JSC SITRONICS AND SUBSIDIARIES

Independent Auditors' Report

Combined Financial Statements
Years Ended December 31, 2005, 2004, 2003

JSC SITRONICS AND SUBSIDIARIES

TABLE OF CONTENTS

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INDEPENDENT AUDITORS' REPORT

To the Shareholders of JSC SITRONICS:

We have audited the accompanying consolidated balance sheets of JSC SITRONICS and subsidiaries (collectively – "the Group") as of December 31, 2005, 2004 and 2003, and the related consolidated statements of operations and comprehensive income, changes in shareholders' equity, and cash flows for the years then ended. 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 standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. 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, 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 financial statements present fairly, in all material respects, the consolidated financial position of the Group as of December 31, 2005, 2004 and 2003, and the consolidated results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 27, the accompanying financial statements for the years ended December 31, 2005, 2004 and 2003 have been restated.

Deloitte & Touche

ZAO Deloitte & Touche CIS

January 4, 2007
Moscow, Russia

CONSOLIDATED BALANCE SHEETS
AS OF DECEMBER 31, 2005, 2004 AND 2003 (RESTATED)
(Amounts in thousands of U.S. dollars, except share amounts)

	Notes	2005 (As restated, see Note 27)	2004 (As restated, see Note 27)	2003 (As restated, see Note 27)
ASSETS				
CURRENT ASSETS:				
Cash and cash equivalents	4	$ 83,359	$ 39,685	$ 4,841
Short-term investments	5	10,397	14,303	419
Trade receivables, net	6	158,855	45,536	20,415
Other receivables and prepaid expenses, net	7	56,880	35,959	14,480
Inventories and spare parts	8	113,917	82,021	24,058
Deferred tax assets, current portion	21	4,785	4,325	3,100
Total current assets		428,193	221,829	67,313
Property, plant and equipment, net	9	94,947	53,000	44,358
Intangible assets, net	10	19,734	15,689	500
Long-term investments	11	865	1,457	12,410
Long-term trade receivables	12	14,575	-	-
Prepaid rent	13	2,230	3,297	-
Restricted cash	14	2,105	2,105	-
Deferred tax assets	21	3,441	3,666	-
TOTAL ASSETS		**$ 566,090**	**$ 301,043**	**$ 124,581**

See notes to consolidated financial statements.

JSC SITRONICS AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS
AS OF DECEMBER 31, 2005, 2004 AND 2003 (RESTATED) (CONTINUED)
(Amounts in thousands of U.S. dollars, except share amounts)

	Notes	2005 (As restated, see Note 27)	2004 (As restated, see Note 27)	2003 (As restated, see Note 27)
LIABILITIES AND SHAREHOLDERS' EQUITY				
CURRENT LIABILITIES:				
Accounts payable	15	$ 104,488	$ 37,726	$ 13,891
Taxes payable		40,557	9,715	7,495
Accrued expenses and other current liabilities	16	105,909	67,049	17,514
Short-term loans and notes payable	17	105,062	69,021	28,686
Current portion of long-term debt	18	925	8,606	3,107
Deferred tax liabilities, current portion	21	664	910	1,220
Total current liabilities		357,605	193,027	71,913
LONG-TERM LIABILITIES:				
Capital lease obligations	19	1,605	863	1,463
Long-term debt	18	6,125	7,954	23,943
Deferred tax liabilities	21	9,010	6,920	1,794
Total long-term liabilities		16,740	15,737	27,200
COMMITMENTS AND CONTINGENCIES	24	-	-	-
TOTAL LIABILITIES		374,345	208,764	99,113
MINORITY INTERESTS		28,926	27,167	1,856
SHAREHOLDERS' EQUITY:				
Share capital (1,886,771,000 shares authorized and issued as of December 31, 2005, 2004 and 2003 respectively, with par value of 1 ruble)	20	59,213	59,213	59,213
Additional paid-in capital	20	76,130	43,862	14,725
Retained earnings/(accumulated deficit)		28,490	(40,737)	(52,087)
Accumulated other comprehensive (loss)/income		(1,014)	2,774	1,761
TOTAL SHAREHOLDERS' EQUITY		162,819	65,112	23,612
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY		**$ 566,090**	**$ 301,043**	**$ 124,581**

See notes to consolidated financial statements.

JSC SITRONICS AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS AND OTHER COMPREHENSIVE INCOME/(LOSS) FOR THE YEARS ENDED DECEMBER 31, 2005, 2004 AND 2003 (RESTATED)

(Amounts in thousands of U.S. dollars, except share and per share amounts)

	Notes	Year ended December 31, 2005 (As restated, see Note 27)	2004 (As restated, see Note 27)	2003 (As restated, see Note 27)
Revenues		$ 952,569	$ 473,592	$ 99,055
Cost of sales, exclusive of depreciation and amortization shown separately below		(715,634)	(397,263)	(55,774)
Research and development expenses		(23,644)	(9,246)	(7,828)
Selling, general and administrative expenses		(54,755)	(33,873)	(19,831)
Depreciation and amortization		(11,476)	(6,491)	(3,568)
Other operating expenses, net		(4,819)	(652)	(1,997)
OPERATING INCOME		142,241	26,067	10,057
Interest income		872	197	-
Interest expense, net of amounts capitalized		(9,810)	(7,120)	(2,772)
Foreign currency transactions (loss)/gain		(2,914)	233	1,404
Income before income tax and minority interests		130,389	19,377	8,689
Income tax expense	21	(35,147)	(3,234)	(2,926)
Income before minority interests		95,242	16,143	5,763
Minority interests		(26,015)	(4,793)	(740)
NET INCOME		**$ 69,227**	**$ 11,350**	**$ 5,023**
Translation adjustment, net of minority interests of $(380), $768 and $53, respectively, and income tax of nil		(3,788)	1,013	1,761
Comprehensive income		$ 65,439	$ 12,363	$ 6,784
Weighted average number of common shares outstanding	2	1,886,771,000	1,886,771,000	1,886,771,000
Earnings per share, basic and diluted, USD	2	0.037	0.006	0.003

See notes to consolidated financial statements.

JSC SITRONICS AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED DECEMBER 31, 2005, 2004 AND 2003 (RESTATED)
(Amounts in thousands of U.S. dollars)

	Year ended December 31, 2005 (As restated, see Note 27)	2004 (As restated, see Note 27)	2003 (As restated, see Note 27)
OPERATING ACTIVITIES:			
Net income	$ 69,227	$ 11,350	$ 5,023
Adjustments to reconcile net income to net cash provided by/(used in) operations:			
Depreciation and amortization charge	11,476	6,491	3,568
Minority interests	26,015	4,793	740
Non-cash compensation to employees	-	1,478	-
Gain from disposal of property, plant and equipment	(2,389)	(2,048)	-
Deferred income tax (benefit)/expense	(314)	(4,566)	386
Doubtful debt (recovery)/expense	(2,296)	(2,762)	1,276
Changes in operating assets and liabilities:			
Trade receivables	(136,186)	(15,443)	(3,945)
Other receivables and prepaid expenses	(19,300)	(10,388)	(7,074)
Inventories and spare parts	(32,114)	(39,041)	(8,819)
Prepaid rent	1,067	(3,297)	-
Accounts payable	64,023	4,080	(2,405)
Taxes payable	29,985	1,277	(1,746)
Accrued expenses and other current liabilities	49,411	45,081	5,915
Net cash provided by/(used in) operating activities	58,605	(2,995)	(7,081)
INVESTING ACTIVITIES:			
Purchases of property, plant and equipment	(40,642)	(6,608)	(5,618)
Proceeds from disposals of property, plant and equipment	2,546	2,223	-
Purchases of intangible assets	(6,752)	(495)	-
Purchases of businesses, net of cash acquired	(28,658)	11,195	-
Proceeds from disposal of an interest in a subsidiary	-	2,000	-
Purchases of short-term investments	(4,414)	(6,796)	-
Purchases of long-term investments	(194)	-	(2,088)
Proceeds from sales of short-term investments	8,319	-	-
Proceeds from sales of long-term investments	-	10,567	-
Net cash (used in)/provided by investing activities	$ (69,795)	$ 12,086	$ (7,706)

CONSOLIDATED STATEMENTS OF CASH FLOWS (CONTINUED)
FOR THE YEARS ENDED DECEMBER 31, 2005, 2004 AND 2003 (RESTATED)
(Amounts in thousands of U.S. dollars)

	Year ended December 31 2005 (As restated, see Note 27)	2004 (As restated, see Note 27)	2003 (As restated, see Note 27)
FINANCING ACTIVITIES:			
Contributions of the controlling shareholder	$ 56,766	-	-
Distributions to the controlling shareholder	(24,498)	-	-
Proceeds from short-term borrowings	92,250	$ 45,888	$ 4,943
Principal payments on short-term borrowings	(64,488)	-	-
Proceeds from long-term borrowings	10,679	7,486	19,678
Principal payments on long-term borrowings	(12,800)	(27,541)	(6,292)
Principal payments on capital lease obligations	(1,193)	(600)	(1,071)
Net cash provided by financing activities	56,716	25,233	17,258
Effects of foreign currency translation on cash and cash equivalents	(1,852)	520	275
INCREASE IN CASH AND CASH EQUIVALENTS	43,674	34,844	2,746
CASH AND CASH EQUIVALENTS, beginning of the year	39,685	4,841	2,095
CASH AND CASH EQUIVALENTS, end of the year	$ 83,359	$ 39,685	$ 4,841
CASH PAID DURING THE YEAR FOR:			
Interest, net of amounts capitalized	$ (9,201)	$ (8,241)	$ (1,651)
Income taxes	(7,925)	(4,432)	(3,132)
NON-CASH ITEMS:			
Equipment acquired under capital lease	2,500	1,104	2,191
Property contributed to share capital of a subsidiary	-	-	1,927

Non-cash investing and financing activities for the years ended December 31, 2005, 2004 and 2003 included acquisitions of subsidiaries, as described in Note 3.

See notes to consolidated financial statements.

JSC SITRONICS AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY FOR THE YEARS ENDED DECEMBER 31, 2005, 2004 AND 2003 (RESTATED)

(Amounts in thousands of U.S. dollars)

	Share	Additional paid-in capital	(Accumulated deficit)/ retained earnings	Accumulated other comprehensive income/ (loss)	Total
Balances at January 1, 2003 (as restated, see Note 27)	**$ 59,213**	**$ 14,725**	**$ (57,110)**	**$ -**	**$ 16,828**
Translation adjustment, net of minority interests of $53 and income tax of nil	-	-	-	1,761	1,761
Net income	-	-	5,023	-	5,023
Balances at December 31, 2003 (as restated, see Note 27)	**$ 59,213**	**$ 14,725**	**$ (52,087)**	**$ 1,761**	**$ 23,612**
Contributions of the controlling shareholder (Note 3)	-	29,137	-	-	29,137
Translation adjustment, net of minority interests of $768 and income tax of nil	-	-	-	1,013	1,013
Net income	-	-	11,350	-	11,350
Balances at December 31, 2004 (as restated, see Note 27)	**$ 59,213**	**$ 43,862**	**$ (40,737)**	**$ 2,774**	**$ 65,112**
Contributions of the controlling shareholder (Note 20)	-	56,766	-	-	56,766
Distributions to the controlling shareholder (Note 3)	-	(24,498)	-	-	(24,498)
Translation adjustment, net of minority interests of $(380) and income tax of nil	-	-	-	(3,788)	(3,788)
Net income	-	-	69,227	-	69,227
Balances at December 31, 2005 (as restated, see Note 27)	**$ 59,213**	**$ 76,130**	**$ 28,490**	**$ (1,014)**	**$ 162,819**

See notes to consolidated financial statements.

1. DESCRIPTION OF BUSINESS

The financial statements of JSC SITRONICS and subsidiaries (the "Group") reflect the consolidation of separate financial statements of operating entities related by means of direct or indirect ownership of a majority voting interest by the Group's holding company, JSC SITRONICS. The Group's business was established upon the acquisition by JSFC Sistema ("Sistema") of semiconductor and industrial electronics assets, through a combination of privatisation and private transactions from 1994 to 1998. In 2002, Sistema established a holding company for these technology businesses, that was subsequently renamed JSC SITRONICS ("SITRONICS"). At the same time, the Group obtained control over Strom Telecom, a Czech telecommunication equipment and software manufacturer. In July 2004, Sistema acquired a 51% stake of Kvazar-Micro, a Ukrainian IT and systems integration company, which the Group acquired from Sistema in October 2005. Sistema remains the controlling shareholder of SITRONICS, which represents the Technology business segment of Sistema.

The Group operates along five operating segments:

Telecommunication Solutions Segment is engaged in the design, manufacture and distribution of hardware and software products including convergence solutions. It also offers system integration and customization services for fixed line and mobile telecommunication operators.

Information Technologies Solutions Segment is engaged in computer hardware distribution, systems integration, IT consulting and software development services for telecommunication operators, banking and financial institutions and the public sector.

Microelectronic Solutions Segment is engaged in design, manufacture, testing and distribution of semiconductor products and components; distribution and production of chip cards, microchip packaging and related solutions.

Consumer Electronics Segment is engaged in the manufacture and sale of a range of consumer products, including televisions, DVD systems, portable electronics and mobile devices, as well as industrial electronics devices. The segment sells products under SITRONICS brand and is engaged in distribution of products under other brands.

Electronics Manufacturing Services Segment is engaged in the manufacture of electronic devices for original equipment manufacturers, with a primary focus on LCD monitors, notebook computers and mobile phones.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation of Financial Statements – The accompanying financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America ("U.S. GAAP").

The Group's entities maintain accounting records in local currencies of the countries of their domicile in accordance with the requirements of respective accounting and tax legislation. The accompanying financial statements differ from the financial statements prepared for statutory purposes in that they reflect certain adjustments, appropriate to present the financial position, results of operations and cash flows in accordance with U.S. GAAP, which are not recorded in the accounting books of the Group's entities.

(Amounts in thousands of U.S. dollars, except share amounts or if otherwise stated)

Principles of Consolidation – The consolidated financial statements include the accounts of SITRONICS and its majority-owned subsidiaries, as well as the accounts of Cosmos Wealth, a variable interest entity of which the Group is a primary beneficiary. As the Group has been formed through a reorganisation of entities under common control, these consolidated financial statements have been presented as if the transfers of Sistema's interests in the Group's subsidiaries had occurred from the beginning of the earliest period presented. The assets and liabilities of the subsidiaries transferred to the Group by Sistema are recorded in these financial statements at the historical cost of Sistema. Any difference between the historical cost of net assets, and the consideration paid is accounted for as an adjustment to the shareholders' equity of the Group.

The effective ownership interest and proportion of voting power of SITRONICS in its significant subsidiaries as well as locations of their principal business operations as of December 31, 2005, 2004 and 2003 were as follows:

Operating entities	**Effective ownership interest as of December 31,**			**Voting interest as of December 31,**		
	2005	**2004**	**2003**	**2005**	**2004**	**2003**
Telecommunication Solutions segment						
Strom Telecom (Czech Republic)	100%	67%	100%	100%	67%	100%
Tesla tech (Czech Republic)	100%(1)	34%(1)	51%	100%	51%	51%
Mediatel (Russia)	100%	100%	72% (2)	100%	100%	100%
Information Technologies Solutions segment						
Kvazar-Micro Corporation (Netherlands)	51%	51%(2)	-	51%	51%	-
Kvazar-Micro International (United Kingdom)	51%(1)	51% (1)(2)	-	100%	100%	-
Kvazar-Micro Techno (Ukraine)	51% (1)	51% (1)(2)	-	100%	100%	-
Factory Kvazar-Micro (Ukraine)	51% (1)	51% (1)(2)	-	100%	100%	-
Kvazar-Micro.ru (Russia)	51% (1)	51% (1)(2)	-	100%	100%	-
Microelectronic Solutions segment						
Mikron (Russia)	77%	77%	71%	77%	77%	71%
VZPP-Mikron (Russia)	51%	51%	51%	51%	51%	51%
Smart Cards (Russia)	65%	-	-	65%	-	-
Consumer Electronics segment						
SITRONICS Consumer Electronics (Russia)	100%	100%	100%	100%	100%	100%
SITRONICS Ukraine (Ukraine)	100%	-	-	100%	-	-
Electronics Manufacturing Services segment						
Kvant (Russia)	78%	31%	-	88%	35%	-
Elaks (Russia)	82%	80%	80%	82%	80%	80%
Elion (Russia)	75%	75%	73%	90%	90%	88%
Concel (Russia)	100%	100%	100%	100%	100%	100%

(1) Including indirect ownership
(2) Including interests held by Sistema

Accounts of newly-consolidated entities have been included in the Group's financial statements from the beginning of the year, when control was acquired, with pre-acquisition earnings of an interest purchased during the year included in minority interest in the statement of operations.

All significant intercompany transactions, balances and unrealized gains/(losses) on transactions have been eliminated.

Variable Interest Entity – The Group consolidates Cosmos Wealth, a variable interest entity, of which the Group is a primary beneficiary. Cosmos Wealth operates in Southeast Asia, buying wafers from Russian entities of the Microelectronic Solutions segment, dicing the wafers into integrated circuits (ICs) and packaging the ICs for resale to original equipment manufacturers. Cosmos Wealth is directly owned by Sistema. The assets of Cosmos Wealth, as well as results of its operations have not been significant to the Group during the three-year period ended December 31, 2005.

Use of Estimates – The preparation of 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 of the reporting period. Actual results could differ from those estimates.

Examples of significant estimates include revenue recognition, allowance for doubtful accounts, carrying value of long-lived assets and inventories, valuation allowances on deferred tax assets, warranty liabilities, obligations related to employee benefits, and contingencies.

Foreign Currency Translation Methodology – The Group follows a translation policy in accordance with Statement on Financial Accounting Standards ("SFAS") No. 52, "Foreign Currency Translation".

Management has determined that the functional currencies of the Group's significant subsidiaries for the years ended December 31, 2005, 2004 and 2003 are as follows:

Telecommunication Solutions segment	
Strom Telecom (Czech Republic)	Czech Krone ("CZK")
Tesla tech (Czech Republic)	CZK
Mediatel (Russia)	Russian Ruble ("RUB")
Information Technologies Solutions segment	
Kvazar-Micro Corporation (Netherlands)	US Dollar ("USD")
Kvazar-Micro International (United Kingdom)	USD
Kvazar-Micro Techno (Ukraine)	Ukrainian Hryvnia ("UAH")
Factory Kvazar-Micro (Ukraine)	UAH
Kvazar-Micro.ru (Russia)	RUB
Microelectronic Solutions segment	
Mikron (Russia)	RUB
VZPP-Mikron (Russia)	RUB
Smart Cards (Russia)	RUB
Consumer Electronics segment	
SITRONICS Consumer Electronics (Russia)	RUB
SITRONICS Ukraine (Ukraine)	UAH
Electronics Manufacturing Services segment	
Kvant (Russia)	RUB
Elaks (Russia)	RUB
Elion (Russia)	RUB
Concel (Russia)	RUB

The Group has selected the USD as its reporting currency and has translated the financial statements of subsidiaries with a different functional currency into the USD. Assets and liabilities are translated at the exchange rates current at the balance sheet date, while income and expense items are translated at average rates of exchange prevailing during the period. The resulting translation difference is recorded as a separate component of other comprehensive income/(loss).

The translation of assets and liabilities into USD for the purpose of these financial statements does not indicate that the Group could or will in the future convert the reported values of the assets and liabilities in USD.

Cash and Cash Equivalents – Cash and cash equivalents include cash on hand, amounts on deposit in banks and cash invested temporarily in various instruments having original maturities of less than three months.

Fair Value of Financial Instruments – Financial instruments carried on the balance sheet include cash, accounts receivable, investments, derivative financial instruments, accounts payable and fixed and variable rate debts. The particular recognition methods adopted are disclosed in the individual policy statements associated with each item.

The estimation of the Group's fair value of financial instruments with subsidiaries and affiliates of Sistema is not practicable based on the related party nature of underlying transactions. The estimated fair value of short-term financial instruments and long-term variable rate financial instruments with third parties as of December 31, 2005 approximated their carrying value as reflected in the consolidated balance sheet.

Accounts Receivable – Accounts receivable are stated at their net realizable value after deducting an allowance for doubtful accounts. Such provisions reflect either specific cases of delinquency or defaults or estimates based on evidence of collectability.

The Telecommunication Solutions segment of the Group enters into sale agreements with certain of its clients, including, but not limited to, Sistema subsidiaries, where the final payment is not due until more than 12 months from the delivery date. Long-term trade receivables from parties other than Sistema subsidiaries are measured at amortized cost using the effective interest method.

Value-Added Taxes – Value-added taxes ("VAT") related to sales are payable to the tax authorities on an accrual basis based upon invoices issued to the customer. VAT incurred for purchases may be reclaimed, subject to certain restrictions, against VAT related to sales. VAT related to purchase transactions that are reclaimable after the balance sheet dates are recorded in other receivables and prepaid expenses.

Inventories and Spare Parts – Inventories and spare parts comprise raw materials and spare parts, work-in-progress, finished goods and goods for resale and are stated at the lower of cost or market.

The Information Technologies Solutions segment accounts for its inventories using the first-in-first-out ("FIFO") cost method. The cost of inventories of other Group entities is computed on an average cost basis.

Cost of raw materials includes cost of purchase, customs duties, transportation and handling costs. Work-in-progress and finished goods are stated at production cost, which includes manufacturing overheads. The Group periodically assesses its inventories and spare parts for obsolete and slow-moving stock.

Property, Plant and Equipment – For the consolidated entities acquired through business combinations accounted for by the purchase method, property, plant and equipment ("PP&E") were assigned their fair values at the acquisition date. If fair values of the identifiable net assets of the acquired entities exceeded acquisition cost, the fair values of non-current assets held by the acquired entities at the acquisition date, including PP&E, were reduced by such excess. All subsequent purchases of PP&E have been recorded at cost.

Cost includes major expenditures for improvements and replacements which extend useful lives of the assets or increase their revenue generating capacity. Repairs and maintenance are charged to the statements of operations as incurred.

Items of PP&E that are retired or otherwise disposed of are eliminated from the consolidated balance sheet along with the corresponding accumulated depreciation. Any gain or loss resulting from such retirement or disposal is included in the determination of consolidated net income.

Land is not depreciated. PP&E are depreciated on a straight-line method utilizing estimated useful lives of the assets as follows:

Buildings	40-50 years
Leasehold improvements	Lesser of the estimated useful life or the term of the lease
Plant, machinery and equipment	3-15 years

Intangible Assets – Intangible assets represent costs of purchased and internally developed software, costs of customer contracts and the related customer relationships, trademarks and licenses.
The intangible assets acquired through business combinations accounted for by the purchase method, were assigned fair values at the acquisition date. Other acquired intangible assets are recorded at cost.

Costs of developing computer software products incurred by the Group are accounted for in accordance with SFAS No. 86, "Accounting for the Costs of Computer Software to be Sold, Leased or Otherwise Marketed." Accordingly, software development costs incurred subsequent to the determination of technological feasibility and marketability of a software product are capitalized. Technological feasibility is established when the Group has completed all planning, designing, coding, and testing activities that are necessary to establish that a product can be produced to meet its design specifications including functions, features, and technical performance requirements.

Finite-life intangible assets are amortized on a straight-line method as follows:

Software development costs	Greater of the ratio of current product revenues to total projected product revenues or the estimated economic life of the product (3-5 years)
Customer contracts and the related customer relationships	3-10 years
Purchased software, licenses and other intangible assets	3-5 years

The Group's trademarks have unlimited contractual life and are not amortized, but are reviewed, at least annually, for impairment.

Investments – Investments in corporate shares where the Group owns less than 20% of share capital, are accounted for at cost of acquisition.

The Group also purchases promissory notes from and originates loans to other entities (primarily to other subsidiaries of Sistema) for investing purposes. These notes and loans are carried at amortized cost.

Impairment of Long-Lived Assets – The Group periodically evaluates the recoverability of the carrying amount of its long-lived assets in accordance with SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets". Whenever events or changes in circumstances indicate that the carrying amounts of those assets may not be recoverable, the Group 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, the Group 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. Management does not believe any indicators of impairment occurred relating to the Group's investments in long-lived assets during the three years period ended December 31, 2005.

Leasing Arrangements – The Group accounts for leases, that include leases of equipment and vehicles, as well as office premises, based on the requirements of SFAS No. 13, "Accounting for Leases."

Leases of property, plant and equipment where the Group has substantially all the risks and rewards of ownership are classified as capital leases. For capital leases, the present value of the future minimum lease payments at the inception of the lease or fair value which ever is less is reflected as an asset and a liability in the balance sheet. Principal amounts due within one year are classified as current liabilities and the remaining balance as long-term liabilities. If there is no reasonable certainty that the Group will obtain ownership by the end of the lease term, the property, plant and equipment acquired under finance leases are depreciated over the shorter of the useful life of the asset or the lease term.

Leases in which a significant portion of the risks and rewards of ownership are retained by the lessor are classified as operating leases. Payments made under operating leases are charged to the income statement on a straight-line basis over the period of the lease.

Revenue Recognition – The Group's segments recognize revenues only when all of the following conditions have been met: (i) there is persuasive evidence of an arrangement; (ii) delivery has occurred; (iii) the fee is fixed and determinable; and (iv) collectability of the fee is reasonably assured.

Revenues under arrangements specific to the respective segments of the Group are recognized as follows:

Telecommunication Solutions segment:

The segment's arrangements for sale of software products are multiple-element arrangements, involving provision of related services, including customization, implementation and integration services, as well as ongoing support and maintenance provided to customers.

If the services element of the arrangement is deemed essential to the functionality of the software arrangement, the accounting for performance of construction-type contracts is applied, provided that the following conditions are met: (a) contracts executed by the parties normally include provisions that clearly specify the enforceable rights regarding goods or services to be provided and received by the parties, the consideration to be exchanged, and the manner and terms of settlement; (b) the buyer can be expected to satisfy its obligations under the contract; (c) the Group can be expected to perform its contractual obligations. Revenue on such arrangements is recognized applying the percentage-of-completion method. The measurement of progress towards completion is based on the ratio of hours performed to date to estimated total hours at completion. Contract is considered as substantially completed when (a) product is delivered, and (b) product is accepted by the customer.

If the services element of the arrangement is not deemed essential to the functionality of the software, the service revenues are accounted for separately from the software revenues. In such multiple-element arrangements, the software component is accounted for using the residual method.

Information Technologies Solutions segment:

Because of frequent sales price reductions and rapid technology obsolescence, revenues from the segment's computer hardware sales to dealers under agreements allowing price protection are deferred until the dealers sell the merchandise.

The segment's arrangements regarding systems integration services typically include multiple elements, such as equipment and software, installation services and post-contract support. A multiple-element arrangement is separated into more than one unit of accounting if all of the following criteria are met: i) the delivered items have value to the customer on a standalone basis; ii) there is objective and reliable evidence of the fair value of the undelivered items; iii) the arrangement includes a general right of return relative to the delivered items, delivery or performance of the undelivered items is considered probable and substantially in the control of the Group.

If evidence of the fair value of the undelivered elements of the arrangement does not exist, all revenue from the arrangement is deferred until such time that evidence of fair value does exist, or until all elements of the arrangement are delivered. Fees allocated to post-contract support are recognized as revenue on a pro rata basis over the support period. Fees allocated to other services are recognized as revenue as services are performed.

Revenue and cost of sales from contracts involving solutions achieved through modification of telecommunications equipment or software are recognized by reference to the stage of completion of the contract at the balance sheet date when the outcome of a contract can be estimated reliably. This is normally measured by the proportion that contract costs incurred for work performed to date relate to the estimated total contract costs, except where this would not be representative of the stage of completion. Variations in contract work, claims and incentive payments are included to the extent that they have been agreed with the customer. Where the outcome of a contract cannot be estimated reliably, equal amounts of revenue and costs are recognized until results can be estimated more precisely. When it is probable that total contract costs will exceed total contract revenue, the expected loss is recognized immediately.

Microelectronic Solutions, Consumer Electronics and Electronics Manufacturing Services segments:

The products of these segments are generally sold with a limited warranty of product quality. The product return reserves, warranty and other post-contract support obligations are accrued at the time of sale. The Group accrues for known warranty if a loss is probable and can be reasonably estimated, and accrues for estimated incurred but unidentified issues based on historical activity.

The Electronics Manufacturing Services segment enters into arrangements with certain manufacturers and distributors of consumer electronics products to assemble such products at its facilities. In those cases where the Group's responsibility to the customer is limited solely to assembly services or where the Group buys components from and subsequently sells the assembled devices to the same counterparty, the Group records only the net amount retained as its revenues.

Vendor Programs – Funds received from IT vendors for price protection, vendor rebates, marketing, training, product returns and promotion programs are recorded as adjustments to product costs, revenue, or selling, general and administrative expenses according to the nature of the program.

Research and Development Costs – Research and development ("R&D") costs are fully charged to the consolidated statements of operations when incurred. Research and development costs incurred between the date on which technological feasibility is established and when the related product is available-for-sale are capitalized. For the years ended December 31, 2005, 2004 and 2003, R&D expenses totaled $23.6 million, $9.2 million and $7.8 million, respectively.

Income Taxes – Income taxes for the Group's subsidiaries have been computed in accordance with the respective local laws. Income tax rate enacted as of December 31, 2005 in the RF equals 24%, Ukraine-25%, Czech Republic-26% (24% starting from January 1, 2006).

Deferred income taxes are accounted for under the liability method and reflect the tax effect of all significant temporary differences between the tax bases of assets and liabilities and their reported amounts in the accompanying consolidated financial statements. A valuation allowance is provided for deferred tax assets, if it is more likely than not that these items will either expire before the Group will be able to realize the benefit, or the future deductibility is uncertain.

Retirement and Post-Retirement Benefits – Subsidiaries of the Group contribute to the local state pension funds and social funds, on behalf of all their employees.

In the RF, all social contributions, including contributions to the pension fund, are substituted with a unified social tax ("UST") calculated by the application of a regressive rate from 26% to 2% (from 35.6% to 2% before January 1, 2005) of the annual gross remuneration of each employee. UST is allocated to three social funds, including the pension fund, where the rate of contributions vary from 20% to 2% (from 28% to 2% prior to January 1, 2005), respectively, depending on the annual gross salary of each employee. The contributions are expensed as incurred.

Other subsidiaries of the Group are required to contribute a specified percentage of each employee payroll up to a fixed limit to pension fund, unemployment fund and social security fund. The contributions are expensed as incurred.

Borrowing Costs – Borrowing costs are recognized as an expense in the period in which they were incurred. Borrowing costs for assets that require a period of time to get them ready for their intended use are capitalized and amortized over the related assets' estimated useful lives. The capitalized borrowing costs for the years ended December 31, 2005, 2004 and 2003 were not significant.

Advertising Costs – Advertising costs are expensed as incurred. Advertising costs for the years ended December 31, 2005, 2004 and 2003 were $4.9 million, $3.9 million and $1.2 million, respectively, and were reflected as a component of selling, general and administrative expenses in the consolidated statements of operations.

Earnings per Share – Earnings per share ("EPS") have been determined using the weighted average number of shares outstanding during the years ended December 31, 2005, 2004 and 2003.

Minority Interests – Minority interests represent shares in book value of net assets of the Group's subsidiaries proportional to equity interests in those entities owned by shareholders that are not members of the Group.

Distributions to Shareholders – Distributable retained earnings of the Group are determined in accordance with Russian statutory accounting regulations and significantly differ from amounts calculated on the basis of U.S. GAAP.

Recently Adopted Accounting Pronouncements – In March 2005, the Financial Accounting Standards Board ("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 became effective for the Group in the year ended December 31, 2005. The adoption of Interpretation No. 47 did not have a material impact on the Group’s financial position or results of operations.

New Accounting Pronouncements – In May 2005, the FASB issued Statement of Financial Accounting Standards (“SFAS”) No. 154, “Accounting Changes and Error Corrections”, which replaces APB Opinion No. 20, “Accounting Changes” and SFAS No. 3, “Reporting Accounting Changes in Interim Financial Statements”. SFAS No. 154 changes the requirements for the accounting and reporting of a change in accounting principle and is applicable to all voluntary changes and to changes required by an accounting pronouncement if such pronouncement does not specify transition provisions. SFAS No. 154 requires retrospective application to the prior periods’ financial statements of changes in accounting principle. In cases when it is impracticable to determine the period-specific or cumulative effects of an accounting change, the statement provides that the new accounting principle should be applied as of the earliest period for which retrospective application is practicable or, if impracticable to determine the effect of a change to all prior periods, prospectively from the earliest date practicable. This Statement is effective for the Group from January 1, 2006.

In June 2005, the Emerging Issues Task Force (“EITF”) reached a consensus on EITF Issue No. 05-6, “Determining the Amortization Period for Leasehold Improvements”, which was modified in September 2005. EITF No. 05-6 requires that leasehold improvements acquired in a business combination or purchased subsequent to the inception of a lease be amortized over the lesser of the useful life of the assets or a term that includes renewals that are reasonably assured at the date of the business combination or purchase. EITF No. 05-6 is effective for leasehold improvements that are purchased or acquired in reporting periods beginning after June 29, 2005. The adoption of EITF No. 05-6 did not have a material impact on the Group’s financial position and results of operations.

In October 2005, the FASB issued FASB Staff Position (“FSP”) FAS 13-1, “Accounting for Rental Costs Incurred during a Construction Period”. Under the provisions of FSP FAS 13-1, lessees may not capitalize rental costs incurred on building or ground operating leases during a construction period. Instead, rental costs should be expensed on a straight-line basis starting at the beginning of the lease term, i.e., when the lessee takes possession of or is given control of the leased property. The provisions of FSP FAS 13-1 are effective for the Group for the year ending December 31, 2006. The adoption of FSP FAS 13-1 did not have a material impact on the Group’s financial position and results of operations.

In February 2006, the FASB issued SFAS No. 155, “Accounting for Certain Hybrid Financial Instruments, an amendment to SFAS No. 133 “Accounting for Derivative Instruments and Hedging activities’ and SFAS No. 140 “Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities”. SFAS No. 155 addresses application of SFAS No. 133 to beneficial interests in securitized financial assets and permits to remeasure fair value for any hybrid financial instrument that contains an embedded derivative that otherwise would require bifurcation, requires to evaluate interests in securitized financial assets to identify interests that are freestanding derivatives or that are hybrid financial instruments that contain an embedded derivative requiring bifurcation, amends SFAS No. 140 to eliminate the prohibition on a qualifying special purpose entity from holding a derivative financial instrument that pertains to a beneficial interest other than another derivative financial instrument, and clarifies certain other derivatives classification issues. This Statement is effective for all financial instruments acquired or issued after the beginning of an entity's first fiscal year that starts after September 15, 2006, and is not expected to have a material impact on the Group's financial position and results of operations.

In March 2006, the FASB issued SFAS No. 156, "Accounting for Servicing of Financial Assets". SFAS No. 156 amends SFAS No. 140 "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities" with respect to the accounting for separately recognized servicing assets and servicing liabilities. The Statement clarified and amended the measurement methods and principles of recognition of mortgage and other servicing assets and liabilities. SFAS No.156 is effective as of beginning of the first fiscal year that begins after September 15, 2006. The Group does not anticipate that this Statement will have a material impact on the Group's financial position and results of operations.

In June 2006, the FASB issued Interpretation No. 48, "Accounting for Uncertainty in Income Taxes", of SFAS No. 109, "Accounting for Income Taxes". The Interpretation applies to all tax positions that are within the scope of SFAS No. 109 and requires the two-step approach for recognizing and measuring tax benefits. The Interpretation establishes a "more-likely-than-not" recognition threshold that must be met before a tax benefit can be recognized in the financial statements. To meet this threshold, the enterprise must determine that upon examination by the taxing authority, the tax position is more likely to be sustained than not, based on the technical merits of the position. Once the recognition threshold has been met, enterprises are required to recognize the largest amount of tax benefit that is greater than 50 percent likely of being realized upon ultimate settlement with the taxing authority. In both steps, enterprises must presume that the taxing authority has full knowledge of all relevant information. The Interpretation also requires enterprises to make explicit disclosures at the end of each reporting period about uncertainties in their income tax positions, including a detailed rollforward of tax benefits taken that do not qualify for financial statement recognition. The Interpretation is effective for fiscal years beginning after December 15, 2006, and should be applied to all tax positions upon initial adoption. The cumulative effect of applying the provisions of the Interpretation should be reported as an adjustment to the opening balance of retained earnings for that fiscal year.

In September 2006, the FASB issued SFAS No. 157, Fair Value Measurements ("SFAS 157"). SFAS 157 defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles, and expands disclosures about fair value measurements. This Statement applies under other accounting pronouncements that require or permit fair value measurements, the FASB having previously concluded in those accounting pronouncements that fair value is the relevant measurement attribute. Accordingly, this Statement does not require any new fair value measurements. SFAS 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. This Statement is required to be adopted by the Group on January 1, 2008. The Group is currently assessing the impact of the adoption of this Statement.

In September 2006, the FASB issued SFAS No. 158, Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans-an amendment of FASB Statements No. 87, 88, 106, and 132(R) ("SFAS 158"). SFAS 158 requires companies that sponsor a postretirement benefit plan to fully recognize, as an asset or liability, the overfunded or underfunded status of their benefit plan(s). The funded status is measured as the difference between the fair value of the plan's assets and its benefit obligation. SFAS 158 also requires companies to measure their plan assets and benefit obligations as of year-end balance sheet date. SFAS 158 is becoming effective for fiscal years ending after December 15, 2006; the provision to require measurement at the entity's year-end balance sheet date will be effective for fiscal years ending after December 15, 2008. The Group does not expect the adoption of SFAS 158 to have a material impact on its financial position or results of operations.

(Amounts in thousands of U.S. dollars, except share amounts or if otherwise stated)

3. ACQUISITIONS

Kvazar-Micro – In July 2004, Sistema purchased 51.0% of Kvazar-Micro for a cash consideration of $28.0 million, including a contribution to the share capital of Kvazar-Micro of $18.0 million. Control over Kvazar-Micro's operations was obtained by the Group starting from this date. Assets and liabilities of Kvazar-Micro have been recorded by the Group at their fair values as of the date of acquisition by Sistema.

The purchase price allocation was as follows:

Current assets	$	68,718
Non-current assets		3,635
Trademarks		3,211
Customer contracts and the related customer relationships		13,864
Current liabilities		(43,485)
Non-current liabilities		(4,068)
Minority interest		(13,875)
Purchase price	**$**	**28,000**

Customer contracts and the related customer relationships acquired are amortized over the remaining contractual terms of approximately 36 months. Trademarks have an unlimited contractual life and are reviewed, at least annually, for impairment.

Through the acquisition of Kvazar-Micro, the Group added Information Technologies Solutions segment to its operations.

In October 2005, the Group purchased 51% stake in Kvazar-Micro from Sistema for cash consideration of $22.6 million. The assets and liabilities of Kvazar-Micro transferred to the Group are recorded in these financial statements at the historical cost of Sistema. The transaction resulted in a decrease of the Group's additional paid-in capital (as a result of a partial return of the controlling shareholder's contribution in the same amount).

Strom Telecom – In July 2004, the Group entered into an agreement with a party controlled by management of Strom Telecom, for the disposal of 33% of the common shares of Strom Telecom for a cash consideration of $2.0 million. At the date of the transaction, the fair value of these shares was determined by the Group's management to be approximately equal to the book value. The Group has recorded the difference of $1.5 million between the fair value of the stake and the consideration received as a compensation to management.

In July 2005, the Group re-acquired this 33% stake in Strom Telecom for $19.8 million. The fair value of the acquired net assets as of the date of this transaction was determined to be in excess of the purchase price. The allocation of purchase price decreased cost of the PP&E by $3.9 million.

Mediatel – In January 2004, the Group entered into an agreement with MGTS, a subsidiary of Sistema, in respect of corporate governance of Mediatel (the Group owned 49% of Mediatel voting common shares, with the remaining shares owned by MGTS). The agreement provided that control over operating and financial policies of Mediatel was transferred to the Group.

In December 2005, the Group purchased 51% stake in Mediatel from MGTS for cash consideration of $1.9 million, increasing the Group's voting power in Mediatel to 100%. The assets and liabilities of Mediatel transferred to the Group are recorded in these financial statements at the historical cost of MGTS. The transaction resulted in a decrease of the Group's additional paid-in capital in the same amount. In 2006, Mediatel was renamed to SITRONICS Telecom Solutions.

Kvant – In May 2005, the Group acquired an additional 53% stake in Kvant, a manufacturer of consumer electronics devices located in Zelenograd, for a total consideration of $7.2 million, increasing the Group's voting power in Kvant to 88%. The Group has obtained control over Kvant's operations and started to utilize its facilities to enhance operations of its consumer electronics segment. The acquisition was accounted for using the purchase method of accounting. The excess of purchase price over the respective share of Kvant's net assets comprising $7.8 million was allocated to the cost of the manufacturing plant.

Smart Cards – In May 2005, the Group entered into an agreement with Giesecke & Devrient GmbH ("G&D") concerning the foundation and operation of Smart Cards, where the Group owns 65% interest. The principal activities of the newly established subsidiary include sales and marketing of smart cards and smart card related solutions, embedding of chips, personalization and mailing (lettershop) of chip-cards, for the telecommunication industry and government sectors.

In conjunction with this transaction, the Group is required to repurchase minority shares of Smart Cards in the event of breach of certain conditions set by the foundation agreement, including, but not limited to achieving of sales targets in the years ended December 31, 2006 and 2007. In addition, the Group has a put option to sell its share in Smart Cards to G&D, which is exercisable in the event G&D breaches its obligations set by the foundation agreement. The fair values of these options as of December 31, 2005 was not significant.

Both put option price and the contingent obligation to repurchase minority stake in Smart Cards have been determined as the initial contribution of the parties into the share capital of Smart Cards plus 10% per annum. As of December 31, 2005, both parties were in compliance with the foundation agreement's covenants.

SITRONICS Ukraine – In July 2005, the Group established à subsidiary for marketing and distribution of consumer electronics products in Ukraine with a share capital of $50 thousand.

Vostochny Veter – In December 2005, the Group acquired a 51% stake in Vostochny Veter, a developer of infocommunication solutions, for a cash consideration of $1.5 million. The excess of purchase price over the respective share of Vostochny Veter's net assets was allocated to the cost of Vostochny Veter's proprietary software.

If the additions of Kvazar-Micro, Kvant and Vostochny Veter to the Group had occurred on January 1, 2004, the effect on the Group's revenue, net income and EPS would not be significant.

(Amounts in thousands of U.S. dollars, except share amounts or if otherwise stated)

4. CASH AND CASH EQUIVALENTS

Cash and cash equivalents as of December 31, 2005, 2004 and 2003 comprised the following:

	2005	(000's) 2004	2003
EUR bank deposits	$ 365	$ 1,190	$ 473
USD current accounts with subsidiary of Sistema:			
Moscow Bank for Reconstruction and Development (MBRD)	16,718	7,049	1,477
Current accounts with third parties:			
USD current accounts	42,186	29,604	-
RUB current accounts	13,125	613	-
EUR current accounts	5,442	581	-
CZK current accounts	3,694	38	1,261
Other	1,580	-	1,154
Cash on hand	249	610	476
Total	**$ 83,359**	**$ 39,685**	**$ 4,841**

5. SHORT-TERM INVESTMENTS

USD and RUB denominated short-term investments as of December 31, 2005, 2004 and 2003 comprised the following:

	Annual interest rate	Maturity date	2005	(000's) 2004	2003
Bank deposits with Sistema affiliate East-West United Bank	-	-	-	$ 7,000	-
Promissory notes of Sistema and subsidiaries	various	various	$ 9,308	5,940	-
Other	various	various	1,089	1,363	$ 419
Total short-term investments			**$ 10,397**	**$ 14,303**	**$ 419**

Management anticipates no losses in respect of short-term investments in Sistema, its subsidiaries and affiliates.

(Amounts in thousands of U.S. dollars, except share amounts or if otherwise stated)

6. TRADE RECEIVABLES, NET

Trade receivables, net of provision for doubtful accounts, as of December 31, 2005, 2004 and 2003 comprised the following:

	2005	(000's) 2004	2003
Trade receivables	$ 163,041	$ 50,004	$ 25,078
Less: provision for doubtful accounts	(4,186)	(4,468)	(4,663)
Total	**$ 158,855**	**$ 45,536**	**$ 20,415**

Included in trade receivables as of December 31, 2005, 2004 and 2003 are receivables for services provided and products shipped to subsidiaries and affiliates of Sistema in the amounts of $56.9 million, $31.0 million and $5.3 million, respectively (Note 23). Management anticipates no losses in respect of receivables from these entities.

7. OTHER RECEIVABLES AND PREPAID EXPENSES, NET

Other receivables and prepaid expenses, net of provision for doubtful accounts, as of December 31, 2005, 2004 and 2003 comprised the following:

	2005	(000's) 2004	2003
Advances to suppliers	$ 23,896	$ 14,158	$ 5,453
Recoverable VAT	13,478	8,550	7,395
Other taxes prepaid	7,533	7,058	1,080
Prepaid expenses	5,158	1,584	448
Loans to employees	1,353	1,000	-
Other	7,045	7,206	3,961
Less: provision for doubtful accounts	(1,583)	(3,597)	(3,857)
Total	**$ 56,880**	**$ 35,959**	**$ 14,480**

8. INVENTORIES AND SPARE PARTS

Inventories and spare parts as of December 31, 2005, 2004 and 2003 comprised the following:

	2005	(000's) 2004	2003
Raw materials and spare parts	$ 20,994	$ 13,762	$ 3,470
Work-in-progress	28,030	16,188	13,994
Finished goods and goods for resale	64,893	52,071	6,594
Total	**$ 113,917**	**$ 82,021**	**$ 24,058**

As of December 31, 2005, 2004 and 2003, inventory with the carrying amount of $27.3 million, $25.5 million and nil, respectively, was pledged to Intel (Note 15).

(Amounts in thousands of U.S. dollars, except share amounts or if otherwise stated)

9. PROPERTY, PLANT AND EQUIPMENT, NET

Property, plant and equipment, net of accumulated depreciation, as of December 31, 2005, 2004 and 2003 comprised the following:

	2005	(000's) 2004	2003
Land	$ 1,377	$ 1,377	$ 888
Buildings and leasehold improvements	58,908	35,937	31,399
Plant, machinery and equipment (including leased vehicles and equipment of $7,635, $5,068 and $3,964, respectively)	56,590	40,333	35,167
Construction in progress and equipment for installation	12,646	6,269	5,727
	129,521	83,916	73,181
Less: accumulated depreciation (including leased vehicles and equipment of $2,078, $2,468 and $1,814, respectively)	(34,574)	(30,916)	(28,823)
Total	**$ 94,947**	**$ 53,000**	**$ 44,358**

Depreciation expense for property, plant and equipment for the years ended December 31, 2005, 2004 and 2003 comprised $6.4 million, $3.6 million and $3.4 million, respectively.

10. INTANGIBLE ASSETS, NET

Intangible assets, net of accumulated amortization, as of December 31, 2005, 2004 and 2003 comprised the following:

	2005			(000's) 2004			2003		
	Gross carrying value	Accumulated Amortization	Net carrying value	Gross carrying value	Accumulated amortization	Net carrying value	Gross carrying value	Accumulated Amortization	Net carrying value
Finite-life intangible assets:									
Customer contracts and the related customers relationships	$ 13,864	$ (6,921)	$ 6,943	$ 13,864	$ (2,301)	$ 11,563	-	-	-
Software costs	9,366	(1,276)	8,090	1,715	(800)	915	$ 705	$ (205)	$ 500
Licenses	1,490	-	1,490	-	-	-	-	-	-
	24,720	**(8,197)**	**16,523**	**15,579**	**(3,101)**	**12,478**	**705**	**(205)**	**500**
Indefinite-life intangible assets:									
Trademarks	3,211	-	3,211	3,211	-	3,211	-	-	-
Total intangible assets	**$ 27,931**	**$ (8,197)**	**$ 19,734**	**$ 18,790**	**$ (3,101)**	**$ 15,689**	**$ 705**	**$ (205)**	**$ 500**

Amortization expense for the years ended December 31, 2005, 2004 and 2003 comprised $5.1 million, $2.9 million and $0.2 million, respectively.

(Amounts in thousands of U.S. dollars, except share amounts or if otherwise stated)

Based on the finite-life intangible assets existing as of December 31, 2005, the estimated amortization expense for each of the five succeeding fiscal years and thereafter is as follows:

		(000's)
2006		6,049
2007	$	3,697
2008		1,307
2009		1,232
2010		1,172
Thereafter		3,066
Total	**$**	**16,523**

The 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.

11. LONG-TERM INVESTMENTS

Long-term investments as of December 31, 2005, 2004 and 2003 comprised the following:

		2005		(000's) 2004		2003
Voting common shares of Angstrem (11%)	$	655	$	673	$	439
Voting common shares of Angstrem-M (11%)		210		203		196
Voting common shares of MBRD (7%)		-		-		9,157
MBRD promissory notes		-		-		2,037
Voting common shares of Kvant (35%)		-		581		581
Total long-term investments	**$**	**865**	**$**	**1,457**	**$**	**12,410**

In May 2005, the Group increased its ownership in Kvant to 88%. As a result, the Group obtained control over Kvant's operations (Note 3).

12. LONG-TERM TRADE RECEIVABLES

Long-term trade receivables as of December 31, 2005 comprised receivables from Sistema affiliates maturing in October 2007 (Note 23).

13. PREPAID RENT

In July 2004, Kvazar-Micro.ru entered into a long-term agreement with Sistema for an operating lease of office premises in Moscow for the period of 86 months. The short-term portion of the prepaid rent is included in other receivables and prepaid expenses. See also Note 24.

(Amounts in thousands of U.S. dollars, except share amounts or if otherwise stated)

14. RESTRICTED CASH

Restricted cash as of December 31, 2005 and 2004 represents three deposits placed by Kvazar-Micro in ING Bank to secure the guarantees issued by the bank in favor of certain IT vendors, including Intel (Note 15). Although all these deposits mature not later than December 31, 2005, management intends to prolong these arrangements.

15. ACCOUNTS PAYABLE

As of December 31, 2005 and 2004, the Group's accounts payable included $11.3 million and $18.6 million, respectively, due to Intel. The amounts due to Intel are collateralized by all proceeds (including accounts receivable) derived by the Group from distribution of Intel's products, the Group's inventory of Intel's products and a guarantee in the amount of $2.1 million issued by ING Bank, which is, in its turn, collateralized by the Group's cash deposit of the same amount in the bank (Note 14).

16. ACCRUED EXPENSES AND OTHER CURRENT LIABILITIES

Accrued expenses and other current liabilities as of December 31, 2005, 2004 and 2003 comprised the following:

		(000's)	
	2005	**2004**	**2003**
Customers' prepayments and billings in excess of project costs	$ 82,104	$ 52,865	$ 11,159
Accrued payroll and vacation	2,983	1,672	1,705
Interest payable on debt	2,616	-	-
Current portion of capital lease (Note 19)	1,332	1,155	1,062
Accrued expenses and other current liabilities	16,874	11,357	3,588
Total	**$ 105,909**	**$ 67,049**	**$ 17,514**

Customers' prepayments and billings in excess of project costs as of December 31, 2005, 2004 and 2003 included amounts related to transactions with subsidiaries and affiliates of Sistema of $70.9 million, $48.7 million and $9.5 million, respectively (Note 23).

(Amounts in thousands of U.S. dollars, except share amounts or if otherwise stated)

17. SHORT-TERM LOANS AND NOTES PAYABLE

At December 31, 2005, 2004 and 2003, short-term loans and notes payable comprised the following:

	Annual interest rate (Actual at December 31, 2005)	2005	2004	2003
Revolving credit facilities:				
Including:				
USD-denominated facilities	LIBOR+2.95% (7.65%)	$ 49,816	-	-
		49,816	**-**	**-**
USD and RUB-denominated loans and notes payable to Sistema subsidiaries	6-17%	**18,995**	**$ 53,067**	**$ 19,485**
Loans and notes payable to other parties:				
Including:				
CZK-denominated	-	-	1,548	1,827
USD-denominated	6-9%; LIBOR+3.85% (8.69%)	34,230	-	1,694
Other	Various	2,021	14,406	5,680
		36,251	**15,954**	**9,201**
Total		**$ 105,062**	**$ 69,021**	**$ 28,686**

Revolving Credit Facilities – In August 2005, several Group's entities entered into a credit facility with ABN Amro Bank, limited to $50.0 million (SITRONICS-$12.0 million; Mikron-$24.0 million; VZPP-Mikron-$6.0 million; Elaks-$8.0 million). The loans bear interest of LIBOR plus 2.95% per annum and mature in 2006. As of December 31, 2005, the outstanding balance under this facility totaled $49.8 million.

USD and RUB-Denominated Loans and Notes Payable to Sistema and Subsidiaries – During the year ended December 31, 2005, the Group entered into several USD and RUB-denominated short-term loan agreements with MBRD, bearing interest rates from 6% to 17%. Loans outstanding at December 31, 2005 are collateralized by 1,683,822 (17.2%) of Mikron's common shares.

Loans and Notes Payable to Other Parties – During the year ended December 31, 2005, Mikron and Elaks issued to Donau Bank USD-denominated promissory notes in the amounts of $10.0 million, at 91% of face value, and of $8.0 million, at 94% of face value. These notes mature in 2006 and are guaranteed by MBRD.

In November 2005, SITRONICS entered into a loan agreement with Donau Bank for the amount of $20.0 million, bearing an interest rate of LIBOR plus 3.85%, maturing in November 2006.

The loans are subject to certain restrictive covenants to the Group, including, but not limited to, limitations on the incurrence of additional indebtedness, restrictions to pay dividends, any merger, consolidation or disposition of assets, compliance with certain financial ratios. Management believes that as of the date of these statements, the Group is in compliance with all existing covenants.

(Amounts in thousands of U.S. dollars, except share amounts or if otherwise stated)

18. LONG-TERM DEBT

Long-term debt as of December 31, 2005, 2004 and 2003 consisted of the following:

	Currency	Annual interest rate (Actual at December 31, 2005)	(000's) 2005	2004	2003
Science and Industrial Policy Department of the Moscow Government	RUB	2.88%	$ 3,011	-	-
BAWAG Bank	CZK	PRIBOR+1. 75% (4.28%)	1,929	-	-
EBRD	EUR	LIBOR+5% (7.85%)	925	$ 3,537	-
Sberbank	RUB	-	-	4,684	$ 4,006
Mikron bonds	RUB	-	-	-	10,185
Other	Various	0-16%	1,185	3,774	2,636
			7,050	**11,995**	**16,827**
Loans from subsidiaries of Sistema					
MBRD	RUB	-	-	4,435	-
Sistema	USD	-	-	-	5,425
Investment Pension Company	RUB	-	-	-	3,693
Putney Assets Limited	USD	-	-	-	940
Other	Various	-	-	130	165
			7,050	**16,560**	**27,050**
Less amounts maturing within 12 months			(925)	(8,606)	(3,107)
Total			**$ 6,125**	**$ 7,954**	**$ 23,943**

Science and Industrial Policy Department of the Moscow Government – In December 2005, Mikron entered into a credit facility with the Department of Science and Industrial Policy of the Moscow Government. The facility is limited to 217 million RUR ($7.6 million as of December 31, 2005). These funds will be used to finance modernization of production plant and equipment. The facility bears interest determined as one fourth of the official rate of the Central Bank of Russia and matures in 2010. As of December 31, 2005, $3.0 million was outstanding under this credit facility.

BAWAG – During the year ended December 31, 2005, Strom Telecom entered in a CZK-denominated loan agreement with BAWAG Bank, in the amount of $1.9 million. The loan bears interest of PRIBOR plus 1.75% per annum and matures not later than in 2015.

EBRD – In 2002, Kvazar-Micro entered into a Euro-denominated credit facility with the European Bank for Reconstruction and Development ("EBRD"). The facility allows to borrow up to $8.0 million. The loan includes the Term Loan and the Revolving Facility. The project financed under the facility involves construction and launch of an assembly plant. The credit facility terminates in December 2007 (parties may agree to prolong it to December 2009) and bears interest of LIBOR plus 5% per annum. The facility is secured by shares of Factory Kvazar-Micro, cash deposit in amount of $1.4 million, buildings and related facilities with the carrying value of $0.4 million; and the assignment to the EBRD of the Group's rights, interests and benefits under insurance policies maintained by certain subsidiaries of Kvazar-Micro. As of December 31, 2005, approximately $0.9 million was outstanding under this credit facility.

(Amounts in thousands of U.S. dollars, except share amounts or if otherwise stated)

The facility is subject to a number of restrictive covenants, including, but not limited to certain financial ratios. In the event that Kvazar-Micro breaches any of these covenants or is not in compliance with any of the restrictions, the lender has the right, at its discretion, to claim immediate repayment of the indebtedness under the facility. As of December 31, 2005 and of the date of these statements, Kvazar-Micro was in breach of a number of the covenants. The EBRD has not sent a notice of default to Kvazar-Micro and has issued waivers in respect of certain covenants. However, other breached covenants were not covered by these waivers. Accordingly, the balance outstanding under the facility has been classified as a current liability.

The loans repayments over future periods are as follows:

		(000's)
Year ended December 31,		
2006	$	925
2007		551
2008		457
2009		63
2010		3,101
Thereafter		1,953
Total	**$**	**7,050**

19. CAPITAL LEASE OBLIGATIONS

The capital lease obligations as of December 31, 2005, 2004 and 2003 are presented as follows:

		2005		**(000's) 2004**		**2003**
Total minimum lease payments (undiscounted)	$	3,241	$	2,142	$	2,658
Less amount representing interest		(304)		(124)		(133)
Present value of net minimum lease obligations		2,937		2,018		2,525
Less current portion of lease obligations (Note 16)		(1,332)		(1,155)		(1,062)
Non-current portion of lease obligations	**$**	**1,605**	**$**	**863**	**$**	**1,463**

During 2001-2005, the Group entered into several lease agreements for equipment and vehicles. Most of the agreements expire prior to 2009 and assume transfer of ownership for leased assets to the Group at the end of the lease term.

(Amounts in thousands of U.S. dollars, except share amounts or if otherwise stated)

20. SHARE CAPITAL AND ADDITIONAL PAID-IN CAPITAL

In July 2005, SITRONICS has registered issuance of 5,817,000,000 voting common shares with par value of 1 RUB to Sistema. The issuance of shares was completed in March 2006 (Note 26). As of December 31, 2005, Sistema prepaid $56.8 million for these shares. The contribution was recorded within additional paid-in capital.

21. INCOME TAX

The Group's provision for income taxes for the years ended December 31, 2005, 2004 and 2003 is as follows:

	(000's) Year ended December 31, 2005	2004	2003
Current expense	$ 35,461	$ 7,800	$ 2,540
Deferred (benefit)/expense	(314)	(4,566)	386
Total income tax expense	**$ 35,147**	**$ 3,234**	**$ 2,926**

The provision for income taxes is different from that which would be obtained by applying the Russian statutory income tax rate of 24% to income before income tax and minority interests. The items causing this difference are as follows:

	(000's) Year ended December 31, 2005	2004	2003
Income tax provision computed on income before taxes at Russian statutory rate	$ 31,293	$ 4,650	$ 2,085
Adjustments due to:			
Expenses not deductible for tax purposes	3,458	440	1,078
Effect of different tax rates	2,530	404	496
Foreign currency transactions differences	(2,134)	(2,260)	(733)
Income tax expense	**$ 35,147**	**$ 3,234**	**$ 2,926**

Temporary differences between tax and accounting bases of assets and liabilities give rise to the following deferred tax assets and liabilities as at December 31, 2005, 2004 and 2003:

	(000's) Year ended December 31, 2005	2004	2003
Deferred tax assets			
Property, plant and equipment	$ 4,593	$ 2,229	-
Accounts receivable	4,222	4,372	$ 2,237
Accrued expenses	1,547	658	863
Inventories and spare parts	481	454	-
Other	212	327	-
Total deferred tax assets	**$ 11,055**	**$ 8,040**	**$ 3,100**

(Amounts in thousands of U.S. dollars, except share amounts or if otherwise stated)

	(000's) Year ended December 31, 2005	2004	2003
Deferred tax liabilities			
Property, plant and equipment	(8,479)	(3,952)	(1,794)
Intangible assets	(2,407)	(3,524)	-
Other	(1,617)	(403)	(1,220)
Total deferred tax liabilities	**$ (12,503)**	**$ (7,879)**	**$ (3,014)**
Net deferred tax assets, current	$ 4,785	$ 4,325	$ 3,100
Net deferred tax assets, long-term	$ 3,441	$ 3,666	$ -
Net deferred tax liabilities, current	$ (664)	$ (910)	$ (1,220)
Net deferred tax liabilities, long-term	$ (9,010)	$ (6,920)	$ (1,794)

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 maker or group in deciding how to allocate resources and in assessing performance.

The Group operates along five reportable segments: Telecommunication Solutions, Information Technologies Solutions, Microelectronic Solutions, Consumer Electronics and Electronics Manufacturing Services. Diversification of business entities by those segments was based on principles of production process and product specification. The Group's management evaluates performance of the segments based on their operating income. In 2006, the Group changed the structure of its internal organization to split its former Consumer Electronics segment into two segments: Consumer Electronics and Electronics Manufacturing Services. The Group has retroactively restated its segment information for all periods presented.

Intercompany eliminations presented below consist primarily of intercompany sales transactions, intercompany investments and loans and other intercompany transactions and balances conducted under the normal course of operations.

(Amounts in thousands of U.S. dollars, except share amounts or if otherwise stated)

An analysis and reconciliation of the Group's business segment information to the respective information in the consolidated financial statements for the years ended December 31, 2005, 2004 and 2003 is as follows:

	Year ended December 31, 2005						
	Telecom-munication Solutions	Information Technologies Solutions	Micro-electronic Solutions	Consumer Electronics	Electronics Manu-facturing Services	Corporate	Total
Net sales to external customers	$ 246,592	$ 468,404	$ 56,937	$ 124,038	$ 56,533	$ 65	$ 952,569
Intersegment sales	47	-	15	-	641	-	703
Depreciation and amortization	(3,166)	(5,089)	(1,964)	(1)	(1,036)	(220)	(11,476)
Operating income/(loss)	132,049	6,469	3,622	1,921	(1,678)	(142)	142,241

	Year ended December 31, 2004						
	Telecom-munication Solutions	Information Technologies Solutions	Micro-electronic Solutions	Consumer Electronics	Electronics Manu-facturing Services	Corporate	Total
Net sales to external customers	$ 87,777	$ 293,209	$ 47,200	$ 30,838	$ 14,298	$ 270	$ 473,592
Intersegment sales	-	314	4,853	71	7,054	-	12,292
Depreciation and amortization	(1,793)	(2,654)	(1,488)	(29)	(430)	(97)	(6,491)
Operating income/(loss)	13,344	(829)	11,560	2,372	193	(573)	26,067

	Year ended December 31, 2003						
	Telecommu-nication Solutions	Information Technologies Solutions	Micro-electronic Solutions	Consumer Electronics	Electronics Manu-facturing Services	Corporate	Total
Net sales to external customers	$ 50,457	$ -	$ 40,826	$ 3,363	$ 4,318	$ 91	$ 99,055
Intersegment sales	-	-	-	-	358	-	358
Depreciation and amortization	(586)	-	(2,436)	(34)	(512)	-	(3,568)
Operating income/(loss)	10,060	-	4,183	(3,059)	(408)	(719)	10,057

The reconciliation of segment operating income to the consolidated income before income tax and minority interests is as follows:

	(000's) Year ended December 31,		
	2005	2004	2003
Total segment operating income	$ 142,241	$ 26,067	$ 10,057
Interest income	872	197	-
Interest expense	(9,810)	(7,120)	(2,772)
Foreign currency transactions (loss)/gain	(2,914)	233	1,404
Consolidated income before income tax and minority interests	**$ 130,389**	**$ 19,377**	**$ 8,689**

(Amounts in thousands of U.S. dollars, except share amounts or if otherwise stated)

Information about the Group's revenues attributed to different geographic areas for the years ended December 31, 2005, 2004 and 2003 is shown below.

	(000's) Year ended December 31,		
	2005	**2004**	**2003**
Russia	$ 495,696	$ 202,175	$ 71,532
Ukraine	266,647	135,506	-
Central and Eastern Europe	158,146	112,249	10,462
Asia-Pacific region	18,120	11,489	9,161
Others	13,960	12,173	7,900
Total sales to external customers	**$ 952,569**	**$ 473,592**	**$ 99,055**

Due to a wide variety of products and services produced by the Group, the Group believes that reporting revenues from external customers for each product and service (or group of similar products and services) is impracticable.

As of December 31, 2005, 2004 and 2003, the total assets of reportable segments comprised the following:

	(000's) Year ended December 31,		
	2005	**2004**	**2003**
Telecommunication Solutions	$ 213,347	$ 96,575	$ 38,680
Information Technologies Solutions	110,178	78,817	-
Microelectronic Solutions	98,866	91,612	68,528
Consumer Electronics	90,863	31,329	6,282
Electronics Manufacturing Services	49,287	29,726	15,021
	562,541	**328,059**	**128,511**
Corporate	60,659	22,230	10,082
Intersegment eliminations	(57,110)	(49,246)	(14,012)
Total assets	**$ 566,090**	**$ 301,043**	**$ 124,581**

For the years ended December 31, 2005, 2004 and 2003, the Group's additions to PP&E and intangible assets comprised the following:

	(000's) Year ended December 31,		
	2005	**2004**	**2003**
Telecommunication Solutions	$ 26,009	$ 6,323	$ 5,852
Information Technologies Solutions	2,968	21,646	-
Microelectronic Solutions	4,856	2,761	2,442
Consumer Electronics	39	21	232
Electronics Manufacturing Services	22,026	947	155
Corporate	525	1,376	516
Total additions to PP&E and intangible assets	**$ 56,423**	**$ 33,074**	**$ 9,197**

(Amounts in thousands of U.S. dollars, except share amounts or if otherwise stated)

As of December 31, 2005, 2004 and 2003, the Group's PP&E and intangible assets, net of accumulated depreciation and amortization in respect of their geographical location were presented as follows:

		(000's)	
	2005	**2004**	**2003**
Russia	$ 67,427	$ 37,585	$ 33,780
Czech Republic	30,592	13,355	11,078
Ukraine	16,662	17,749	-
Total PP&E and intangible assets, net of accumulated depreciation and amortization	**$ 114,681**	**$ 68,689**	**$ 44,858**

23. RELATED PARTY TRANSACTIONS

During the years ended December 31, 2005, 2004 and 2003, the Group entered into transactions with related parties as follows:

		(000's) Year ended December 31,	
	2005	**2004**	**2003**
Sales of software and telecommunication equipment	$ 227,972	$ 68,800	$ 37,300
Systems integration	68,722	-	-
Sales of handsets	12,007	12,592	-
Interest expense	(6,219)	(2,956)	(1,121)
Other	2,313	1,148	(122)

Sales of Software and Telecommunication Equipment

Mobile TeleSystems ("MTS") – During the years ended December 31, 2005, 2004 and 2003, Strom Telecom entered into agreements with MTS, a subsidiary of Sistema, and its affiliate Mobile TeleSystems Belarus ("MTS Belarus") for sale of a billing system, a communications software support system and sale of telecommunication equipment. Pursuant to these contracts, Strom Telecom sold software, equipment and related services for approximately $178.4 million, $31.8 million and $26.6 million during the years ended December 31, 2005, 2004 and 2003, respectively.

Comstar UTS – During the years ended December 31, 2005, 2004 and 2003, Strom Telecom and Mediatel entered into several agreements with subsidiaries of Sistema currently comprising Comstar UTS (MGTS, MTU-Inform, Comstar and Telmos). Pursuant to these contracts, Strom Telecom and Mediatel sold telecommunication equipment for approximately $25.9 million, $21.5 million and $10.7 million in the years ended December 31, 2005, 2004 and 2003, respectively.

Invest-Svyaz-Holding – During the years ended December 31, 2005 and 2004, Strom Telecom and Mediatel sold telecommunication equipment to Invest-Svyaz-Holding, a subsidiary of Sistema, for $18.3 million and $15.5 million, respectively.

Multiregional TransitTelecom ("MTT") – During the year ended December 31, 2005, Strom Telecom sold telecommunication equipment to MTT, an affiliate of Sistema, for the amount of $5.4 million.

(Amounts in thousands of U.S. dollars, except share amounts or if otherwise stated)

Systems Integration

During the year ended December 31, 2005, Kvazar-Micro rendered systems integration services to Sistema and its subsidiaries in the amount of $68.7 million, including to MTS and UMC for $43.6 million and $12.6 million, respectively.

Sales of Handsets

During the years ended December 31, 2005 and 2004, the Group sold handsets to Sky Link, an affiliate of Sistema, for $12.0 million and $12.6 million, respectively.

Interest Expense

During the years ended December 31, 2005, 2004 and 2003, the Group had several short-term and long-term loans outstanding from Sistema and its subsidiaries, including MBRD (Notes 17 and 18). Interest expense on these loans amounted to $6.2 million, $3.0 million and $1.1 million for the years ended December 31, 2005, 2004 and 2003, respectively.

24. COMMITMENTS AND CONTINGENCIES

Operating Leases – In May 1999 and January 2000, the Group has entered into long-term agreements for operating leases of land in Zelenograd, maturing in 2015 and 2024, respectively. Rental expenses under these leases were $0.5 million for each of the years ended December 31, 2005 and 2004 and are included in operating expenses in the consolidated statement of operations.

In July 2004, Kvazar-Micro.ru has entered into a long-term agreement with Sistema for an operating lease of office premises in Moscow, which expires in 2011. Rental expenses under this operating lease of $0.4 million for the year ended December 31, 2005 are included in operating expenses in the consolidated statement of operations.

Future minimum rental payments under operating leases in effect as of December 31, 2005, are as follows:

		(000's)
Year ended December 31,		
2006	$	1,059
2007		1,059
2008		1,059
2009		1,059
2010		1,059
Thereafter		6,661
Total	**$**	**11,956**

Capital Commitments – During the year ended December 31, 2005, the Group has entered into an agreement to construct additional production premises for Strom Telecom. As of December 31, 2005, the Group was contractually committed to spend approximately $18.3 million to complete the construction.

Issued Guarantees – During the year ended December 31, 2005, the Group has issued guarantees to Commerzbank for loans obtained by Invest-Svyaz-Holding, a subsidiary of Sistema, for a total amount of $18.0 million. The guarantees expire in 2007. As of December 31, 2005, no event of default has occurred under any of these guarantees.

Legal Proceedings – In the ordinary course of business, the Group may be party to various legal and tax proceedings, and be subject to claims. In the opinion of management, the Group's 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 the Group.

Importation of Goods – Kvazar-Micro utilizes third parties to import goods into the CIS countries. There is a risk that the third parties' import transactions may be challenged by regulatory authorities and determined as inappropriate. The impact that this determination may potentially have on the Group's net income and financial position can not be quantified at this stage due to the lack of precedent for such determinations. No contingent liabilities have been recorded in the Group's financial statements in relation to these transactions.

25. CONCENTRATIONS

Credit Risks – During the years ended December 31, 2005, 2004 and 2003, the Group's sales to Sistema's subsidiaries and affiliates amounted to $310.0 million, $81.4 million and $37.3 million, respectively, or 32.5%, 17.2% and 37.6% of the Group's consolidated revenues for the respective periods. The Group's trade receivables from Sistema's subsidiaries and affiliates as of December 31, 2005, 2004 and 2003 are disclosed in Notes 6 and 12; the Group's cash and short-term investments balances with Sistema's subsidiaries and affiliates are disclosed in Notes 4 and 5, respectively.

Kvazar-Micro collects proceeds from distribution of computer hardware products in the RF and Ukraine through a small number of independent dealers. Amounts due from these dealers as of December 31, 2005 and 2004 were $31.8 million and $23.9 million, respectively. During the years ended December 31, 2005 and 2004, revenues of Kvazar-Micro from distribution of products purchased under a distribution agreement with Intel International B.V. ("Intel") amounted to $228.0 million and $196.8 million, respectively, or 23.9% and 41.6% of the Group's consolidated revenues for the respective periods.

In the Consumer Electronics segment, the Group encounters credit risk as a result of a concentration of receivables among a few significant customers. Twelve new customers in this segment accounted for revenues of $99.4 million in the year ended December 31, 2005, which is 10.4% of the Group's consolidated revenues for this period. Trade receivables from these customers amounted to $54.8 million as of December 31, 2005.

Operating Environment – The Russian and Ukrainian economies, while deemed to be of market status, continue to display certain traits consistent with that of emerging markets. These characteristics have in the past included higher than normal inflation, insufficient liquidity of the capital markets, and the existence of currency controls. The continued success and stability of the Russian and Ukrainian economies will be subject to their respective governments' continued actions with regard to legal and economic reforms.

Russia and Ukraine currently have a number of laws related to various taxes imposed by governmental authorities. Applicable taxes include VAT, corporate income tax, and payroll taxes, together with others. The policies on implementation of these regulations are 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 and Ukraine that are more significant than typically found in countries with more developed tax systems.

Management believes that it has adequately provided for tax liabilities in the Group's consolidated financial statements; however, the risk remains that relevant authorities could take a different position with regard to interpretive issues.

Industry Risks – The industries in which the Group is operating are characterized by rapid technological changes, competitive pricing pressures and cyclical market patterns. The Group's financial results are affected by a wide variety of factors, including general economic conditions in countries where Group's entities operate, industry-specific economic conditions, the timely implementation of new manufacturing technologies, the ability to safeguard patents and intellectual property in rapidly evolving markets and reliance on vendors and independent distributors.
The Group is exposed to the risk of obsolescence of its inventory depending on the mix of future business. As a result, the Group may experience significant period-to-period fluctuations in future operating results due to the factors mentioned above or other factors.

26. SUBSEQUENT EVENTS

Contribution of Sistema – In January 2006, Sistema has fully repaid voting common shares issued by SITRONICS (Note 20). This contribution increased the Group's additional paid-in capital by $173.8 million. As of the date of these statements, the registration of the issuance report was completed.

Commerzbank Loan – In January 2006, the Group entered into a short-term loan with Commerzbank in the amount of $25.0 million, maturing in January 2007, and bearing interest rate of LIBOR plus 3%.

Equity Transactions – In March 2006, SITRONICS issued to Sistema 5,817,000,000 voting common shares with par value of 1 RUB for $206.8 million.

In March 2006, SITRONICS Management, a 100% subsidiary of SITRONICS, purchased from Sistema 1,133,995,091 voting common shares of SITRONICS, for a cash consideration of $40.9 million. The treasury stock was accounted for at cost. The treasury stock was acquired for realization of share-based compensation plans in favor of SITRONICS and Sistema management.

Concurrently with the purchase of treasury stock, Sistema has approved the sale of 385,188,550 common shares of SITRONICS to the newly-appointed Sistema's CEO, who served as SITRONICS' CEO from July 2003 to February 2006. The shares were sold for $13.8 million with a payment date not later than 2010. At the date of the transaction, the fair value of shares sold to Sistema's CEO was estimated at $105.0 million, the award being attributed to his employment by Sistema.

Eurobonds Issuance – In March 2006, SITRONICS Finance S.A., a subsidiary of SITRONICS created in January, 2006, issued $200.0 million 7.875% unsecured notes at 99.672%. These notes are fully and unconditionally guaranteed by SITRONICS and mature in March 2009. SITRONICS Finance S.A. is required to make interest payments on the notes semi-annually in arrears in March and September. The notes are listed on the London Stock Exchange. Proceeds received from the notes were $199.3 million. The related issuance costs comprised $2.5 million.

The notes are subject to certain restrictive covenants to the Group, including, but not limited to, limitations on the incurrence of additional indebtedness, restrictions to pay dividends, any merger, consolidation or disposition of assets, compliance with certain financial ratios. Management believes that as of the date of these statements, the Group is in compliance with all existing covenants.

Innovation Development Center – In March 2006, the Group has entered into a joint venture agreement with Siemens AG concerning foundation of "Innovation Development Center", where the Group owns 50.1% interest. Principal activities of the newly established entity include research, development, and manufacturing of security systems to be marketed in the CIS.

Forward Agreement – In March 2006, SITRONICS entered into a forward agreement with Dresdner bank to buy $40.0 million at fixed rate of 27.8 RUB. This arrangement is used to hedge the fair value of the Group's RUB-denominated investments and accounts receivable, to offset the effect on earnings of changes in exchange rates until these investments and receivables are collected.

Acquisition of Intracom Telecom – In June 2006, SITRONICS acquired 51.0% of common shares of Intracom Telecom for EUR 120.0 million (equivalent of $150.6 million) from Intracom Holdings S.A. Intracom Telecom is a provider of telecommunications solutions and services, such as advanced technological products in the areas of fixed and wireless broadband access and transmission systems, and content delivery systems (IPTV, triple-play), primarily in the Eastern Europe and Middle East.

SITRONICS also entered into a put option with the other shareholder of Intracom Telecom to acquire the remaining 49.0% of common shares of Intracom Telecom. The exercise period of the put option is 36 months following a 24 months period after the acquisition date. The agreement stipulates that the purchase price will be agreed by the parties, or will be equal to the fair value as determined by an independent appraiser.

ABN AMRO Credit Facility – In July 2006, Strom Telecom entered into a credit facility agreement with ABN Amro bank, limited to $15 million. The facility can be drawn in EUR, USD or CZK in form of short-term loans, overdraft, letters of guarantees or bank guarantees, with maturity dates not later than July 2008. The loans bear and interest rate of EURIBOR +0.7%, LIBOR + 0.7%, or PRIBOR + 0.7% per annum, depending on the currency of loans.

Issue of Additional Shares – In August 2006, SITRONICS announced the issuance of additional 293,476,990 common shares with a par value of 1 RUB each. In October 2006, Sitronics has issued these shares to the European Bank for Reconstruction and Development (EBRD) for $80.0 million. These shares are puttable to Sistema. In November 2006, SITRONICS' Board of Directors approved additional issuance of 5,000,000,000 common shares with par value of 1 RUB.

Financing – In October 2006, STROM Telecom signed amendments to existing agreements with HSBC and BAWAG for renewal of its credit facilities. These facilities bear interest rate of PRIBOR + 0.5% and PRIBOR + 1.2%, respectively. The facilities are limited to $26.3 million and $9.7 million, respectively, and mature in 2007.

In November 2006, Strom Telecom entered into a credit facility with ABN-AMRO limited to $15.0 million. The loan bears an interest rate of PRIBOR + 0.9% per annum. The facility can be utilized in USD, EUR or CZK and matures in 2007.

Transactions with Mikron Shares – In December 2006, SITRONICS signed an agreement with Waltermore Ltd. to repurchase 7.6% of voting shares of Mikron for $7.3 million, thus increasing the Group's voting power in Mikron from 78% to 86%.

In December 2006, the Group received a prepayment of 274.6 million rubles (or approximately $10 million) from the Russian Federation Agency for Management of Federal Property for 10% of Mikron ordinary shares that will be issued to the Agency in 2007.

(Amounts in thousands of U.S. dollars, except share amounts or if otherwise stated)

Acquisition of VZPP-Mikron Shares – In December 2006, SITRONICS purchased from a minority shareholder 45.7% of voting shares of VZPP-Mikron for $4.5 million, thus increasing the Group's voting power in VZPP-Mikron from 51% to 97%.

27. RESTATEMENT

Subsequent to the issuance of the Group's 2005 financial statements in June 2006, the Group's management identified the following errors in application of generally accepted accounting principles that occurred in the years ended December 31, 2005, 2004 and 2003:

- During these periods the Group has recognized revenues from Strom Telecom's software sales to Sistema subsidiaries under requirements of SOP 97-2, "Software Revenue Recognition" based on the management's estimate that the Group's software supplied to Sistema subsidiaries does not require significant customization subsequent to delivery. In 2006, the Group's management has reviewed the implementation process for such software and concluded that the required customization in certain instances was significant and that revenue on such arrangements should be recognized in accordance with SOP 81-1, "Accounting for Performance of Construction-Type and Certain Production-Type Contracts";
- In the year ended December 31, 2005, the Group did not consolidate accounts of Cosmos Wealth, a variable interest entity, of which it was a primary beneficiary (see Note 2). In 2006, the Group's management has concluded that accounts of Cosmos Wealth should have been consolidated in the Group's financial statements for the year ended December 31, 2005;
- Certain misclassifications described in the "Reclassification amounts" columns in the tables below.

In addition, the Group has combined the accounts of Videofon MV, a subsidiary of Sistema, in its previously issued financial statements for the year ended December 31, 2005. Videofon MV at that time was considered by Sistema to be a part of its Technology business segment, was managed by the Group and contemplated for transfer to the Group in 2006. In 2006, Sistema reconsidered its strategy for the development of Videofon MV and decided to exclude Videofon MV from the Group.
The accounts of Videofon MV have been excluded from the Group's financial statements for the year ended December 31, 2005. As a result, the Group's financial statements have been restated from the amounts previously reported as follows:

As of and for the year ended December 31, 2005	As previously reported	Exclusion of Videofon MV	Reclassification amounts	Restatement amounts	As restated
Cash and cash equivalents	$ 83,718	$ (359)	-	-	$ 83,359
Trade receivables, net	180,594	(69)	$ (14,000)	$ (7,670)	158,855
Other receivables and prepaid expenses, net	63,298	(3,186)	(3,232)	-	56,880
Inventories and spare parts	101,065	(2,138)	-	14,990	113,917
Deferred tax assets, current portion	2,962	3	-	1,820	4,785
Property, plant and equipment, net	95,155	(208)	-	-	94,947
Intangible assets, net	19,777	(43)	-	-	19,734
Long-term investments	1,637	(3)	(769)	-	865
Long-term trade receivables	1,444	-	13,131	-	14,575
Deferred tax assets	3,451	(10)	-	-	3,441
Accounts payable	102,021	(66)	-	2,533	104,488
Taxes payable	40,744	(187)	-	-	40,557
Accrued expenses and other current liabilities	94,788	(1,405)	-	12,526	105,909
Short-term loans and notes payable	109,356	(4,294)	-	-	105,062

(Amounts in thousands of U.S. dollars, except share amounts or if otherwise stated)

As of and for the year ended December 31, 2005	As previously reported	Exclusion of Videofon MV	Reclassification amounts	Restatement amounts	As restated
Deferred tax liabilities	9,031	(21)	-	-	9,010
Minority interests	33,796	-	(4,870)	-	28,926
Retained earnings	34,450	(40)	-	(5,920)	28,490
Revenues	954,926	(6,375)	-	4,018	952,569
Cost of sales, exclusive of depreciation and amortization shown separately below	(741,029)	4,924	23,644	(3,173)	(715,634)
Research and development expenses	-	-	(23,644)	-	(23,644)
Selling, general and administrative expenses	(51,969)	714	(1,900)	(1,600)	(54,755)
Depreciation and amortization	(11,484)	8	-	-	(11,476)
Other operating expenses, net	(6,828)	109	1,900	-	(4,819)
Operating income	143,616	(620)	-	(755)	142,241
Interest expense, net of amounts capitalized	(10,234)	424	-	-	(9,810)
Foreign currency transactions loss	(3,032)	118	-	-	(2,914)
Income before income tax and minority interests	131,222	(78)	-	(755)	130,389
Income tax expense	(35,463)	39	-	277	(35,147)
Income before minority interests	95,759	(39)	-	(478)	95,242
Minority interests	(29,613)	-	-	3,598	(26,015)
Extraordinary gain	3,956	-	-	(3,956)	-
Net income	70,102	(39)	-	(836)	69,227
Comprehensive income	$ 66,314	$ (39)	$ -	$ (836)	$ 65,439

As of and for the year ended December 31, 2004	As previously reported	Reclassification amounts	Restatement amounts	As restated
Trade receivables, net	$ 55,469	$ (7,000)	$ (2,933)	$ 45,536
Other receivables and prepaid expenses, net	40,250	(4,291)	-	35,959
Inventories and spare parts	73,378	7,000	1,643	82,021
Deferred tax assets, current portion	1,673	-	2,652	4,325
Long-term investments	2,218	(761)	-	1,457
Accrued expenses and other current liabilities	57,434	705	8,910	67,049
Government grants	705	(705)	-	-
Minority interests	34,682	(5,052)	(2,463)	27,167
Accumulated deficit	(35,652)	-	(5,085)	(40,737)
Revenues	488,092	-	(14,500)	473,592
Cost of sales, exclusive of depreciation and amortization shown separately below	(407,159)	9,246	650	(397,263)
Research and development expenses	-	(9,246)	-	(9,246)
Selling, general and administrative expenses	(32,395)	-	(1,478)	(33,873)
Loss from disposal of an interest in a subsidiary	(1,478)	-	1,478	-
Operating income	39,917	-	(13,850)	26,067
Income before income tax and minority interests	33,227	-	(13,850)	19,377
Income tax expense	(6,835)	-	3,601	(3,234)
Minority interests	(7,249)	-	2,456	(4,793)
Net income	19,143	-	(7,793)	11,350
Comprehensive income	$ 20,156	$ -	$ (7,793)	$ 12,363

(Amounts in thousands of U.S. dollars, except share amounts or if otherwise stated)

As of and for the year ended December 31, 2003	As previously reported	Reclassification amounts	Restatement amounts	As restated
Trade receivables, net	$ 19,766	-	$ 649	$ 20,415
Other receivables and prepaid expenses, net	18,728	$ (4,248)	-	14,480
Inventories and spare parts	20,343	-	3,715	24,058
Long-term investments	13,214	(804)	-	12,410
Accrued expenses and other current liabilities	16,463	347	704	17,514
Deferred tax liabilities, current portion	268	-	952	1,220
Government grants	347	(347)	-	-
Minority interests	6,908	(5,052)	-	1,856
Accumulated deficit	(54,795)	-	2,708	(52,087)
Revenues	95,955	-	3,100	99,055
Cost of sales, exclusive of depreciation and amortization shown separately below	(64,162)	7,828	560	(55,774)
Research and development expenses	-	(7,828)	-	(7,828)
Operating income	6,397	-	3,660	10,057
Income before income tax and minority interests	5,029	-	3,660	8,689
Income tax expense	(1,974)	-	(952)	(2,926)
Net income	2,315	-	2,708	5,023
Comprehensive income	$ 4,076	$ -	$ 2,708	$ 6,784