transactions with non-employees, the transition from non-public to public entity status, valuation methods (including assumptions such as expected volatility and expected term), the accounting for certain redeemable financial instruments issued under share-based payment arrangements, the classification of compensation expense, non-GAAP financial measures, first-time adoption of SFAS No. 123R in an interim period, capitalization of compensation cost related to share-based payment arrangements, the accounting for income tax effects of share-based payment arrangements upon adoption of SFAS No. 123R, the modification of employee share options prior to adoption of SFAS No. 123R.

In March 2005, FASB issued Interpretation No. 47, “Accounting for conditional asset retirement obligations – an interpretation of FASB Statement No. 143”. This Interpretation clarifies that the term “conditional asset retirement obligation” as used in FASB Statement No. 143, “Accounting for asset retirement obligations”, refers to a legal obligation to perform an asset retirement activity, in which the timing and/or method of settlement are conditional on a future event that may or may not be within the control of the entity. The obligation to perform the asset retirement activity is unconditional even though uncertainty exists about the timing and/or method of settlement. Uncertainty about the timing and/or method of settlement of a conditional asset retirement obligation should be factored into the measurement of the liability when sufficient information exists to make a reasonable estimate of the fair value of the obligation. Interpretation No. 47 is effective for us beginning January 1, 2006. The Group is currently in the process of assessing effects of Interpretation No. 47 on its consolidated financial position and results of operations.

Notes to consolidated financial statements

for the years ended December 31, 2004, 2003 and 2002

3 Businesses acquired

Gorizont-RT acquisition In December 2004, MTS completed transaction to acquire a 76.0% stake in Gorizont-RT, a GSM mobile phone operator in the Republic of Sakha (Yakutia) in the Far East of Russia, for cash consideration of \$53.2 million. Gorizont-RT holds licenses to provide GSM-900/1800 services in the Republic of Sakha (Yakutia). Commencing from the date of acquisition, MTS consolidates financial results of Gorizont-RT. The Gorizont-RT's customer base as at the date of acquisition was approximately 100,000 subscribers.

The acquisition was accounted for using the purchase method. The purchase price allocation was as follows:

	U.S.\$'000
Current assets	3,820
Non-current asset	17,501
License costs	26,362
Customer base cost	1,050
Trade mark	153
Goodwill	20,214
Current liabilities	(4,949)
Non-current liabilities	(529)
Deferred taxes	(6,814)
Minority interest	(3,604)
Purchase price	53,204

Goodwill is mainly attributable to economic potential of the market assuming low regional penetration level as of the date of acquisition.

Sibintertelecom acquisition In November 2004, MTS acquired a 93.53% stake in Sibintertelecom, mobile phone operator in the Chita region and Aginsk-Buryatsk District in the Far-East of Russia, for cash consideration of \$37.4 million. Sibintertelecom holds a license to provide 900 MHz services in Chita region and Aginsk-Buryatsk District in the Far-East of Russia. Sibintertelecom is the sole mobile service provider in two regions with a total population of 1.23 million. Commencing from the date of acquisition, MTS consolidates financial results of Sibintertelecom. The company's customer base as at the date of acquisition was approximately 100,000 subscribers.

3 Businesses acquired continued

The acquisition was accounted for using the purchase method of accounting. The purchase price allocation was as follows:

	U.S.\$'000
Current assets	5,939
Non-current asset	6,966
License costs	29,555
Customer base cost	1,488
Trademark	465
Goodwill	10,376
Current liabilities	(9,523)
Deferred taxes	(7,668)
Minority interest	(190)
Purchase price	37,408

Goodwill is mainly attributable to economic potential of the market assuming low regional penetration level as of the date of acquisition.

Telesot Alania acquisition In December 2004, MTS purchased a 52.5% stake in Telesot Alania, a GSM mobile phone operator in the Republic of North Ossetia in the Southern part of Russia, for cash consideration of \$6.2 million. Telesot Alania holds a license to provide 1800/900 MHz services in the Republic of North Ossetia in the Southern part of Russia. Commencing from the date of acquisition, MTS consolidates financial results of Telesot Alania. Telesot Alania's customer base as at the date of acquisition was approximately 54,000 subscribers.

The acquisition was accounted for using the purchase method of accounting. The purchase price allocation was as follows:

	U.S.\$'000
Current assets	2,229
Non-current asset	5,085
License costs	3,606
Customer base cost	90
Current liabilities	(767)
Deferred taxes	(887)
Minority interest	(3,110)
Purchase price	6,246

License costs are amortized over the remaining contractual terms of the licenses of approximately two years and customer base is amortized over the average subscribers' life of approximately 60 months.

Notes to consolidated financial statements

for the years ended December 31, 2004, 2003 and 2002

3 Businesses acquired continued

Uzdunrobota acquisition In July 2004, MTS entered into an agreement to acquire 74.0% of Uzbekistan mobile operator JV Uzdunrobota ("Uzdunrobota") for a cash consideration of \$126.4 million, including transaction costs of \$5.4 million. Acquisition was completed on August 1, 2004 and starting from this date Uzdunrobota's financial results are consolidated. Uzdunrobota holds licenses to provide GSM-1800 mobile communication services in the whole territory of Uzbekistan, which has a population of approximately 25.2 million. Uzdunrobota's customer base as of the date of acquisition was approximately 230,000 subscribers.

The acquisition was accounted for using the purchase method. The purchase price allocation for the acquisition was as follows:

	U.S.\$'000
Current assets	5,950
Non-current assets	67,293
License costs	40,861
Customer base cost	958
Trademark	3,622
Goodwill	46,470
Current liabilities	(14,705)
Non-current liabilities	(1,356)
Deferred taxes	(6,384)
Minority interest	(16,308)
Purchase price	126,401

Goodwill is mainly attributable to economic potential of the market assuming low penetration level as of the date of acquisition. License costs are amortized over the remaining contractual terms of the licenses of approximately 12 years and customer base is amortized over the average remaining subscribers' life of approximately 39 months.

MTS also entered into call and put option agreements with the existing shareholders of Uzdunrobota to acquire the remaining 26.0% of common shares of the company. The exercise period for the call and put option is 36 months from the acquisition date. The call and put option agreements stipulate a minimum purchase price of \$37.7 million plus 5% per annum commencing from the acquisition date. Fair value of the option was \$4.0 million at December 31, 2004 and included in other current assets on the consolidated balance sheet.

3 Businesses acquired continued

Primtelefon acquisition In June 2004, MTS purchased 50.0% of Far-Eastern operator CJSC Primtelefon (“Primtelefon”) for cash consideration of \$31.0 million, increasing its effective ownership to 100%, as 50% of Primtelefon’s shares were controlled through Vostok Mobile, a wholly-owned subsidiary of MTS. Commencing from the date of acquisition of the second stake, MTS consolidates financial results of Primtelefon. Primtelefon holds licenses to provide GSM 900/1800 mobile cellular communications in the Far-East region of Russia. The company’s customer base as of the date of acquisition of the controlling stake was approximately 216,000 subscribers.

The acquisition was accounted for using the purchase method. The purchase price allocation was as follows:

	U.S.\$'000
Current assets	11,041
Non-current assets	16,809
License costs	21,891
Current liabilities	(7,488)
Non-current liabilities	(5,671)
Deferred taxes	(5,582)
Purchase price	31,000

License costs acquired are amortized over the remaining contractual terms of the licenses of approximately seven years and customer base is amortized over the average remaining subscribers’ life of approximately 41 months.

Telecom-900 acquisition In August 2001, MTS acquired 81% of the outstanding common stock of Telecom-900, a Russian closed joint-stock company, for a cash consideration of \$26.8 million from Sistema. Telecom-900 is the holding company for three regional mobile phone operators, Siberia Cellular System 900 CJSC (“SCS-900”), Uraltel CJSC (“Uraltel”), and Far East Cellular Systems 900 CJSC (“FECS-900”).

At the date of acquisition these companies had approximately 96,000 subscribers and licenses to provide GSM 900/1800 mobile services in the Novosibirsk region, Altai Republic, Sverdlovsk region and Khabarovsk region.

Telecom-900 acquisition was accounted for using the purchase method of accounting. The purchase price was allocated as follows:

	U.S.\$'000
Current assets	12,136
Non-current assets	29,297
License costs	31,542
Current liabilities	(21,883)
Non-current liabilities	(10,626)
Deferred taxes	(7,754)
Minority interest	(5,900)
Purchase price	26,812

In November 2002, MTS acquired the remaining 19% of Telecom-900 from Invest-Svyaz-Holding, a shareholder of the Group and a wholly-owned subsidiary of Sistema, for a cash consideration of \$6.9 million. The acquisition was accounted for using the purchase method of accounting. The allocation of the purchase price increased recorded license costs by \$2.7 million.

Notes to consolidated financial statements

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3 Businesses acquired continued

On August 13, 2003, Telecom-900, completed the purchase of the 43.7% and 2.95% stakes in Uraltel for a cash consideration of \$35.7 million. The transaction increased Telecom-900's ownership in Uraltel to 99.85%. The acquisition was accounted using purchase method of accounting. The allocation of purchase price increased recorded license cost by \$24.5 million.

In November 2003, the Group completed the purchase of the 30.0% stake in SCS-900 from Sibirtelecom for cash consideration of \$28.6 million. The Group's acquisition of this stake increased its ownership in SCS-900 to 81.0%. On December 29, 2003, the Group acquired for cash consideration of \$9.3 million a 100% stake in ILIT LLC, a company which owns a 7.5% stake in SCS-900, increasing its ownership in SCS-900 to 88.5%. The acquisition was accounted using purchase method of accounting. The allocation of purchase price increased recorded license cost by \$25.7 million.

In March 2004, the Group acquired 11.0% stake in SCS-900 from CJSC Sibirskie Zvezdy for cash consideration of \$8.5 million, increasing its ownership in SCS-900 to 99.5%. The acquisition was accounted for using a purchase method of accounting. The allocation of purchase price increased recorded license cost by \$2.6 million.

In April 2004, the Group acquired 40.0% stake in FECS-900 from OJSC Dalnevostochnaya Kompaniya Electrosvyazi for cash consideration of \$8.3 million, increasing its ownership in FECS-900 to 100.0%. The acquisition was accounted for using a purchase method of accounting. The allocation of purchase price increased recorded license cost by \$4.1 million.

License costs are amortized over the remaining contractual terms of the respective license, ranging from six to ten years at the date of the first acquisition. Customer base is amortized over the average remaining subscribers' life ranging from 32 to 40 months.

Tomsk Cellular Communications acquisition In September 2003, MTS purchased 100.0% of Siberian operator Tomsk Cellular Communications ("TSS") for cash consideration of \$47.0 million. TSS holds licenses to provide GSM 900/1800 mobile cellular communications in the Tomsk region. The company's customer base as of the date of acquisition was approximately 183,000 subscribers.

The acquisition was accounted for using the purchase method. The purchase price allocation was as follows:

	U.S.\$'000
Current assets	3,299
Non-current assets	11,412
License costs	49,282
Current liabilities	(4,543)
Non-current liabilities	(105)
Deferred taxes	(12,345)
Purchase price	47,000

License costs acquired are amortized over the remaining contractual terms of the licenses of approximately eight years and customer base is amortized over the average remaining subscribers' life of approximately 76 months.

3 Businesses acquired continued

Sibchallenge acquisition On August 22, 2003, MTS completed the purchase of 100.0% of Sibchallenge, a cellular operator in the Krasnoyarsk region, for cash consideration of \$45.5 million, paid a finder's fee of \$2.0 million and assumed net debt of approximately \$6.6 million. Sibchallenge holds licenses to provide GSM 900/1800 and DAMPS mobile services in the Krasnoyarsk region of Siberia, the Republic of Khakasiya, and in the Taimyr Autonomous region, all of which are located in the Siberian part of Russia. At the date of acquisition, Sibchallenge had approximately 132,000 subscribers.

The purchase price allocation was as follows:

	U.S.\$'000
Current assets	4,078
Non-current assets	16,678
License costs	52,625
Current liabilities	(6,405)
Non-current liabilities	(6,628)
Deferred taxes	(12,894)
Purchase price	47,454

License costs acquired are amortized over the remaining contractual terms of the licenses of approximately eight years and customer base is amortized over the average remaining subscribers' life of approximately 36 months.

Kuban-GSM acquisition In March 2002, MTS acquired 51% of Kuban-GSM, a Russian closed joint-stock company, for cash consideration of \$71.4 million. At the date of acquisition, Kuban-GSM had approximately 500,000 subscribers and it operates in 13 major cities throughout the south of the European part of the Russian Federation, including Sochi, Krasnodar and Novorossiisk. The Kuban-GSM acquisition was accounted for using the purchase method of accounting.

The purchase price was allocated as follows:

	U.S.\$'000
Current assets	11,751
Non-current assets	80,848
License costs	62,549
Customer base cost	3,561
Current liabilities	(31,289)
Non-current liabilities	(19,827)
Deferred taxes	(15,866)
Minority interest	(20,327)
Purchase price	71,400

In October 2002, MTS exercised its option to acquire additional 353 shares for \$5.0 million payable in cash, increasing its ownership in Kuban-GSM to 52.7%. The acquisition of the additional interest was accounted for using the purchase method of accounting. The allocation of the purchase price increased recorded license costs by \$4.4 million, increased customer base cost by \$0.2 million, and decreased minority interest by \$0.5 million.

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for the years ended December 31, 2004, 2003 and 2002

3 Businesses acquired continued

In September 2003, the Group acquired 100.0% of Kubtelesot for cash consideration of \$107.0 million. Kubtelesot owned 47.3% of Kuban-GSM, and the Group's purchase of this stake increased its ownership in Kuban-GSM to 100.0%. Kubtelesot was a holding company with no operational activities. The acquisition was accounted for using the purchase method of accounting.

The allocation of purchase price increased recorded license cost by \$57.5 million, increased customer base cost by \$8.4 million, and decreased minority interest by \$59.0 million.

In May 2004, Kubtelesot was liquidated and all its shares in Kuban-GSM were transferred to OJSC MTS as the only shareholder.

License costs are amortized over the remaining contractual term of the license of approximately five years at the date of the acquisition. Acquired customer base is amortized over the average remaining subscribers' life of approximately 48 months.

UMC acquisition On March 4, 2003, MTS acquired 57.7% of the outstanding voting interest of UMC, a provider of mobile services in Ukraine, for cash consideration of \$199.0 million, including the acquisition of 16.3% of the outstanding voting interest from Deutsche Telekom AG, a related party, for \$55.0 million. Acquisition costs relating to the transaction of \$1.4 million were capitalized. In connection with the acquisition, MTS also assumed debt of UMC with face value of approximately \$65.0 million, with the fair value of approximately \$62.0 million. At the date of acquisition, UMC had approximately 1.8 million subscribers and was one of the two leading mobile operators in Ukraine, operating under nationwide GSM 900/1800 and NMT 450 licenses.

The acquisition was accounted for using the purchase method. For convenience, MTS consolidated UMC from March 1, 2003. Purchase price allocation is as follows:

	U.S.\$'000
Current assets	82,293
Non-current assets	272,721
License costs	82,200
Customer base cost	30,927
Current liabilities	(63,551)
Non-current liabilities	(78,580)
Deferred taxes	(27,425)
Minority interest	(99,581)
Purchase price	199,004

MTS paid \$171.5 million of the purchase price in cash and agreed to pay the balance of the purchase price of \$27.5 million to Cetel B.V., a wholly-owned subsidiary of Deutsche Telekom AG, within one year. The amount payable accrued interest of 9% per annum. In March 2004, MTS cash settled the balance payable to Cetel B.V.

3 Businesses acquired continued

MTS also had an option agreement with Ukrtelecom to purchase its remaining 26.0% stake in UMC, exercisable from February 5, 2003 to November 5, 2005, with an exercise price of \$87.6 million. On June 4, 2003, MTS exercised its call option. As a result of the transaction, MTS' ownership in UMC increased from 57.7% to 83.7%. The acquisition was accounted for using purchase method of accounting. The allocation of purchase price increased recorded license cost by \$10.2 million, increased customer base cost by \$13.9 million, and decreased minority interest by \$66.4 million.

In addition, MTS entered into a put and call option agreement with TDC Mobile International A/S ("TDC") for the purchase of its 16.3% stake in UMC. The exercise period of the call option was from May 5, 2003 to November 5, 2004, and the put option was exercisable from August 5, 2003 to November 5, 2004. The call option price was \$85.0 million plus interest accrued from November 5, 2002 to the date of the exercise at 11% per annum; the price of the put option was calculated based on reported earnings of UMC prior to the exercise and was subject to a minimum amount of \$55.0 million. On June 25, 2003, MTS notified TDC of its intent to exercise its rights under the put and call option agreement. The purchase was completed during July 2003. MTS paid cash consideration of approximately \$91.7 million to purchase the remaining 16.3% stake in UMC. The acquisition was accounted for using purchase method of accounting. The allocation of purchase price increased recorded license cost by \$52.7 million, increased customer base cost by \$8.7 million, and decreased minority interest by \$43.8 million.

The UMC license costs are amortized over the remaining contractual terms of the licenses of approximately nine to 13 years at the date of the acquisition, acquired customer base is amortized over the average remaining subscribers' life of approximately 32 months. Other acquired intangible assets, represented mostly by software, are amortized over their respective useful lives of three to ten years.

In accordance with SFAS No. 141, "Business combinations", the Group recognized \$8.0 million of goodwill relating to workforce-in-place.

TAIF Telcom acquisition In April 2003, MTS acquired 51.0% of the common shares of TAIF Telcom, a Russian open joint-stock company, for cash consideration of \$51.0 million and 50.0% of the preferred shares of TAIF Telcom for cash consideration of \$10.0 million. In May 2003, MTS acquired an additional 1.7% of the common shares of TAIF Telcom for cash consideration of \$2.3 million. In connection with the acquisitions, MTS also assumed indebtedness of approximately \$16.6 million that was collateralized by telecom equipment.

MTS also entered into call and put option agreements with the existing shareholders of TAIF Telcom to acquire the remaining 47.3% of common shares and 50.0% of preferred shares of TAIF Telcom.

The exercise period for the call option on common shares is 48 months from the acquisition date and for the put option on common shares is 36 months following an 18-month period after the acquisition date. The call and put option agreements for the common shares stipulate a minimum purchase price of \$49.0 million plus 8% per annum commencing from the acquisition date. The exercise period for the call option on preferred shares is 48 months following a 24-month period after the acquisition date and for the put option on preferred shares it is a 24-month period after the acquisition date. The call and put option agreements for the preferred shares stipulate a minimum purchase price of \$10.0 million plus 8% per annum commencing from the acquisition date. Fair value of the option was \$3.5 million at December 31, 2003.

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for the years ended December 31, 2004, 2003 and 2002

3 Businesses acquired continued

The purchase price allocation for initial stake acquired was as follows:

	U.S.\$'000
Current assets	3,870
Non-current assets	48,391
License costs	68,407
Current liabilities	(26,099)
Non-current liabilities	(5,550)
Deferred taxes	(16,814)
Minority interest	(8,965)
Purchase price	63,240

License costs acquired are amortized over the remaining contractual terms of the licenses of approximately four years and customer base is amortized over the average remaining subscribers' life of approximately 38 months.

TAIF Telcom provides mobile services in the GSM-900/1800 standard in the Republic of Tatarstan and in the Volga region of Russia. At the date of acquisition, TAIF Telcom had approximately 240,000 subscribers.

In September 2004, MTS exercised its option to acquire the remaining 47.3% of common shares and 50.0% of preferred shares in TAIF Telcom for cash consideration of \$63.0 million, increasing its ownership to 100.0%. The Group received title to the acquired shares in October 2004. The purchase price allocation increased recorded license cost by \$35.8 million, increased acquired customer base by \$4.2 million; goodwill was recorded in the amount of \$21.2 million. Goodwill is mainly attributable to economic potential of the market.

Dontelecom acquisition On September 26, 2002, MTS completed its acquisition of 66.7% of the outstanding common stock of Dontelecom, a closed joint-stock company, for cash consideration of \$15.0 million (including 33.3% acquired from Sistema for \$7.5 million). At the date of acquisition, Dontelecom had approximately 39,000 subscribers. Dontelecom holds a GSM-900/1800 license to operate in the Rostov region. This acquisition was accounted for using the purchase method.

The purchase price was allocated as follows:

	U.S.\$'000
Current assets	3,422
Non-current assets	8,401
License costs	14,739
Current liabilities	(5,849)
Non-current liabilities	(357)
Deferred taxes	(3,675)
Minority interest	(1,681)
Purchase price	15,000

In October 2002, the Group completed the acquisition of the remaining 33.3% of the outstanding common stock of Dontelecom for \$7.5 million. The acquisition was accounted for using the purchase method of accounting. The purchase increased the recorded license costs by \$7.3 million.

3 Businesses acquired continued

License costs are amortized over the remaining contractual term of the license of approximately three years at the date of the acquisition. Customer base is amortized over the average remaining subscribers' life of approximately 20 months.

BM Telecom acquisition In May 2002, MTS completed its acquisition of 100% of the outstanding common stock of Ufa-based BM Telecom, a closed joint-stock company, for \$41.0 million in cash. At the date of acquisition, BM Telecom had approximately 100,000 subscribers and it holds a GSM-900/1800 license to operate in Bashkortostan Republic of Russia. This acquisition was accounted for using the purchase method.

The purchase price was allocated as follows:

	U.S.\$'000
Current assets	3,312
Non-current assets	14,736
License costs	48,932
Current liabilities	(3,603)
Non-current liabilities	(10,227)
Deferred taxes	(12,150)
Purchase price	41,000

License costs associated with the acquisition of BM Telecom are amortized over the remaining term of the license of approximately five years. Customer base is amortized over the average remaining subscribers' life of approximately 30 months.

Acquisitions of various regional companies In August 2003, the Group reached an agreement to acquire, in a series of related transactions, equity interests in five Russian regional mobile phone operators from MCT Corporation for a total of \$71.0 million. The Group agreed to purchase a 43.7% stake in Uraltel (described above) and 100.0% of Vostok Mobile BV, which holds a 50.0% stake in Primtelefon.

The Group also agreed to purchase Vostok Mobile South, which holds 50.0% stakes in Astrakhan Mobile and Volgograd Mobile, as well as an 80.0% stake in Mar Mobile GSM. The Group also entered into agreements to acquire the remaining 20.0% of Mar Mobile GSM and another 2.95% stake in Uraltel from existing shareholders unrelated to MCT Corporation for approximately \$1.0 million.

On August 26, 2003, the Group completed the acquisition of Vostok Mobile and recorded a 50.0% stake investment in Primtelefon using the equity method of accounting.

On October 14, 2003, the Group completed the purchase of Vostok Mobile South and thus acquired a 50.0% stake in Volgograd Mobile and Astrakhan Mobile and an 80.0% stake in Mar Mobile GSM. Also, in a separate transaction the Group completed the acquisition of the remaining 20.0% stake in Mar Mobile GSM from existing shareholders unrelated to MCT Corporation, thus consolidating a 100.0% ownership in the company.

Notes to consolidated financial statements

for the years ended December 31, 2004, 2003 and 2002

3 Businesses acquired continued

In August 2004, MTS acquired from UTK the remaining 50.0% stakes in Astrakhan Mobile and Volgograd Mobile, increasing its ownership to 100.0%. The acquisition price was paid in cash and amounted to \$1.1 million and \$2.9 million, respectively. Commencing from the date of acquisition financial results of both companies are consolidated into MTS' financial statements. Astrakhan Mobile holds a 800/1800 MHz license covering the Astrakhan region (population of approximately 1 million) and Volgograd Mobile holds a 800/1800 MHz license covering the Volgograd region (population of approximately 2.7 million). As of July 31, 2004, the two companies provided AMPS/DAMPS services to around 10 thousand subscribers. The acquisition was accounted for using the purchase method of accounting. The allocation of purchase price for the first and second stakes in both companies resulted in an increase in license cost by \$16.5 million.

In April 2004, MTS acquired from OJSC Sibitelecom additional 7.5% stake in MSS, a company which operates in the Omsk region, for \$2.2 million in cash. This acquisition increased MTS' ownership in MSS to 91%. The acquisition was accounted for using the purchase method of accounting. The allocation of purchase price increased recorded license cost by \$1.1 million.

In April and May of 2004, MTS acquired the remaining stakes in the following subsidiaries:

- 35% of MTS-NN (a service provider in Nizhny Novgorod) for \$0.5 million, and
- 49% of Novitel (handsets dealer in Moscow) for \$1.3 million.

Both acquisitions increased MTS' share in the respective companies to 100%. The acquisitions were accounted for using the purchase method of accounting. The allocation of purchase price increased recorded goodwill by \$1.8 million.

In August 2004, MTS acquired from OJSC Volgatelecom remaining 49% stake in UDN-900 for \$6.4 million in cash. This acquisition increased MTS' ownership in UDN to 100%. The allocation of purchase price increased recorded license cost by \$0.3 million. UDN-900 provides GSM 900 services under the MTS brand in Udmurtia Republic (population 1.6 million). UDN's subscriber base as of July 31, 2004 was 219,760.

Pro-forma results of operations (unaudited) The following unaudited pro-forma financial data for the years ended December 31, 2004 and 2003, gives effect to the acquisitions of Uzdurobota, Primtelefon and other various regional companies as if they had occurred at January 1, 2003.

	2004 U.S.\$'000	2003 U.S.\$'000
Pro-forma:		
Net revenues	3,986,932	2,636,072
Net operating income	1,440,480	936,174
Net income	972,362	495,411
Earnings per share, basic and diluted	0.49	0.25

The pro-forma information is based on various assumptions and estimates. The pro-forma information is not necessarily indicative of the operating results that would have occurred if the Group acquisitions had been consummated as of January 1, 2003, nor is it necessarily indicative of future operating results. The pro-forma information does not give effect to any potential revenue enhancements or cost synergies or other operating efficiencies that could result from the acquisitions. The actual results of operations of these companies are included in the consolidated financial statements of the Group only from the respective dates of acquisition.

4 Cash and cash equivalents

Cash and cash equivalents as of December 31, 2004 and 2003 comprised the following:

	2004 U.S.\$'000	2003 U.S.\$'000
U.S. dollar current accounts	107,172	20,130
U.S. dollar term deposits	45,295	886
Ruble current accounts	90,527	40,597
Ruble deposits	2,596	20,201
Hryvnia current accounts	10,190	1,371
Uzbek som deposit accounts	15,106	–
Uzbek som current accounts	715	–
Other	2,549	7,191
Total cash and cash equivalents	274,150	90,376

5 Short-term investments

Short-term investments, denominated in U.S. dollars, as of December 31, 2004 comprised of the following:

	Annual interest rate %	Maturity date	2004 U.S.\$'000
OJSC Moscow Bank of Reconstruction and Development	8.4	December 9, 2005	30,000
East-West United Bank S.A.	2.0	April 04, 2005	23,100
OJSC Moscow Bank of Reconstruction and Development	8.4	October 10, 2005	10,000
OJSC Moscow Bank of Reconstruction and Development	8.4	December 14, 2005	10,000
Other			260
Total short-term investments			73,360

Short-term investments, denominated in U.S. dollars, as of December 31, 2003 comprised of the following:

	Annual interest rate %	Maturity date	2003 U.S.\$'000
OJSC Moscow Bank of Reconstruction and Development	4.8	February 2, 2004	200,000
OJSC Moscow Bank of Reconstruction and Development	8.4	October 21, 2004	19,100
OJSC Moscow Bank of Reconstruction and Development	8.0	October 4, 2004	10,000
OJSC Moscow Bank of Reconstruction and Development	8.4	November 23, 2004	5,000
OJSC Moscow Bank of Reconstruction and Development	8.4	December 5, 2004	5,900
OJSC Moscow Bank of Reconstruction and Development	8.4	December 20, 2004	5,000
Total short-term investments			245,000

OJSC Moscow Bank of Reconstruction and Development is a related party (see also Note 17).

Notes to consolidated financial statements

for the years ended December 31, 2004, 2003 and 2002

6 Trade receivables, net

Trade receivables as of December 31, 2004 and 2003 were as follows:

	2004 U.S.\$'000	2003 U.S.\$'000
Accounts receivable, subscribers	154,453	87,149
Accounts receivable, roaming	24,731	26,500
Allowance for doubtful accounts	(16,659)	(13,698)
Trade receivables, net	162,525	99,951

The following table summarizes the changes in the allowance for doubtful accounts for the years ended December 31, 2004, 2003 and 2002:

	2004 U.S.\$'000	2003 U.S.\$'000	2002 U.S.\$'000
Balance, beginning of the year	13,698	6,270	5,187
Provision for doubtful accounts	26,459	32,633	7,047
Accounts receivable written off	(23,498)	(25,205)	(5,964)
Balance, end of the year	16,659	13,698	6,270

7 Inventory

Inventory as of December 31, 2004 and 2003 comprised of the following:

	2004 U.S.\$'000	2003 U.S.\$'000
Spare parts for base stations	14,775	26,635
Handsets and accessories	30,574	23,499
Other inventory	44,169	17,157
Total inventory	89,518	67,291

Obsolescence expense for the years ended December 31, 2004, 2003 and 2002 amounted to \$4,610, \$3,307 and \$5,614, respectively, and was included in general and administrative expenses in the accompanying consolidated statements of operations. Spare parts for base stations included in inventory are expected to be utilized within a 12-month period.

8 Property, plant and equipment

The net book value of property, plant and equipment as of December 31, 2004 and 2003 was as follows:

	2004 U.S.\$'000	2003 U.S.\$'000
Network and base station equipment (including leased network and base station equipment of \$67,905 and \$66,311, respectively) and related leasehold improvements	2,538,240	1,775,180
Office equipment, computers, software and other (including leased office equipment, computers and software of \$1,613 and \$1,923, respectively)	249,458	147,395
Buildings and related leasehold improvements	202,095	151,262
Vehicles	15,658	11,611
Property, plant and equipment, at cost	3,005,451	2,085,448
Accumulated depreciation (including accumulated depreciation on leased equipment of \$30,304 and \$23,343)	(901,416)	(532,268)
Equipment for installation	275,010	334,264
Construction in-progress	855,273	368,632
Property, plant and equipment, net	3,234,318	2,256,076

Depreciation expenses during the years ended December 31, 2004, 2003 and 2002 amounted to \$385.7, \$233.1 and \$116.0 million, respectively, including depreciation expenses for leased property, plant and equipment in the amount of \$5.4, \$7.6 and \$3.4 million, respectively.

9 Other intangible assets

Intangible assets at December 31, 2004 and 2003 comprised of the following:

	Useful lives	2004			2003		
		Gross carrying value U.S.\$'000	Accumulated amortization U.S.\$'000	Net carrying value U.S.\$'000	Gross carrying value U.S.\$'000	Accumulated amortization U.S.\$'000	Net carrying value U.S.\$'000
Amortized intangible assets							
Acquired customer base	20 to 76 months	94,632	(50,276)	44,356	81,289	(18,307)	62,982
Rights to use premises	10 years	19,638	(12,393)	7,245	19,638	(10,476)	9,162
Numbering capacity with finite contractual life, software and other	3 to 10 years	474,921	(215,236)	259,685	338,222	(119,269)	218,953
		589,191	(277,905)	311,286	439,149	(148,052)	291,097
Unamortized intangible assets:							
Numbering capacity with indefinite contractual life		17,247	-	17,247	13,047	-	13,047
Total other intangible assets		606,438	(277,905)	328,533	452,196	(148,052)	304,144

Notes to consolidated financial statements

for the years ended December 31, 2004, 2003 and 2002

9 Other intangible assets continued

As a result of a limited availability of local telephone numbering capacity in Moscow and the Moscow region, MTS has been required to enter into agreements for the use of telephone numbering capacity with several telecommunication operators in Moscow. Costs of acquiring numbering capacity with finite contractual life are amortized over period of five to ten years in accordance with the terms of the contract entered into to acquire such capacity. Numbering capacity with indefinite contractual life is not amortized.

The significant component of MTS' right to use premises was obtained in the form of contributions to its charter capital in 1993. These premises included MTS' administrative offices and facilities utilized for mobile switching centers. In addition and simultaneously with acquisition of UMC in 2003 the Group obtained some additional property rights.

Amortization expense for the years ended December 31, 2004, 2003 and 2002 amounted to \$129.9 million, \$69.2 million and \$30.0 million, respectively. Based on the amortizable intangible assets existing at December 31, 2004, the estimated amortization expense is \$130.5 million during 2005, \$82.6 million during 2006, \$54.3 million during 2007, \$37.6 million during 2008, \$2.8 million during 2009 and \$3.5 million thereafter. Actual amortization expense to be reported in future periods could differ from these estimates as a result of new intangible assets acquisitions, changes in useful lives and other relevant factors.

10 Deferred connection fees

Deferred connection fees for the years ended December 31, 2004 and 2003 were as follows:

	2004 U.S.\$'000	2003 U.S.\$'000
Balance at beginning of the year	46,644	41,904
Payments received and deferred during the year	93,082	34,112
Amounts amortized and recognized as revenue during the year	(46,978)	(29,372)
Balance at end of the year	92,748	46,644
Less current portion	45,083	21,467
Non-current portion	47,665	25,177

MTS defers initial connection fees paid by subscribers for the first time activation of network service as well as one-time activation fees received for connection to various value-added services. These fees are recognized as revenue over the estimated average subscriber life (see Note 2).

11 Debt

At December 31, 2004 and 2003 debt comprised of the following:

	Currency	Annual interest rate (Actual rate at December 31, 2004 %)	2004 U.S.\$'000	2003 U.S.\$'000
9.75% Notes due 2008	USD	9.75	400,000	400,000
8.38% Notes due 2010	USD	8.38	400,000	400,000
10.95% Notes due 2004	USD	10.95	–	299,640
Floating Rate Notes due 2004	USD	–	–	298,196
Total Notes			800,000	1,397,836
Less current portion				597,836
Total Long-Term Notes			800,000	800,000
Syndicated loan	USD	LIBOR+2.50% (5.28%)	600,000	–
EBRD	USD	LIBOR+3.10% (5.88%)	150,000	–
CSFB	USD	LIBOR+2.20% (4.76%)	140,000	–
HSBC Bank plc & ING-BHF-Bank	USD	LIBOR+0.44% (3.21%)	77,003	–
Hermes Credit Facility	EUR	EURIBOR+0.65% (2.86%)	63,851	55,550
ING Bank (Eurasia)	USD	LIBOR+2.25%-4.15% (4.81%-6.71%)	46,667	60,000
HSBC	USD	LIBOR+2.75% (5.24%)	17,500	25,000
Ericsson	USD	LIBOR+4.00% (6.56%)	14,850	23,400
Deutsche Telekom AG and TDC Mobile International A/S	USD	–	–	14,819
Nordea Bank Sweden	USD	LIBOR+0.40% (3.18%)	6,499	–
West LB	EUR	EURIBOR+2.00% (4.22%)	4,000	5,092
KFW	EUR	EURIBOR+0.95% (3.16%)	1,478	4,313
Citibank	USD	LIBOR+1.15% (3.71%)	868	10,000
Dresdner	USD	–	–	15,400
AVAL bank	UAH	–	–	10,890
International Moscow Bank	RUR	–	–	10,864
MBRD	RUR	–	–	1,220
Ruble denominated debt	RUR	4.30%-16.50%	1,924	5,860
Other debt	USD	–	–	3,322
Total debt			1,124,640	245,730
Less current portion			370,845	103,312
Total long-term debt			753,795	142,418

Notes to consolidated financial statements

for the years ended December 31, 2004, 2003 and 2002

11 Debt continued

The Notes On December 21, 2001, MTS Finance S.A. ("MTS Finance"), a 100% beneficially-owned subsidiary of MTS, registered under the laws of Luxembourg, issued \$250.0 million 10.95% (effective interest rate of 11.25%) Notes at the price of 99.254%. Proceeds received from the Notes, net of underwriting discount, were \$248.1 million. Related debt issuance costs in the amount of \$3.9 million were capitalized. On March 20, 2002, MTS Finance issued additional \$50.0 million 10.95% (effective interest rate of 10.25%) Notes at a price of 101.616%. Proceeds received from these Notes, including the offering premium, were \$50.8 million. Related debt issuance costs in the amount of \$0.6 million were capitalized. All the Notes are fully and unconditionally guaranteed by MTS OJSC. MTS Finance made interest payments on the Notes semi-annually in arrears on June 21 and December 21 of each year, commencing on June 21, 2002. The Notes were listed on the Luxemburg Stock Exchange. In May 2002, these Notes were registered with the SEC under the Securities Act of 1933. In December 2004, the Group redeemed all outstanding Notes, mentioned above, in the principal amount plus accrued interest thereon to the date of redemption.

On January 30, 2003, MTS Finance issued \$400.0 million 9.75% Notes at par. These Notes are fully and unconditionally guaranteed by MTS OJSC and mature on January 30, 2008. MTS Finance is required to make interest payments on the Notes semi-annually in arrears on January 30 and July 30, commencing on July 30, 2003. The Notes are listed on the Luxembourg Stock Exchange. Proceeds received from the Notes were \$400.0 million and related debt issuance costs of \$3.9 million were capitalized.

On August 5, 2003, MTS Finance issued \$300.0 million Notes bearing interest at floating rate three months LIBOR + 4.00% at the price of 99%. These Notes were fully and unconditionally guaranteed by MTS OJSC and matured on August 7, 2004. MTS Finance was required to make interest payments on the Notes quarterly, commencing on November 5, 2003. The Notes were listed on the Luxembourg Stock Exchange. Proceeds received from the Notes, net of underwriting discount, were \$297.0 million and related debt issuance costs of \$1.8 million were capitalized. On May 5, 2004, the Group redeemed all outstanding Floating Rate Notes, mentioned above, in the principal amount plus accrued interest thereon to the date of redemption.

On October 14, 2003, MTS Finance issued \$400.0 million Notes bearing interest at 8.38% at par. The cash proceeds, net of issuance costs of approximately \$4.6 million, amounted to \$395.4 million. These Notes are fully and unconditionally guaranteed by MTS OJSC and will mature on October 14, 2010. MTS Finance is required to make interest payments on the Notes semi-annually in arrears on April 14 and October 14 of each year, commencing on April 14, 2004. The Notes are listed on the Luxembourg Stock Exchange.

Subject to certain exceptions and qualifications, the indentures governing the Notes contain covenants limiting the Group's ability to:

- incur debt;
- create liens;
- lease properties sold or transferred by the Group;
- enter into loan transactions with affiliates;
- merge or consolidate with another person or convey its properties and assets to another person; and
- sell or transfer any of its GSM licenses for the Moscow, St. Petersburg, Krasnodar and Ukraine license areas.

11 Debt continued

In addition, if the Group experiences certain types of mergers, consolidations or other changes in control, noteholders will have the right to require the Group to redeem the Notes at 101% of their principal amount, plus accrued interest. The Group is also required to take all commercially reasonable steps necessary to maintain a rating of the Notes from Moody's or Standard & Poor's. The Notes also have cross default provisions with publicly traded debt issued by Sistema, the Shareholder of the Group.

If the Group fails to meet these covenants, after certain notice and cure periods, the noteholders can accelerate the debt to be immediately due and payable.

Management believes that the Group is in compliance with all restrictive debt covenants provisions during the three-year period ended as of December 31, 2004.

Syndicated Loan In July 2004, MTS OJSC entered into a \$500.0 million Syndicated Loan Agreement ("Syndicated Loan") with international financial institutions: ING Bank N.V., ABN AMRO Bank N.V., HSBC Bank PLC, Raiffeisen Zentralbank Oesterreich AG ZAO, Bank Austria Creditanstalt AG, Commerzbank Aktiengesellschaft and others. The credit facility bears interest of LIBOR +2.50% per annum and matures in three years. The proceeds were used by OJSC MTS for corporate purposes, including refinancing of its existing indebtedness. In September 2004, MTS extended the total amount available under the Syndicated Loan for an additional \$100.0 million to a total amount of \$600.0 million. Commitment fee for the Syndicated Loan amounted to \$0.5 million. The debt issuance costs in the amount of \$10.2 million has been capitalized. At December 31, 2004, \$600.0 million was outstanding under this credit facility. The Syndicated Loan is subject to certain restrictive covenants including, but not limited to, certain financial ratios. As of December 31, 2004, the Group is in compliance with all existing covenants.

EBRD loan In December 2004, MTS OJSC entered into a credit facility with European Bank for Reconstruction and Development ("EBRD") for the total amount of \$150.0 million. The facility bears interest at LIBOR +3.10%. Commitment fee of 0.50% per annum should be paid in accordance with the credit agreement. The final maturity of this agreement is December 15, 2011.

As of December 31, 2004, the balance outstanding under the loan was \$150.0 million. The loan is subject to certain restrictive covenants including, but not limited to, certain financial ratios. As of December 31, 2004 the Group is in compliance with all existing covenants.

CSFB loans In April 2004, MTS OJSC entered into a short-term bridge loan facility with Credit Swiss First Boston for the total amount of \$200.0 million. The proceeds were used to repay the Floating Rate Notes originally due in August 2004. Amounts outstanding under the loan agreement bear interest at LIBOR +2.25%. The MTS OJSC repaid \$110.0 million and \$90.0 million due under the loan in June 2004 and July 2004, respectively.

In October 2004, MTS Finance entered into a short-term loan facility with CSFB for the total amount of \$140.0 million. Amounts outstanding under the loan agreement bear interest at LIBOR +2.20%. The final maturity of this short-term loan facility was April 29, 2005. As of December 31, 2004 the balance outstanding under the loan was \$140.0 million. The loan is subject to certain restrictive covenants including, but not limited to, certain financial ratios. As of December 31, 2004, the Group is in compliance with all existing covenants.

Notes to consolidated financial statements

for the years ended December 31, 2004, 2003 and 2002

11 Debt continued

HSBC Bank plc and ING BHF-BANK AG In October 2004, MTS OJSC entered into two credit facility agreements with HSBC Bank plc and ING BHF-BANK AG for the total amount \$122.3 million. The funds were used to purchase telecommunication equipment and software from Siemens AG and Alcatel SEL AG for the technical upgrade and expansion of network. Euler Hermes Kreditversicherungs-AG, the German credit export agency, is providing export credit cover in respect to both facilities. The facility bears interest at LIBOR +0.44%. A commitment fee of 0.20% per annum and an arrangement fee of 0.25% should be paid in accordance with the loan agreement. The principal and interest amounts are to be repaid in 17 equal half-year installments, starting July 2005 for the first agreement and September 2005 for the second one. As of December 31, 2004, the outstanding balance under these agreements was \$77.0 million. The final maturity of these agreements is in July and September 2013. The loan facility is subject to certain restrictive covenants. As of December 31, 2004, the Group is in compliance with all existing covenants.

Hermes Credit Facility (“HECF”) On December 30, 2003, UMC entered into Hermes Credit Facility with ING BHF Bank and Commerzbank Aktiengesellschaft to finance the acquisition of GSM equipment from Siemens AG. The aggregate amount available under this credit facility is EUR 47.4 million (\$64.5 million at December 31, 2004). In 2004, the agreement was amended to increase the amount available under the facility by EUR 9.2 million (\$12.5 million as of December 31, 2004). The loan is guaranteed by MTS OJSC and bears interest at EURIBOR +0.65%. The amount outstanding is redeemable in ten equal semi-annual installments starting on July 31, 2004. As of December 31, 2004 and 2003, the amounts outstanding under the loan were \$63.9 million and \$55.6 million, respectively. The available credit facility as at December 31, 2004 and 2003 was \$0.6 million and \$3.7 million, respectively.

ING Bank (“Eurasia”) In September 2003, UMC entered into a \$60.0 million syndicated credit facility with ING Bank (“Eurasia”) ZAO, ZAO Standard Bank and Commerzbank Aktiengesellschaft with an interest rate of LIBOR + 2.25% – 4.15%. The loan is guaranteed by MTS OJSC. The proceeds were used by UMC to refinance its existing indebtedness. The loan is payable in eight equal quarterly installments starting from September 2004. As of December 31, 2004 and 2003, \$46.7 million and \$60.0 million were outstanding, respectively, under this credit facility.

HSBC Bank LLC In October 2003, TAIF Telcom entered into a \$25.0 million credit facility with HSBC Bank LLC, which is guaranteed by MTS OJSC. The facility bears interest at LIBOR +2.75% and is redeemable in ten equal quarterly installments commencing on June 2004. The funds were used to purchase telecommunication equipment and general corporate purposes. The loan is subject to certain restrictive covenants including, but not limited to, restriction on the amount of dividends paid by TAIF Telcom until MTS owns 100% of TAIF Telcom’s outstanding common stock. As of December 31, 2004 and 2003 the outstanding balances under the credit facility were \$17.5 million and \$25.0 million, respectively.

Ericsson debt restructuring In December 1996, Rosico, a wholly-owned subsidiary merged into MTS OJSC in June 2003, entered into a credit agreement with Ericsson Project Finance AB (“Ericsson”) that provided for a credit facility with an aggregate principal amount of \$60.0 million and had a maximum term of five years (the “Ericsson Loan”). The loan was repayable in ten equal consecutive quarterly payments of \$6.0 million commencing in 1999. On July 24, 2001, MTS, Rosico and Ericsson signed an amendment to the credit agreement rescheduling Rosico principal payments in 19 consecutive quarterly installments. The amounts advanced under the agreement bear interest of LIBOR +4.00%. If Rosico fails to pay any amount under this facility, the overdue interest would bear interest at a rate of an additional 6.00% per annum. The credit agreement contains covenants restricting Rosico’s ability to encumber its present and future assets and revenues without lenders’ express consent.

Concurrent with the Group's acquisition of Rosico, Sistema agreed to fund the full and timely repayment of the Ericsson Loan and to indemnify Rosico and MTS for any costs incurred by either Rosico or MTS in connection with the repayment of the Ericsson Loan. During 2000, Sistema and MTS agreed on a method that would allow Sistema to fund its obligation in a manner that minimizes the total costs of meeting this obligation (including related tax costs). Under this method, MTS enters into long-term, ruble-denominated Promissory Notes with 0% interest and maturities from 2049 to 2052 to repay a portion of the funding from Sistema. The carrying value of these Notes is insignificant at December 31, 2004, December 31, 2003 and 2002. The Group records interest expense on these notes over the term, such that the full amount of the obligation will be reflected as a liability at the date of repayment. Through December 31, 2004, Sistema has made payments under this obligation in the amount of \$60.0 million, \$45.1 million of which are repayable in the form of long-term, ruble denominated Promissory Notes with 0% interest. Amounts receivable from Sistema under this indemnification are recorded as shareholder receivable in the accompanying consolidated balance sheets.

On February 25, 2003, Ericsson assigned all of its rights and obligations under the Ericsson Loan to Salomon Brothers Holding Company, Inc.

At December 31, 2004 and 2003, \$14.9 million and \$23.4 million were outstanding, respectively, under the Ericsson Loan.

Deutsche Telekom AG and TDC Mobile International A/C The credit facilities with Deutsche Telekom AG and TDC Mobile International A/C bear interest at LIBOR +5.00%-7.00% and were redeemable in five equal quarterly installments commencing April 2003. At December 31, 2003 the unpaid balance under these loans was \$14.8 million. The debt was fully repaid in April 2004.

Nordea Bank Sweden loan In September 2003, Primtelefon entered into a long-term loan facility with Nordea Bank Sweden for the total amount of \$9.8 million. Amounts outstanding under the loan agreement bear interest at LIBOR +0.40% and mature in October 2006. The loan is guaranteed by MTS OJSC. As of December 31, 2004 and 2003, the amounts outstanding under the loan were \$6.5 million and nil, respectively.

WestLB International loan In July 2002, MTS-P entered into a credit facility agreement with WestLB International S.A. Amounts outstanding under this agreement bear interest of EURIBOR +2.00% per annum for the first two years for each advance and 4.00% per annum for the remaining interest periods for each advance until maturity. The final maturity of this agreement is December 28, 2006. The loan is guaranteed by MTS OJSC. As of December 31, 2004 and 2003, the balances outstanding under the loan were \$4.0 million and \$5.1 million, respectively.

KFW On December 21, 1998, UMC entered into two loan agreements with KWF, a German bank, for EUR 1.9 million and EUR 10.9 million. These loans bear interest at EURIBOR +0.95% per annum and mature on March 31, 2004 and February 28, 2005, respectively. As of December 31, 2004 and 2003 the outstanding balances under these loans were \$1.5 million and \$4.3 million, respectively.

Notes to consolidated financial statements

for the years ended December 31, 2004, 2003 and 2002

11 Debt continued

Citibank credit facility In November 2002, Telecom XXI entered into a credit facility with Citibank. Amounts borrowed under the credit facility bear interest of LIBOR +3.50% per annum. Overdue amounts bear an additional 3.00% per annum. The \$10.0 million outstanding under this facility as of December 31, 2003, was fully repaid in July 2004.

The balance outstanding as at December 31, 2004, in the amount of \$0.9 million is comprised of the amounts borrowed by Primtelefon and Astrakhan Mobile, which bear interest at LIBOR +1.15% and are payable in 2006.

Dresdner Bank Credit Facilities In December 2001 and April 2002, UDN-900 entered into credit agreements with Dresdner Bank ("Dresdner"), maturing on April 2004. As of December 31, 2003 the amount outstanding under these agreements was \$5.4 million. These borrowings bear interest at LIBOR +3.20% per annum and are guaranteed by MTS OJSC. In April 2004, the loans were fully repaid.

In October 2002, MSS entered into a credit agreement with Dresdner to borrow up to \$10.0 million. As of December 31, 2004 and 2003, \$nil and \$10.0 million, respectively, were outstanding under this agreement. Borrowings under this agreement bear interest of LIBOR +3.20%-3.35% per annum. The loan was guaranteed by MTS OJSC.

AVAL Bank On December 31, 2003, UMC had the balance of \$10.9 million of overdraft with AVAL bank. The short-term overdraft facility was limited to 110.0 million hryvnias (\$20.6 million at December 31, 2003), bore interest at 10.00-16.00% per annum and matured on June 30, 2004. The balance of the overdraft was fully repaid in January 2004.

International Moscow Bank On June 9, 2003, Kuban-GSM entered into a 350.0 million ruble (\$12.6 million at December 31, 2004) credit facility with International Moscow Bank. Amounts borrowed under this facility mature in June 2005, bear an interest rate of 13.4% per annum and are collateralized by equipment with a book value of 458.1 million rubles (approximately \$16.5 million at December 31, 2004). As of December 31, 2003, approximately \$10.9 million was outstanding under this facility. The loan was fully repaid in March 2004. As of December 31, 2004, the available credit facility was \$12.6 million.

ABN AMRO loan In November 2004, MTS signed a loan agreement with ABN AMRO Bank N.V. (Stockholm branch) for \$ 56.6 million and EUR 8.4 million. These funds will be used to purchase telecommunication equipment from Ericsson AB for expansion of the network. The loan is repayable on a biannual basis in equal installments over nine years and bears an interest rate of USD LIBOR/EURIBOR +0.35% per annum. As of December 31, 2004, nil was outstanding under the facility.

MBRD In August 2004, Novitel entered into ruble-denominated credit facility with Moscow Bank for Reconstruction and Development ("MBRD"), a related party. The facility allows borrowings of up to 60.0 million ruble (\$2.2 million at December 31, 2004). The loan bears interest at 15.00% per annum and is collateralized by equipment with a book value of 63.0 million rubles (approximately \$2.3 million at December 31, 2004). The facility was fully repaid by December 2004.

11 Debt continued

In 2003, Dontelecom entered into a ruble-denominated loan agreement with MBRD. The amounts borrowed bore interest at 18.5% and were payable in June 2004. As of December 31, 2003, \$1.2 million were outstanding under the facility. The loan was fully repaid in June 2004.

During the year 2003, MTS OJSC signed several short-term loan agreements with MBRD. Amounts borrowed were payable during the period of one to two months. During 2003, interest expense on these loans was approximately \$0.3 million.

The following table presents aggregate scheduled maturities of debt principal outstanding as of December 31, 2004:

	U.S.\$'000
Payments due in the year ended December 31,	
2005	370,845
2006	365,749
2007	227,195
2008	447,240
2009	40,100
Thereafter	473,511
	1,924,640

In December 2004, the Group entered into two variable-to-fixed interest rate swap agreements with ABN AMRO Bank N.V and with HSBC Bank PLC to hedge MTS' exposure to variability of future cash flows caused by the change in LIBOR related to the Syndicated Loan. MTS agreed with ABN AMRO to pay a fixed rate of 3.27% and receive a variable interest of LIBOR on \$100.0 million for the period from October 7, 2004 up to July 27, 2007. MTS agreed with HSBC Bank PLC to pay a fixed rate of 3.25% and receive a variable interest of LIBOR on \$150.0 million for the period from October 7, 2004 up to July 27, 2007. These instruments qualify as cash flow hedges under the requirements of SFAS No. 133 as amended by SFAS No. 149. As of December 31, 2004, the Group recorded a liability of \$0.6 million in relation to these contracts in the accompanying consolidated balance sheet and a loss of \$0.5 million net of tax of \$0.1 million as other comprehensive income in the accompanying consolidated statement of changes in shareholders equity in relation to the change in fair value of these agreements. In 2004, there were no amounts reclassified from other comprehensive income to income due to hedge ineffectiveness.

Notes to consolidated financial statements

for the years ended December 31, 2004, 2003 and 2002

12 Capital lease obligations

The following table presents future minimum lease payments under capital leases together with the present value of the net minimum lease payments as of December 31, 2004:

	U.S.\$'000
Payments due in the year ended December 31,	
2005	10,547
2006	3,233
2007	826
2008	171
2009	169
Thereafter	451
Total minimum lease payments (undiscounted)	15,397
Less amount representing interest	(2,889)
Present value of net minimum lease payments	12,508
Less current portion of lease payable	(8,561)
Non-current portion of lease payable	3,947

For a schedule by years of future minimum lease payments under capital leases to Invest-Svyaz-Holding, a related party, together with the present value of the net minimum lease payments as of December 31, 2004, see Note 17.

13 Accrued liabilities

Accrued liabilities at December 31, 2004 and 2003 were comprised of the following:

	2004 U.S.\$'000	2003 U.S.\$'000
Accrued payroll and vacation	44,673	6,595
VAT	32,174	33,545
Interest payable	31,177	32,911
Taxes other than income	23,706	31,139
Other accruals	48,947	39,599
Total accrued liabilities	180,677	143,789

14 Income tax

MTS' provision for income taxes was as follows for the years ended December 31, 2004, 2003 and 2002:

	2004 U.S.\$'000	2003 U.S.\$'000	2002 U.S.\$'000
Current provision for income taxes	430,687	285,481	129,406
Deferred income tax benefit	(76,023)	(43,001)	(18,989)
Total provision for income taxes	354,664	242,480	110,417

Effective January 1, 2002, the statutory income tax rate in Russia was set at 24%. From January 1, 2004, UMC statutory income tax rate changes from 30% to 25% as a result of changes in Ukrainian tax legislation.

The statutory income tax rate reconciled to MTS' effective income tax rate is as follows for the years ended December 31, 2004, 2003 and 2002:

	2004 %	2003 %	2002 %
Statutory income tax rate for year	24.0	24.0	24.0
Adjustments:			
Expenses not deductible for tax purposes	1.0	2.3	2.1
Effect of higher tax rate of UMC	0.2	0.9	–
Currency exchange and transaction gains	1.2	1.6	–
Other	(0.6)	0.4	(0.3)
Effective income tax rate	25.8	29.2	25.8

Temporary differences between the tax and accounting bases of assets and liabilities give rise to the following deferred tax assets and liabilities at December 31, 2004 and December 31, 2003:

	2004 U.S.\$'000	2003 U.S.\$'000
Assets (liabilities) arising from tax effect of:		
Deferred tax assets		
Depreciation of property, plant and equipment	48,829	19,171
Deferred connection fees	22,598	8,805
Subscriber prepayments	18,151	12,030
Accrued expenses	18,934	7,316
Allowance for doubtful accounts	5,220	14,157
Inventory obsolescence	2,759	3,906
Amortization of intangible assets	9,148	5,444
Loss carryforward (Rosico and MSS)	7,171	7,113
Other	4,328	5,683
	137,138	83,625
Valuation allowance	(7,171)	(7,113)
Total deferred tax assets	129,967	76,512

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for the years ended December 31, 2004, 2003 and 2002

14 Income tax continued

	2004 U.S.\$'000	2003 U.S.\$'000
Deferred tax liabilities		
Licenses acquired	(179,935)	(168,889)
Depreciation of property, plant and equipment	(31,429)	(14,084)
Customer base	(10,746)	(15,506)
Other intangible assets	(9,797)	(11,980)
Other	(8,600)	(2,258)
Total deferred tax liabilities	(240,507)	(212,717)
Net deferred tax liability	(110,540)	(136,205)
Net deferred tax assets, current	49,850	44,423
Net deferred tax liability, long term	(160,390)	(180,628)

As of December 31, 2004, the Group had a tax loss carryforward in the amount of \$29,879 related to operations of Rosico. As of December 31, 2003, the Group had taxable losses carryforwards in the amount of \$29,638 related to operations of Rosico and MSS. These loss carryforwards resulted in deferred tax assets at December 31, 2004 and December 31, 2003 in the amounts of \$7,171 and \$7,113, respectively. As Russian companies are required to file tax declarations on a standalone basis, MTS is not able to utilize these losses to offset its taxable income. While Rosico was merged into MTS OJSC in June 2003, the Group has still recorded a valuation allowance for the entire amount of the available tax loss carryforward related to Rosico as MTS has not yet performed all procedures necessary to determine what amounts will be available for deductions in the future.

The Group does not record a deferred tax liability related to undistributed earnings of UMC, as it intends to permanently reinvest these earnings. The undistributed earnings of UMC amounted to \$559.5 and \$327.8 million as of December 31, 2004 and 2003, respectively.

15 Shareholders' equity

In accordance with Russian laws, earnings available for dividends are limited to profits determined in accordance with Russian statutory accounting regulations, denominated in rubles, after certain deductions. Net income of MTS OJSC for the years ended December 31, 2004, 2003 and 2002 that is distributable under Russian legislation totaled 15,209 million rubles (\$527.9 million), 13,423.0 million rubles (\$437.4 million) and 10,759 million rubles (\$343.3 million), respectively.

In December 2004, the shareholder of the Group T-Mobile Worldwide Holding GMBH sold its 15.09% stake in MTS on the open market in the form of GDRs.

16 Stock bonus and stock option plans

In 2000, MTS established a stock bonus plan and stock option plan (the "Option Plan") for selected officers, key employees and key advisors. During its initial public offering in 2000 (see Note 1) MTS allotted 9,966,631 shares of its common stock to fund the Option Plan.

During 2004, 2003 and 2002, MTS made several grants pursuant to its stock option plan to employees and directors of the Group. These options generally vest over a two-year period from the date of the grant, contingent on continued employment of the grantee with the Company.

A summary of the status of the Group's Option Plan is presented below:

	Shares	Weighted average exercise price U.S.\$'000
Outstanding at January 1, 2002	1,829,221	1.31
Granted	2,846,681	1.49
Forfeited	(27,481)	1.31
Outstanding at December 31, 2002	4,648,421	1.42
Granted	1,952,632	2.43
Exercised	(37,557)	1.31
Exchanged for cash award	(1,746,310)	1.31
Forfeited	(19,776)	1.31
Outstanding at December 31, 2003	4,797,410	1.87
Granted	1,665,256	5.95
Exercised	(2,726,966)	1.49
Forfeited	(204,730)	1.92
Outstanding at December 31, 2004	3,530,970	4.09

As of December 31, 2004, the Group had the following stock options outstanding:

Exercise prices	Number of shares	Remaining weighted average life (years)
2.43	1,868,214	0.54
5.95	1,662,756	1.54
	3,530,970	

None of the options outstanding at December 31, 2004 and 2003 were exercisable.

Notes to consolidated financial statements

for the years ended December 31, 2004, 2003 and 2002

16 Stock bonus and stock option plans continued

According to the terms of the Option Plan, the exercise price of the options equals the average market share price during the 100-day period preceding the grant date. The difference in the exercise price of the option and the market price at the date of grant is shown as unearned compensation in the consolidated statements of changes in shareholders' equity and is amortized to expense over the vesting period of two years. This amount historically had been insignificant to the consolidated financial statements.

The Group's Option Plan does not routinely allow a grantee to receive cash in lieu of shares, however due to the lack of liquidity for the Group's stock in the Russian market, 1,746,310 options were cancelled by MTS in 2003 and exchanged for a cash award of \$2.9 million.

The fair value of options granted during the three years in the period ended December 31, 2004 were estimated using the binomial option pricing model based on the following assumptions:

	2004	2003	2002
Risk free rate	4.5%	5.2%	6.1%
Expected dividend yield	3%	3%	3%
Expected volatility	48.8%	40.0%	50.0%
Expected life (years)	2	2	2
Fair value of options (per share)	\$2.36	\$1.02	\$0.50

In accordance with Russian legislation, MTS Board members and key employees may be considered insiders with respect to the Group and thus may be restricted from selling their shares.

17 Related parties

Related party balances as of December 31, 2004 and 2003, comprised of the following:

	2004 U.S.\$'000	2003 U.S.\$'000
Accounts receivable:		
Rosno for insurance	9,065	—
Kvazar-Micro for information systems consulting	2,161	—
MTT for interconnection	1,497	822
T-Mobile for roaming	1,198	853
Maxima for advertising	884	83
STROM telecom for software	—	1,074
Receivables from investee companies	2,963	524
Total accounts receivable, related parties	17,768	3,356

17 Related parties continued

	2004 U.S.\$'000	2003 U.S.\$'000
Accounts payable:		
Strom Telecom for software	7,070	—
MTT for interconnection	2,964	—
T-Mobile for roaming	1,580	—
MTU-Inform for interconnection	2,398	2,398
MGTS for interconnection	607	704
Cetel B.V. for UMC shares	—	27,500
Other	2,390	1,302
Total accounts payable, related parties	17,009	31,904

Transactions with major related parties are described below.

Moscow Bank of Reconstruction and Development (“MBRD”) Starting August 2000, MTS has been keeping certain bank and deposit accounts with MBRD, whose major shareholder is Sistema. As of December 31, 2004, MTS’ cash position at MBRD amounted to \$72.0 million in current accounts. As of December 31, 2003, MTS’ cash position at MBRD amounted to \$279.7 million, including \$265.2 million in time deposits and \$14.5 million in current accounts. The related interest accrued and collected on the deposits for the years ended December 31, 2004 and 2003 amounted to \$6.8 million and \$9.9 million, respectively, and was included as a component of interest income in the accompanying consolidated statements of operations.

Borrowing transactions with MBRD are described in Note 11.

Rosno OJSC MTS arranged medical insurance for its employees and property with Rosno OJSC, whose significant shareholder is Sistema. Insurance premium paid to Rosno OJSC for the years ended December 31, 2004, 2003 and 2002 amounted to \$7.6 million, \$16.9 million and \$4.9 million, respectively. Management believes that all of the insurance contracts with Rosno OJSC have been entered at market terms.

Kvazar-Micro Corporation (“Kvazar”) Kvazar, a Ukrainian-based company providing solutions, services, and business consulting in the field of information and communication technologies. Since July 2004, Sistema is a controlling shareholder of Kvazar. In 2004, MTS signed agreements for software implementation services with Kvazar. Related fees for the year 2004 amounted to approximately \$9.7 million. Management believes that these agreements are at market terms.

Maxima Advertising Agency (“Maxima”) In 2004, 2003 and 2002, MTS had agreements for advertising services with Maxima, a subsidiary of Sistema. Advertising costs related to Maxima for the years ended December 31, 2004, 2003 and 2002 amounted to \$48.9 million, \$23.7 million and \$12.1 million, respectively. Management believes that these agreements are at market terms.

Telmos In 2004, 2003 and 2002, MTS had interconnection arrangements with, and received domestic and international long-distance services from Telmos, a subsidiary of Sistema. Interconnection and line rental expenses for the years 2004, 2003 and 2002 comprise \$1.6 million, \$1.6 million and \$1.8 million, respectively. Management believes that these arrangements are at market terms.

Notes to consolidated financial statements

for the years ended December 31, 2004, 2003 and 2002

17 Related parties continued

Moscow City Telephone Network (“MGTS”) In 2004, 2003 and 2002, MTS had line rental agreements with MGTS and rented cable plant from MGTS for installation of optic-fiber cable. MTS also rented buildings for administrative office, sales and marketing offices as well as premises for switching and base station equipment. Rental expenses for the years 2004, 2003 and 2002 amounted to \$5.9 million, \$4.5 million and \$3.4 million, respectively. Management believes that all these transactions were made at market terms. Sistema is the majority shareholder of MGTS.

MTU-Inform In 2004, 2003 and 2002, MTS had interconnection and line rental agreements with MTU-Inform, a subsidiary at Sistema. Interconnection and rental expenses for the years 2004, 2003 and 2002, were \$25.7 million, \$23.3 million and \$24.3 million, respectively. In 2003 and 2002, MTS also purchased telephone numbering capacity from MTU-Inform for \$2.0 million and \$2.6 million, respectively. Management believes that these agreements are at market terms.

Comstar In 2004, 2003 and 2002, MTS had interconnection and line rental agreements with Comstar, a subsidiary of Sistema. Cost of interconnecton and line rental services rendered by Comstar for the years 2004, 2003 and 2002, amounted to \$3.1 million, \$3.6 million and \$3.5 million, respectively. In 2004, MTS also purchased telephone numbering capacity from Comstar for \$ 4.2 million. Management believes that these agreements are at market terms.

T-Mobile In 2004, 2003 and 2002, the Group had non-exclusive roaming agreements with T-Mobile, a shareholder of the Group. Roaming expenses for the years ended December 31, 2004, 2003 and 2002 amounted to \$ 6.1 million, \$1.7 million and \$1.1 million, respectively. Management believes that these agreements are at market terms.

Invest-Svyaz-Holding In 2004 and 2003, MTS entered into agreements with Invest-Svyaz-Holding, a shareholder of MTS and a wholly-owned subsidiary of Sistema, for leasing of network equipment and billing system. These leases were recorded as capital leases in compliance with requirements of SFAS No. 13, “Accounting for leases”. The present value of future lease payments due within one year are classified as current liabilities, and the remaining balance as long-term liabilities. The interest rate implicit in these leases varies from 14% to 44%, which management believes are market terms.

The following table summarizes the future minimum lease payments under capital leases to Invest-Svyaz-Holding together with the present value of the net minimum lease payments as of December 31, 2004:

	U.S.\$'000
Payments due in the year ended December 31,	
2005	8,174
2006	3,058
2007	653
Total minimum lease payments (undiscounted)	11,885
Less amount representing interest	(2,436)
Present value of net minimum lease payments	9,449
Less current portion of lease obligations	(6,103)
Non-current portion of lease obligations	3,346

17 Related parties continued

In addition to the above lease transactions, the Group guarantees debt of Invest-Svyaz-Holding in the amount of \$21.6 million to a third party, which is used by Invest-Svyaz-Holding primarily to finance its leases to the Group.

For the year ended December 31, 2004, principal and interest paid to Invest-Svyaz-Holding were \$6.4 and \$4.1, respectively. Principal and interest paid to Invest-Svyaz-Holding for the year ended December 31, 2003 were \$5.4 million and \$3.3 million, respectively. Principal and interest paid for the year ended December 31, 2002, were \$2.9 million and \$1.4 million, respectively. Management believes that these agreements are at market terms.

STROM telecom During 2004 and 2003, the Group entered into a number of agreements with STROM telecom, a subsidiary of Sistema, for a total amount up to \$116.5 and \$32.3 million, respectively. Pursuant to these contracts, the Group purchased in 2004 and 2003 billing systems and communication software support systems for approximately \$9.1 million and \$23.7 million, respectively. Advances paid under these agreements and outstanding as of December 31, 2004 and 2003, amount to \$51.0 million and \$1.1 million, respectively.

MTT In 2004, MTS had interconnection and line rental agreements with MTT, a subsidiary of Sistema. Interconnection expenses for the year 2004 amounted to \$16.1 million. Management believes that these agreements are at market terms.

See Note 3 for other related parties transactions.

18 General and administrative expenses

General and administrative expenses for the years ended December 31, 2004, 2003 and 2002 consisted of the following:

	2004 U.S.\$'000	2003 U.S.\$'000	2002 U.S.\$'000
Salaries and social contributions	256,989	156,808	84,706
Repair and maintenance	81,538	39,406	20,361
General and administrative	72,586	42,530	26,549
Rent	54,054	31,968	15,578
Billing and data processing	28,238	22,067	9,549
Taxes other than income	50,033	40,432	39,119
Consulting expenses	19,694	11,361	7,692
Insurance	7,554	7,351	6,774
Inventory obsolescence expense	4,610	3,307	5,614
General and administrative expenses	575,296	355,230	215,942

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for the years ended December 31, 2004, 2003 and 2002

19 Investments and advances to associates

At December 31, 2004 and 2003, the Group's investments in and advances to associates included, respectively, the following:

	2004 U.S.\$'000	2003 U.S.\$'000
MTS Belarus – loans receivable	51,894	51,481
MTS Belarus – equity investment	27,699	5,884
Primtelefon – equity investment	–	31,174
Astrakhan Mobile and Volgograd Mobile – equity investment	–	5,806
Astrakhan Mobile and Volgograd Mobile – loans receivable	–	6,850
Volgograd Mobile – loans receivable	–	204
MSS – note receivable	–	827
Receivables from other investee companies	1,642	1,359
Total investments in and advances to associates	81,235	103,585

MTS Belarus As of December 31, 2004 and 2003, the Group provided MTS Belarus with a total of \$51.9 million and \$51.5 million in loans, respectively. These loans bear interest at 3.00% to 11.00% per annum. In addition, the Group guarantees the debt of MTS Belarus in the amount of \$25.0 million to several banks.

Primtelefon, Astrakhan Mobile and Volgograd Mobile As described in Note 3, in August 2003 the Group purchased equity interests in various Russian regional mobile operators, including stakes in Primtelefon, Astrakhan Mobile and Volgograd Mobile, as a part of its strategic business plans.

Following the acquisition in 2004 of the additional stakes in Primtelefon, Astrakhan Mobile and Volgograd Mobile, those companies have been consolidated starting June 30, 2004 for Primtelefon and September 1, 2004 for both Astrakhan Mobile and Volgograd Mobile.

The Group's share in net income of unconsolidated affiliates is included in other income in the accompanying consolidated statements of operations. For the years ended December 31, 2004, 2003 and 2002, this share amounted \$24.2 million, \$2.7 million and nil net income, respectively.

20 Operating licenses

In connection with providing telecommunication services, the Group has been issued various operating licenses by the Russian Ministry of Information Technologies and Communications. In addition to the licenses received directly from the Russian Ministry of Information Technologies and Communications, the Group was granted access to various telecommunication licenses through acquisitions. At December 31, 2004 and 2003, the recorded values of the Group's telecommunication licenses were as follows:

	2004 U.S.\$'000	2003 U.S.\$'000
Moscow license area (MTS OJSC)	255,812	255,812
Ukraine (UMC)	171,815	151,857
Krasnodar and Adigeya regions (Kuban-GSM)	124,396	124,396
Five regions of Asian Russia (Telecom-900)	91,202	84,395
North-Western region (Telecom XXI)	74,639	74,639
Tatarstan Republic (TAIF Telcom)	104,159	68,407
Krasnoyarsk region, Taimyr region and Khakassia Republic (Sibchallenge)	52,625	52,625
Tomsk region (TSS)	49,282	49,282
Bashkortostan Republic (BM Telecom)	48,932	48,932
Far East (Primtelefon)	48,107	—
Uzbekistan (Uzdunrobita)	40,861	—
Rostov region (Dontelecom)	22,067	22,067
Seven regions of European Russia	19,503	19,503
Other	85,029	8,212
Licenses, at cost	1,188,429	960,127
Accumulated amortization	(417,158)	(257,024)
Licenses, net	771,271	703,103

Amortization expense for the years ended December 31, 2004, 2003 and 2002 amounted to \$160.1 million, \$113.6 million and \$63.7 million, respectively.

Based on the amortizable intangible assets existing at December 31, 2004, the estimated future amortization expense is \$222.9 million during 2005, \$168.5 million during 2006, \$125.6 million during 2007, \$75.8 million during 2008, \$37.3 million during 2009 and \$140.8 million thereafter. Actual amortization expense to be reported in future periods could differ from these estimates as a result of new intangible assets acquisitions, changes in useful lives and other relevant factors.

Each of the Group's licenses, except the licenses covering the Moscow license area and Uzbekistan, contains a requirement for service to be commenced and for subscriber number and territorial coverage targets to be achieved by a specified date. The Group has met these targets or received extensions to these dates in those regional license areas in which the Group has not commenced operations. Management believes that the Group is in compliance with all material terms of its licenses.

The Group's operating licenses do not provide for automatic renewal. The Group has limited experience with the renewal of its existing licenses. However, management believes that licenses required for the Group's operations will be renewed upon expiration.

Notes to consolidated financial statements

for the years ended December 31, 2004, 2003 and 2002

21 Commitments and contingencies

Capital commitments As of December 31, 2004, the Group had executed non-binding purchase agreements in the amount of approximately \$164.7 million to subsequently acquire property, plant and equipment.

Operating leases The Group has entered into lease agreements of space for telecommunication equipment and offices, which expire in various years up to 2053. Rental expenses under these operating leases of \$54.0 million, \$32.0 million and \$15.6 million for the years ended December 31, 2004, 2003 and 2002, respectively, are included in general and administrative expenses in the accompanying statements of operations. Future minimum lease payments due under non-cancelable leases at December 31, 2004 are as follows:

	U.S.\$'000
Payments due in the years ended December 31,	
2005	33,459
2006	17,787
2007	14,021
2008	10,670
2009	7,261
Thereafter	35,475
Total	118,673

Operating licenses Since the commencement of MTS' operations in 1994, a number of telecommunication licenses for the Russian Federation were issued to MTS and its now consolidated subsidiaries. These license agreements stipulate that certain fixed "contributions" be made to a fund for the development of telecommunication networks in the Russian Federation. Most of MTS' current licenses provide for the payment of such fees, which in the aggregate could total approximately \$103.0 million, as at December 31, 2004. According to the terms of licenses, such contributions are to be made during the license period upon the decision and as defined by the Board of directors of the Association of GSM-900 Operators (the "Association"). The Association is a non-governmental, not-for-profit association, and its Board of directors comprises representatives of the major cellular communications companies, including MTS.

The Association has not adopted any procedures enforcing such payments and no such procedures have been established by Russian legislation. To date, MTS has not made any such payments pursuant to any of the current operating licenses issued to MTS and its consolidated subsidiaries. Further, the management of MTS believes that MTS will not be required to make any such payments in the future. In relation to these uncertainties, MTS has not recorded a contingent liability in the accompanying consolidated financial statements.

Provision for doubtful accounts In 2003, MTS incurred a loss of \$16.7 million due to dealers and subscriber fraud. In 2003, the Group's management took measures to prevent further fraud of that nature. No significant losses from the dealers' fraud were incurred during year ended December 31, 2004.

21 Commitments and contingencies continued

Issued guarantees As of December 31, 2004, the Group has issued guarantees to third-party banks for the loans taken by Invest-Svyaz-Holding, a shareholder of the Group for a total amount of \$21.6 million (see Note 17). The guarantees expire by May 2006. The Group issued additional guarantees on behalf of MTS-Belarus, an equity investee, for the total amount of \$25.0 million. Under these guarantees, the Group could be potentially liable for a maximum amount of \$46.6 in case of the borrower's default under the obligations. The guarantees expire by April 2007.

As of December 31, 2004, no event of default has occurred under any of the guarantees issued by the Group.

Contingencies The Russian economy, while deemed to be of market status beginning in 2002, continues to display certain traits consistent with that of an emerging market. These characteristics have in the past included higher-than-normal inflation, insufficient liquidity of the capital markets, and the existence of currency controls, which cause the national currency to be illiquid outside of Russia. The continued success and stability of the Russian economy will be subject to the government's continued actions with regard to supervisory, legal, and economic reforms.

On January 1, 2004, a new law on telecommunications came into effect in Russia. The law sets the legal basis for the telecommunications business in Russia and defines the status that state bodies have in the telecommunications sector. The Group cannot predict with any certainty how the new law will affect MTS. The new law creates a new interconnect pricing regime in 2004 that should be more transparent and unified and it creates a universal service charge calculated as a percentage of revenue, which will be introduced from 2005. The new law may increase the regulation of the MTS operations and until the time when appropriate regulations consistent with the new law are promulgated, there will be a period of confusion and ambiguity as regulators interpret the legislation.

Russia currently has a number of laws related to various taxes imposed by both federal and regional governmental authorities. Applicable taxes include value added tax ("VAT"), corporate income tax (profits tax), a number of turnover-based taxes, and payroll (social) taxes, together with others. Laws related to these taxes have not been in force for significant periods, in contrast to more developed market economies; therefore, the government's implementation of these regulations is often inconsistent or nonexistent. Accordingly, few precedents with regard to tax rulings have been established. Tax declarations, together with other legal compliance areas (for example, customs and currency control matters), are subject to review and investigation by a number of authorities, which are enabled by law to impose extremely severe fines, penalties and interest charges. These facts create tax risks in Russia that are more significant than those typically found in countries with more developed tax systems.

In recent years, the Russian government has initiated revisions of the Russian tax system. Effective January 1, 1999, the first part of the Tax Code was enacted. Effective January 1, 2001, the second part of the Tax Code was enacted and effective January 1, 2002 new regulations, relating to federal income tax were enacted. The new tax system is generally intended to reduce the number of taxes, the overall tax burden on businesses, and to simplify the tax laws.

Notes to consolidated financial statements

for the years ended December 31, 2004, 2003 and 2002

21 Commitments and contingencies continued

Generally, tax declarations remain open and subject to inspection for a period of three years following the tax year. As of December 31, 2004, tax declarations of the Group for the preceding three fiscal years were open to further review.

In the ordinary course of business, MTS may be party to various legal and tax proceedings, and subject to claims, certain of which relate to the developing markets and evolving fiscal and regulatory environments in which MTS operates. In the opinion of management, MTS' liability, if any, in all pending litigation, other legal proceeding or other matters will not have a material effect upon the financial condition, results of operations or liquidity of MTS.

Management believes that it has adequately provided for tax liabilities in the accompanying consolidated financial statements; however, the risk remains that relevant authorities could take differing positions with regard to interpretive issues and the effect could be significant.

UMC On June 7, 2004, the General Prosecutor of Ukraine filed a claim against MTS and others in the Kiev Commercial Court seeking to unwind the sale by Ukrtelecom of its 51% stake in UMC to MTS. The complaint also seeks an order that would prohibit MTS from alienating 51% of its stake in UMC until the claim is resolved.

On August 12, 2004, the Kiev Commercial Court rejected a claim of General Prosecutor of Ukraine against MTS. No appeal was filed to the Court by the office of General Prosecutor of Ukraine within an established period. As of the date of these statements an office of General Prosecutor of Ukraine filed a request to the Constitutional Court of Ukraine to clear out terms of the State Privatization Plan for 2000-2002 and respond whether Ukrtelecom had a right to sell its 51% stake in UMC.

MTS believes that it acquired a stake in UMC in full compliance with Ukrainian law and, if required, intends to vigorously defend its acquisition of UMC.

22 Segment information

SFAS No. 131, "Disclosures about segments of an enterprise and related information", established standards for reporting information about operating segments in financial statements. Operating segments are defined as components of an enterprise engaging in business activities about which separate financial information is available that is evaluated regularly by the chief operating decision makers or groups in deciding how to allocate resources and in assessing performance. The Group's business is organized based on geographical operations. Management of the Group regularly reviews certain operational and statistical information by license area, however currently no discrete financial information is available on this basis, therefore the performance is measured and decisions about resource allocation are made by management based on operating income by legal entities as an aggregate of the license area information.

Intercompany eliminations presented below consist primarily of the following items: intercompany sales transactions, elimination of gross margin in inventory and other intercompany transactions conducted under the normal course of operations.

At December 31, 2004, the Group has several operating segments, of which four are reportable segments – MTS OJSC, UMC, Telecom XXI and Kuban-GSM.

	2004 U.S.\$'000	2003 U.S.\$'000	2002 U.S.\$'000
Revenue			
MTS OJSC	2,129,544	1,471,198	1,044,877
UMC ¹	832,313	394,038	–
Telecom XXI	297,194	210,460	79,166
Kuban-GSM	225,350	168,401	79,317
Other	796,256	432,770	211,826
Intercompany eliminations	(393,663)	(130,669)	(53,430)
Total revenue	3,886,994	2,546,198	1,361,756
Depreciation and amortization:			
MTS OJSC	253,485	199,946	144,004
UMC	124,935	66,392	–
Telecom XXI	57,265	36,782	17,343
Kuban-GSM	68,140	32,299	21,224
Other	175,221	82,185	27,109
Intercompany eliminations	(3,317)	(1,688)	–
Total depreciation and amortization	675,729	415,916	209,680
Operating income:			
MTS OJSC	728,101	527,837	365,698
UMC	317,860	131,704	–
Telecom XXI	104,936	80,632	2,331
Kuban-GSM	74,622	74,599	27,725
Other	198,390	123,577	72,806
Intercompany eliminations	(4,846)	(15,751)	(4,189)
Total operating income	1,419,063	922,598	464,371

¹Acquired in March 2003.

Notes to consolidated financial statements

for the years ended December 31, 2004, 2003 and 2002

22 Segment information continued

	2004 U.S.\$'000	2003 U.S.\$'000	2002 U.S.\$'000
Total operating income	1,419,063	922,598	464,371
Currency exchange and transaction losses (gains)	(6,529)	(693)	3,474
Interest income	(21,792)	(18,076)	(8,289)
Interest expense	107,956	106,551	44,389
Other (income)/expenses	(33,456)	3,420	(2,454)
Income before provision for income taxes and minority interest	1,372,884	831,396	427,251
Additions to long-lived assets			
MTS OJSC	679,023	389,446	360,598
UMC ¹	303,761	900,465	–
Telecom XXI	62,333	174,128	175,361
Kuban-GSM	69,689	172,949	199,225
Other	714,344	393,526	169,378
Total additions to long-lived assets	1,829,150	2,030,514	904,562
¹ Acquired in March 2003.			
		2004 U.S.\$'000	2003 U.S.\$'000
Long-lived assets:			
MTS OJSC		1,891,869	1,454,570
UMC, including goodwill in the amount of \$8,000 as of December 31, 2004 and 2003		838,020	648,812
Telecom XXI		295,505	288,256
Kuban-GSM		279,883	276,883
Other, including goodwill in amounts of \$100,329 and \$533 as of December 31, 2004 and 2003, respectively		1,174,582	623,037
Intercompany eliminations		(37,408)	(19,702)
Total long-lived assets		4,442,451	3,271,856
Total assets:			
MTS OJSC		2,717,814	2,328,426
UMC		993,997	772,792
Telecom XXI		363,888	345,784
Kuban-GSM		393,656	319,546
Other		1,573,239	727,600
Intercompany eliminations		(461,407)	(268,797)
Total assets		5,581,187	4,225,351

23 Subsequent events

The Notes On January 27, 2005, MTS Finance issued \$400.0 million 8.00% Unsecured Notes at 99.736%. These Notes are fully and unconditionally guaranteed by MTS OJSC and mature on January 28, 2012. MTS Finance is required to make interest payments on the Notes semi-annually in arrears on January 28 and July 28, commencing on July 28, 2005. The Notes are listed on the Luxembourg Stock Exchange. Proceeds received from the Notes were \$398.9 million.

ADS ratio change In December 2004, the Group announced that it will be changing its current ADS ratio effective January 3, 2005, the first trading day in 2005. The ratio has changed from one ADS per 20 ordinary shares to one ADS per five ordinary shares.

Acquisition of subsidiary In February 2005, MTS signed an agreement to acquire a 74.9% stake in Sweet-Com LLC, a holder of 3.5GHz radio frequency allocation for Moscow region, for a cash consideration of \$2.0 million. The Company is providing wide-range radio access services for the “last mile” based on the Radio-Ethernet technology.

The purchase price allocation for this acquisition has not been yet finalized at the date of these statements.

Tax audit In March 2005, the Russian tax authorities audited MTS OJSC’s compliance with tax legislation for the year ended December 31, 2002. Based on the results of this audit, the Russian tax authorities assessed that 372,152 thousand roubles (approximately \$13.4 million as at December 31, 2004) of additional taxes, penalties and fines were payable by the Group. The Group has prepared and filed with the Arbitrary Court of Moscow a petition to recognize the tax authorities’ resolution as partially invalid. The amount of disputed taxes and fines equals 281,504 thousand roubles (approximately \$10.1 million).

CSFB loan In April 2005, the loan due to Credit Swiss First Boston in the amount of \$140.0 million was fully repaid.

Report of independent registered public accounting firm

To the shareholders of OJSC Mobile TeleSystems:

We have audited the accompanying consolidated balance sheets of Mobile TeleSystems, a Russian Open Joint-Stock Company, and subsidiaries (the “Group”) as of December 31, 2004 and 2003, and the related consolidated statements of operations, changes in shareholders’ equity and cash flows for each of the three years in the period ended December 31, 2004. These financial statements are the responsibility of the Group’s management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (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. The Group is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. An audit includes 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 Group’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 and 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, such consolidated financial statements present fairly, in all material respects, the financial position of the Group as of December 31, 2004 and 2003, and the results of its operations and its cash flows for each of the three years in the period ended December 31, 2004, in conformity with accounting principles generally accepted in the United States of America.

A handwritten signature in cursive script, likely representing a member of the audit firm Deloitte & Touche. The signature is written in dark ink and is positioned above the date text.

March 22, 2005, except for Note 23,
as to which the date is May 24, 2005

Non-GAAP financial measures

Non-GAAP financial measures This annual report includes financial information prepared in accordance with accounting principles generally accepted in the United States of America, or US GAAP, as well as other financial measures referred to as non-GAAP. The non-GAAP financial measures should be considered in addition to, but not as a substitute for, the information prepared in accordance with US GAAP.

Operating income before depreciation and amortization (OIBDA) and OIBDA margin. OIBDA represents operating income before depreciation and amortization. OIBDA margin is defined as OIBDA as a percentage of our net revenues. Our OIBDA may not be similar to OIBDA measures of other companies; is not a measurement under accounting principles generally accepted in the United States and should be considered in addition to, but not as a substitute for, the information contained in our consolidated statement of operations. We believe that OIBDA provides useful information to investors because it is an indicator of the strength and performance of our ongoing business operations, including our ability to fund discretionary spending such as capital expenditures, acquisitions of mobile operators and other investments and our ability to incur and service debt. While depreciation and amortization are considered operating costs under generally accepted accounting principles, these expenses primarily represent the non-cash current period allocation of costs associated with long-lived assets acquired or constructed in prior periods. Our OIBDA calculation is commonly used as one of the bases for investors, analysts and credit rating agencies to evaluate and compare the periodic and future operating performance and value of companies within the wireless telecommunications industry. OIBDA can be reconciled to our consolidated statements of operations as follows:

Reconciliation of non-GAAP financial measures to GAAP financial measures – amounts in millions USD

OIBDA and OIBDA margin can be reconciled to MTS' consolidated statements of operations as follows

	Years ended 31 December		Change
	2004	2003	
Operating income	1,419.1	922.6	54%
Add: depreciation and amortization	675.7	415.9	62%
OIBDA	2,094.8	1,338.5	57%
Operating margin	36.5%	36.2%	31BP
Add: depreciation and amortization as a percentage of revenues	17.4%	16.3%	108BP
OIBDA margin	53.9%	52.6%	129BP

Free cash flow and free cash flow before acquisitions can be reconciled to MTS' consolidated statements of cash flows as follows:

	Year ended 31 December 2004
Net cash provided by operating activities	1,711.6
Less:	
Purchases of property, plant and equipment	1,204.4
Purchases of intangible assets	154.5
Investment in and advances to associates	0.4
Free cash flow before acquisitions	352.2
Acquisitions of subsidiaries, net of cash acquired	355.7
Free cash flow	(3.5)

Non-GAAP financial measures

Net debt represents total debt less cash and cash equivalents and short-term investments. Our net debt calculation is commonly used as one of the bases for investors, analysts and credit rating agencies to evaluate and compare our periodic and future liquidity within the wireless telecommunications industry. The non-GAAP financial measures should be considered in addition to, but not as a substitute for, the information prepared in accordance with US GAAP.

Net debt can be reconciled to our consolidated balance sheets as follows:

	31 December 2004	31 December 2003
Debt, current portion	370.8	103.3
Notes payable, current portion	–	597.8
Capital lease obligations, current portion	8.6	9.1
Notes payable, net of current portion	800.0	800.0
Debt, net of current portion	753.8	142.4
Capital lease obligations, net of current portion	3.9	7.6
Total debt	1,937.1	1,660.2
Less: cash and cash equivalents	274.2	90.4
short-term investments	73.4	245.0
Net debt	1,589.5	1,324.8
Total debt to OIBDA	0.9x	1.2x
Net debt to OIBDA	0.8x	1.0x

Definitions

SUBSCRIBER We define a subscriber as an individual or organization whose account shows chargeable activity within 61 days (or 183 days in the case of the “JEANS” and “SIM-SIM” brand tariffs) and whose account does not have a negative balance for more than this period. Prior to October 1, 2004, UMC used a 90-day period for such purposes with respect to its “JEANS” and “SIM-SIM” subscribers.

MOU Average monthly minutes of usage per subscriber (MOU) is calculated by dividing the total number of minutes of usage during a given period by the average number of our subscribers during the period and dividing by the number of months in that period. For Ukraine, the 2003 figure has been calculated based on the months of March to December 2003.

ARPU Average monthly service revenue per subscriber (ARPU) is calculated by dividing our service revenues for a given period, including guest roaming fees, by the average number of our subscribers during that period and dividing by the number of months in that period. For Ukraine, the 2003 figure has been calculated based on the months of March to December 2003.

SAC Subscriber acquisition costs are calculated as total sales and marketing expenses and handset subsidies for a given period per additional subscriber. Sales and marketing expenses include advertising expenses and commissions to dealers. SAC per gross additional subscriber is calculated by dividing SAC during a given period by the total number of gross subscribers added by us during the period. For Ukraine, the 2003 figure has been calculated based on the months of March to December 2003.

CHURN We define our churn as the total number of subscribers who cease to be subscribers (as defined above) during the period (whether involuntarily due to non-payment or voluntarily, at such subscriber’s request), expressed as a percentage of the average number of our subscribers during that period. For Ukraine, the 2003 figure has been annualized based on the months of March to December 2003.

The significant decrease in the 2004 churn rate in Ukraine is largely attributable to the change in our churn policy for “JEANS” and “SIM-SIM” subscribers in Ukraine. Under the previous churn policy, the 2004 churn rate in 2004 was 23%.

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