MTS

ANNUAL REPORT
2005

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

Mobile TeleSystems OJSC ("MTS") is the largest mobile phone operator in Russia and the CIS, and is among the top 10 mobile operators in the world in terms of total numbers of subscribers.

At year-end 2005, MTS was the number one operator, in terms of subscribers, in Russia, Uzbekistan, Turkmenistan, and Belarus. MTS and its subsidiaries provide GSM 900/1800 services to a total population of approximately 233 million people.

In 2005 the Company provided GSM 900/1800 mobile communication services under the MTS postpaid and prepaid brands in Russia and Belarus. In Ukraine, MTS operates under the UMC postpaid brand, and JEANS and SIM-SIM prepaid brands.

In Uzbekistan, the subsidiary operates as Uzdunrobita. In Turkmenistan, MTS operates as BCTI. The Company is moving rapidly toward a single "MTS" brand identity throughout the Company's regions of operation.

In addition to voice communications services, MTS and its subsidiaries also offer an ever growing array of additional value-added services (VAS) such as voicemail, text and multimedia messaging (SMS and MMS), internet access, news, entertainment, and e-mail through GPRS data services, fax, location-based services (LBS), as well as other products and technologies.

The Company was founded in October 1993. Its shares are listedin the form of Level-III American Depositary Receipts (ADRs) on the New York Stock Exchange in June 2000 (ticker: MBT), where its major volumes are traded.

The Company's depository receipts are also traded on the London Stock Exchange (ticker: MBLD), Frankfurt Stock Exchange (ticker: MKY), Berlin Stock Exchange, and Munich Stock Exchange.

MTS shares have been traded as a non-listed security on the Moscow Interbank Currency Exchange (MICEX) since October 2003. In November 2003, common shares of MTS were included into MICEX "B" Quotation List (ticker: MTSI).

On September 19, 2005, MTS shares began trading on the Russian Trading System (RTS) exchange as a non-listed security.

At year-end 2005, MTS had 27,668 employees.

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Altai Republic
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Vologda region
Voronezh region
Yamalo-Nenetsk Autonomous District
Yaroslavl region

Non-operational areas in Russia
Chechen republic
Chukotsk Autonomous District
Evenkia Autonomous District
Koryakski Autonomous District

[1] As of September 30, 2006

COMPANY HISTORY

The history of MTS is one of growth as the Company expanded through acquisitions and the construction of its own networks across the world's largest country and, in recent years, the fast-growing economies of the Commonwealth of Independent States. Present in the Russian market for more than 12 years, the Company was one of the first Russian companies to conduct an initial public offering. Below is a brief history of MTS' pioneering growth and entry into new markets.

1993 Mobile TeleSystems was founded as a Closed Joint-Stock company in October 1993 by a consortium led by Moscow City Telephone Network (MGTS), Deutsche Telekom (through its T-Mobile subsidiary), Siemens and some smaller shareholders. At the time, MGTS and its Russian partners held 53% of the new company's shares, with Deutsche Telecom and Siemens holding the remaining 47%.

1994–1997 In 1994 MTS launched GSM services in Moscow. In 1996, JSFC Sistema acquired a majority stake in MTS while Deutsche Telecom bought out Siemens' shares in the Company. In 1997, the Company began its expansion outside of the capital, acquiring licenses in Tver, Kostroma, and the Komi Republic.

1998–1999 In 1998, MTS bought a competitor, Russian Telephone Company (RTK), and acquired licenses for key Central Russian regions such as Smolensk, Pskov, Kaluga, Tula, Vladimir, and Ryazan. Through its investment in the company ReKom, MTS was able to build networks in Bryansk, Kursk, Orlov, Lipetsk, Voronezh, and Belgorod regions. A further agreement with the Rosiko Company allowed MTS to develop its GSM-1800 standard network in 17 regions in Central Russia and 11 in the Urals.

Despite the August 1998 financial crisis, MTS continued to expand its presence across Russia to become a truly national mobile operator. In March 2000, as a result of the merger of MTS CJSC and RTK CJSC, Mobile TeleSystems Open Joint Stock Company (MTS OJSC) was created.

2000–2001 On June 30, 2000, MTS carried out a successful initial public offering (IPO), only the second ever carried out by a Russian company, of Level-III American Depositary Receipts (ADRs) on the New York Stock Exchange (NYSE). The IPO sent a clear signal of renewed investor confidence in Russia's resurgent economy and belief in the attractive prospects for the Russian mobile telephony market.

The funds raised by the IPO were directed, in part, toward further geographic expansion. During the same year, MTS expanded its network into Amur and Yaroslavl regions as well as the Republic of Udmurtia.

During 2001, the Company's regional expansion across Russia continued with its entry into seven more Russian regions. MTS also acquired a strong foothold in Russia's North-West region with the acquisition of Telecom XXI. The Company entered the St. Petersburg market in December of that year.

2002–2003 In April 2002, MTS acquired the largest mobile telephony operator in the South of Russia, Kuban GSM and in the same year acquired another large company in the area, Don-Telecom, further strengthening its position in this strategically important region. At the same time the Company built networks in Perm and Chelyabinsk, bolstering its presence in the Urals.

The October 2002 acquisition of the company Bit allowed MTS to significantly expand its geographic presence and provided the Company with licenses for GSM-900 standard services in Tuva, Sakhalin, Chukotka Autonomous Okrug and the Republic of Kalmykia. Also in 2002, MTS launched networks in Murmansk, Tambov, Arkhangelsk, and Nenets Autonomous Okrug, Vologda, Tyumen, the Republic of Karelia, and Altai Republic.

In 2002, MTS expanded outside of Russia for the first time, establishing a network in Belarus through a 49% participation in Joint Venture MTS Belarus. In 2003, the Company entered the large and fast-growing Ukrainian market, completing the 100% acquisition of number one Ukrainian mobile operator Ukrainian Mobile Communications (UMC).

In November 2002, MTS launched its JEANS prepaid billing brand across Russia. JEANS would quickly become the pre-eminent prepaid cellular brand in Russia.

At the same time the company continued its expansion in Russia's regions, acquiring a controlling shareholding of the largest operator in Tatarstan, TAIF-Telcom. It also obtained 100% shareholdings in three key regional operators: Sibchallenge, Tomsk Cellular, and MarMobile GSM. In addition, MTS acquired shareholdings in Primtelefon, Astrakhan Mobile and Volgograd Mobile. The company also expanded its own-built network with commercial launches in Orenburg and Saratov regions.

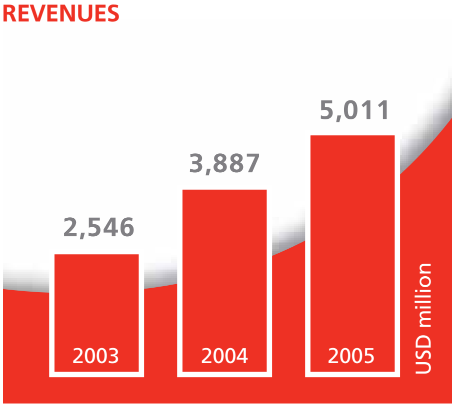
2004 In July 2004, MTS entered Uzbekistan, acquiring Uzdunrobita, the country's largest mobile operator. With a population of 25.2 million, mobile penetration of 1.5% and fixed-line penetration of 7.5%, Uzbekistan represents a key long-term growth prospect for the Company.

During 2004, the Company launched networks in Samara, Irkutsk, Ulyanovsk, the Republic of Buryatiya, Kamchatka Oblast, the Republic of Chuvashia, Stavropol, and the Republic of Mordovia. In addition, MTS acquired Sibintertelecom in Siberia and Gorizont RT at a privatization in Yakutia.

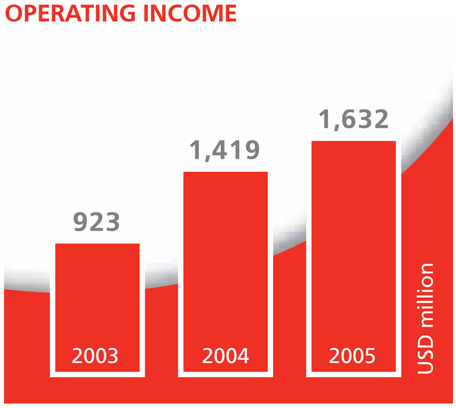
SIMPLY **MTS**

MTS AT A GLANCE

REVENUES



OPERATING INCOME



CONSOLIDATED STATEMENT OF OPERATIONS DATA

USD million	2005	2004	2003
Revenues	5,011.0	3,887.0	2,546.2
Operating income	1,632.0	1,419.1	922.6
Operating income margin	33%	37%	36%
Net income	1,126.4	987.9	517.2
Net income margin	22%	25%	20%

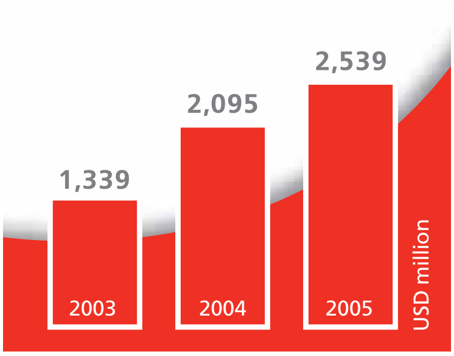
CONSOLIDATED CASH FLOW DATA

USD million	2005	2004	2003
Cash provided by operating activities	1,797.4	1,711.6	966.0
Cash used in investing activities	(2,452.1)	(1,543.2)	(1,910.1)
(of which capital expenditures)	(2,181.4)	(1,358.9)	(958.8)
Cash provided by financing acitivities	461.5	10.8	997.5

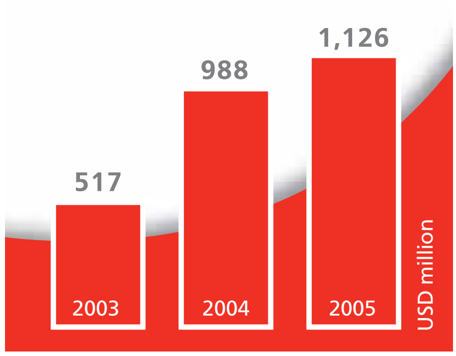
CONSOLIDATED BALANCE SHEET DATA (END OF PERIOD)

USD million	2005	2004	2003
Cash, cash equivalents and short-term investments	106.3	347.5	335.4
Property and equipment, net	4,482.7	3,234.3	2,256.1
Intangible assets, net	1,439.4	1,208.1	1,015.8
Total assets	7,545.8	5,581.2	4,225.4
Total debt including current portion	2,850.6	1,937.1	1,660.3
Total liabilities	4,220.9	2,995.8	2,453.8
Total shareholders' equity	3,294.1	2,523.3	1,723.9

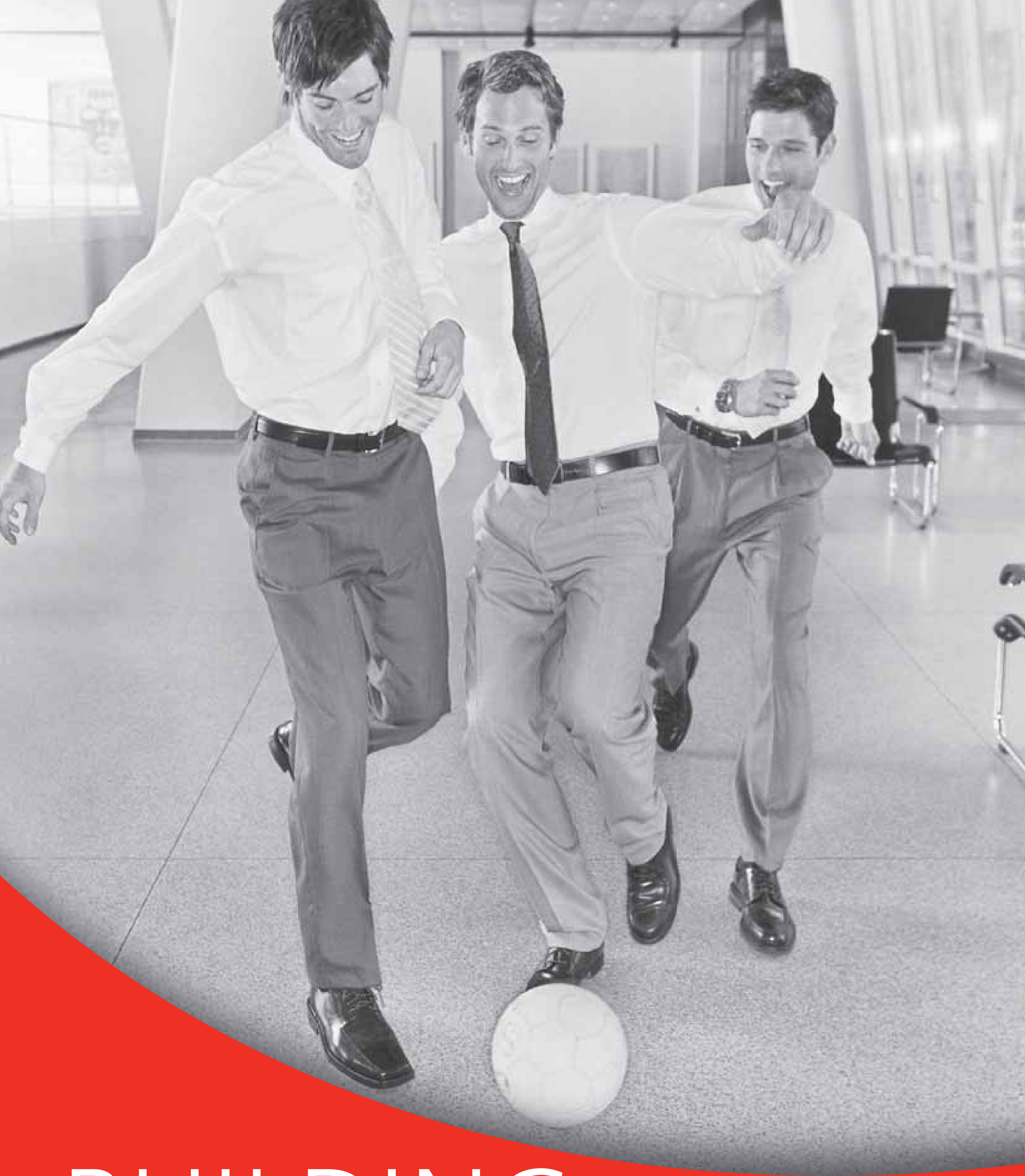
OIBDA



NET INCOME



Subscribers at close of year (millions)	2005	2004	2003
Total consolidated subscribers at close of year	58.19	34.22	16.72
Russia	44.22	26.54	13.37
Moscow and the Moscow region	10.18	7.52	4.94
St. Petersburg and the Leningrad region	2.45	1.82	1.18
Other Russian regions	31.58	17.20	7.25
Ukraine	13.33	7.37	3.35
Uzbekistan	0.58	0.31	-
Turkmenistan	0.07	-	-
Belarus joint venture	2.13	1.21	0.46
ARPU (US$)	**2005**	**2004**	**2003**
Russia	8	12	17
Turkmenistan	-	-	-
Ukraine	10	13	15
Uzbekistan	16	-	-
Belarus	11	12	-
SAC (US$)	**2005**	**2004**	**2003**
Russia	19	21	26
Turkmenistan	-	-	-
Ukraine	14	19	32
Uzbekistan	4	-	-
Belarus	15	14	-
MOU (minutes)	**2005**	**2004**	**2003**
Russia	128	157	144
Turkmenistan	-	-	-
Ukraine	117	114	97
Uzbekistan	433	-	-
Belarus	433	417	-
CHURN	**2005**	**2004**	**2003**
Russia	20.7%	27.5%	47.3%
Turkmenistan	-	-	-
Ukraine	21.8%	15.8%	23.8%
Uzbekistan	59.7%	-	-
Belarus	17.7%	24.3%	-
Total number of employees at close of year	27.668	23.385	19.555



BUILDING **NETWORKS**

HIGHLIGHTS OF 2005

JANUARY "The Virtual World of the Russian Museum", sponsored by MTS, opens at the Russian State Museum in Moscow, marking the 250th anniversary of Moscow State University (MGU). The multimedia project provides a platform for Russia's cultural treasures both in Russia and worldwide.

FEBRUARY MTS launches the "MTS-Search" internet portal, as the Company pioneers the use of Location Based Services (LBS) in Russia that provide tailored news and information based on a user's geographic location.

In the same month, MTS receives an award in the mobile telephony category in the Russian "National Trademark" competition, based on polling of consumers throughout Russia.

MARCH Norilsk Nickel, one of Russia's largest companies, selects MTS as its exclusive cellular provider for its operations in Norilsk.

APRIL MTS launches MTS-Team, a special tariff program oriented toward small businesses and the small office/home office (SOHO) segment as the Company stregthens its leadership across the corporate segment.

In the same month, the leading U.S. business journal Forbes listed MTS among the world's largest 2,000 businesses.

MAY MTS was added to the Morgan Stanley Capital International Emerging Markets Index (MSCI EM), effective May 31, 2005. According to MSCI, more than USD3 trillion in capital is benchmarked to its indices globally. The addition reflects MTS' importance as a key Russian equity outside of the traditional oil and gas sectors.

The Company announced a return of profit to shareholders with a dividend recommendation of RUR5.75 per ordinary share (approximately USD1.03 per ADR) or approximately 40% of its net profit under U.S. GAAP.

In the same month MTS expanded its network to the Republic of Kalmykia.

JUNE MTS announced acquisition of an additional 24% of its Gorizont RT subsidiary, increasing its ownership to 100% as part of a long-term strategy of consolidating the Company's ownership of its subsidiaries. MTS had acquired a 76% stake in the company in a privatization tender in November 2004. The company is a market leading GSM mobile telecommunications operator in the Republic of Sakha in the Russian Far East.

Also in June, MTS entered the Turkmenistan market for the first time, acquiring a controlling 51% stake in Barash Communication Technologies, Inc., (BCTI), a U.S. company that is the leading mobile telecommunications operator in the country. In mid-2005 BCTI had a 97% market share in Turkmenistan and held GSM-900/1800 and AMPS licenses for the entire territory of the country, covering approximately 6.6 million people.

On June 30, 2005, the Company marked its fifth anniversary as a NYSE-listed equity by ringing the closing bell at the NYSE. During its first five years as a NYSE-traded company, MTS' market capitalization grew from USD2 billion to USD13 billion, while the total number of subscribers grew from around 500,000 to approximately 42 million over the same period.

JULY In the beginning of July, the Company announced the merger of eight of its 100%-owned subsidiaries into MTS: Telecom XXI, Kuban-GSM, Digital Network of Udmurtia, Dontelecom, MTS-Barnaul, MTS-Nizhny Novgorod, Telecom-900 and Amur Cellular Communications. The merger represented an important step in the Company's strategy of streamlining the structure and management of its regional operations while creating synergies across the entire group.

SEPTEMBER The Company announced the appointment of Mikhail Shamolin as Vice President for Sales and Client Services. Tatyana Yevtushenkova was named Vice President for Strategy and Development.

In the same month, Deutsche Telekom sold its remaining 10.1% stake in the Company. The sale represented the successful exit of the company from MTS and the conclusion of a 12-year partnership between Deutsche Telekom and MTS' Russian shareholders.

OCTOBER In October, MTS launched its network in the Jewish Autonomous Oblast in Russia's Far East.

NOVEMBER MTS announced its entry into three regions in Russia's North Caucasus: Ingushetia, Karachay-Cherkessia and Kabardino-Balkaria.

As part of its ongoing management optimization program, the Company announced the appointment of Grzegorz Esz, formerly a senior executive at ERA, Poland's leading GSM provider, as deputy chief marketing officer.

DECEMBER In December, MTS announced the full-scale launch of its new macro-regional contact centers. By consolidating more than 50 call centers into just 10, the program introduced new technology while ensuring MTS provides all of its corporate and private clientele with a uniformly excellent standard of customer service.

In the same month, MTS announced a project for the wide-scale deployment of MTS-branded Wi-Fi high-speed wireless internet access, with an initial launch of 60 wireless hot spots in convenient locations across Moscow, with plans to deploy 300 additional hot spots across Moscow in 2006.

The month also saw MTS acquire Bitel, Kyrgyzstan's leading mobile telephony provider. Due to the seizure of Bitel's office after the purchase, which the Company views as illegal under local and international law, MTS has been involved in litigation and other efforts to regain operational control of Bitel.

At the end of 2005, MTS was present in 83 of Russia's 88 regions and remained the Russian market leader. The Company also had market leading positions in Ukraine, Uzbekistan, and Turkmenistan, as well as in Belarus through its 49%-controlled unconsolidated associate. The Company had 58.19 million subscribers[1] at year end, making it one of the world's largest mobile providers in terms of the total number of subscribers.

EVENTS AFTER THE REPORTING PERIOD

At the Company's extraordinary general meeting (EGM) on March 28, 2006, the Company's shareholders elected seven directors to MTS' Board of Directors: Alexey Buyanov, senior vice president, Sistema; Alexander Gorbunov, chief of the strategy and development, Sistema; Vladimir Lagutin, member of the Board of Directors of Sistema and Sistema Telecom; Sir Peter Middleton GCB, independent director; Helmut Reuschenbach, independent director; Sergey Schebetov, general director, Sistema Telecom; and Vassily Sidorov, president and CEO of MTS.

A meeting of the Board the same day appointed Sergey Schebetov as chairman and Vladimir Lagutin as deputy chairman of MTS' Board of Directors.

In April 2006, following Mr. Sidorov's resignation, Leonid Melamed was named acting president and CEO of MTS. A veteran business leader with more than 100 publications to his name, Mr. Melamed joined MTS from the leading Russian insurance company ROSNO, where he served as general director and chairman of the Executive Board. His appointment as president and CEO was subsequently approved at a vote at an extraordinary general meeting in June 2006.

Also in April, Vsevolod Rozanov was named vice president and chief financial officer. Prior to joining MTS, Mr. Rozanov served as deputy general director of Comstar-United TeleSystems.

On April 21, MTS signed an agreement to attract USD1.33 billion through a syndicated loan. The loan was provided by a range of international banks, including the Bank of Tokyo-Mitsubishi UFJ Ltd., Bayerische Landesbank, HSBC Bank plc, ING Bank N.V., Raiffeisen Zentralbank Oesterreich AG and Sumitomo Mitsui Banking Corporation Europe Limited.

In May, MTS launched its new brand, the distinctive egg logo featured throughout this Annual Report, and immediately began re-branding its advertising, storefronts and promotional materials. In June, at the extraordinary meeting of shareholders, Leonid Melamed was confirmed as President and chief executive officer of MTS.

Also in June, at the annual general meeting of shareholders (AGM), the Board of Directors approved dividend payments in the amount of USD562 million, or roughly USD1.40 per ADR. In addition, Leonid Melamed, President and CEO of MTS, accordingly took his seat on the Board of Directors.

In July, MTS acquired Dagtelecom, a GSM-900 operator in Dagestan. In August, the Board of Directors approved both MTS' new corporate direction and a new group management structure, both of which the Company will elaborate upon in 2006 and beyond.

[1] See page 79 for definition of Subscriber.

DEVELOPING **OPPORTUNITIES**

LETTER TO SHAREHOLDERS

Dear Shareholders,

We are pleased to present you MTS' Annual Report for 2005, a year in which we reinforced our leadership positions in our home markets, while setting the stage for future growth. At year end 2005, MTS could boast over 58 million subscribers and a total license area that covers over 230 million people, placing it squarely among the world's leading mobile phone operators.

The year 2005, though successful for the company, also marked a period of transition for MTS. The year marked a conclusion of our company's extensive development in the Russian marketplace, where we sought first and foremost to grow absolute subscriber numbers and extend our network throughout Russia from the Baltic Sea to the Pacific Ocean.

The year also marked a beginning as we consolidated our operations in Russia, dividing our markets into 10 distinct macro-regions, which each bear P&L responsibility. In addition, we continue to innovate within Russia as we introduced new products and services.
Russia is a quickly maturing market; penetration reached 87% in 2005, and we expect the figure to exceed 100% by yearend 2006. Ukraine is not far behind with 64% penetration, while the market will reach full nominal saturation in 2006. These realities compel us to focus on cultivating our subscribers in as much as acquiring new subscribers by encouraging greater usage of our products and services.

Of paramount importance in such competitive environments is bringing new value-added products and services to market. We witnessed value-added services (VAS) grow from USD430 million in 2004 to USD650 million in 2005, a 51% increase. This is a strong indication that VAS will be a large driver of our business moving forward as our customers look to evolve their mobile phone experience from basic voice to more data-driven products. Looking ahead, we see considerable potential not only digital content, such as music and video, but also digital services that customers can similarly access from their handsets, including mobile banking, insurance services and mobile payments.

Elsewhere, beyond Russia and Ukraine, we continue to examine opportunities in CIS markets and beyond where low mobile and fixed-line penetration offer prospects for long-term growth. The CIS is our home, and we consider expansion into its markets to be our company's number one priority. Our presence in six of the countries of the CIS give us the largest footprint in the region, while our experience managing growth in diverse markets, ranging from virtually no penetration to nearly full penetration, provides us with competitive advantages in developing nearby markets. Coupled with the Company's strong balance sheet and financial performance, we are confident that the company possesses the resources and capabilities to take advantage of market opportunities as they emerge.

We are pleased with the Company's financial performance for a year which witnessed solid growth in both the top and bottom lines. Revenues grew by 29% to USD5.011 billion. In real terms, revenue increased by over USD1 billion, an amount unrivaled by our peers. Operating income before depreciation and amortization (OIBDA[1]), a key non-GAAP metric by which we are often compared to our peers, grew 21% to USD2.539 billion. Net income increased by 14% to USD1.126 billion, a return that enabled the Board of Directors to approve a USD562 million dividend payout to our shareholders[2]. We added more than 24 million subscribers to the Company's consolidated subscriber base in 2005 and over eight million more in the first six months of 2006. Our market share in Russia remains steady at just over 35%[3].

In Ukraine, our UMC operation remains the market leader in spite of a significant increase in competition within the market. New licenses and increased M&A activity brought two new operators into the market, though UMC nonetheless was able to post strong revenue and earnings growth. In Uzbekistan, our subsidiary Uzdunrobita maintained its leading 55% market share as the market begins its development.

In 2005, we entered the Turkmen market, acquiring Barash Communications Technologies Inc., a GSM 900/1800 operation based in Ashgabat. At the time of the purchase, Turkmenistan, with a mere 1% penetration level and a population of 6.6 million, clearly represented a tantalizing market with prospects for sustained, long-term growth. By year's end, BCTI could boast a 74% market share, demonstrating a firm leadership position.

Expansion in the CIS is not without risk, as demonstrated by events surrounding our acquisition of Bitel in Kyrgyzstan in December 2005. On behalf of the Board of Directors and executive management, we would like to take the opportunity to reaffirm our position regarding our ownership of Bitel. The acquisition was completed after proper due diligence and the transaction was carried out in accordance with both international and Kyrgyz legislation and norms. We will continue to defend our ownership in the courts in the appropriate jurisdictions.

The liquidity of our stock increased in 2005 with the sale by T-Mobile of its remaining 10,1% stake in the Company in September. MTS was also added to the Russian Trading System (RTS) index in March 2006 with a 5.7% weighting and we see this move as further enhancing the stock's overall liquidity.

In recent months our management team and the composition of the Board of Directors has altered significantly. This reflects alterations in the Company's shareholding and a common desire to build upon MTS's more than 12 years of successful development. These changes do not represent a break with the past, rather they reflect the Company's ability to constantly adapt to a fast-moving marketplace.

In addition to a new chairman and deputy chairman of the Board and a new president and CEO, we have made some important additions to our management team in recent months. We appointed a new vice president and chief marketing officer, Grzegorz Esz, and a new head of marketing, Garrett Johnston, both of whom boast extensive experience in worldwide telecom marketing, and named a new vice president for corporate communications, Andrei Terebenin, who formerly ran one of Russia's top five public relations agencies. Likewise, in spring 2006, Vsevolod Rozanov, a 10-year veteran of telecom finance, joined as chief financial officer.

We remain committed to the principles of good corporate governance and take our role as corporate citizen very seriously in every market of our operations. We believe that this is simply good business: a transparent and lean management structure is more efficient and can react more rapidly to change, while the support of culture and a helping hand to the disadvantaged help foster a wealthier and more stable society with an appetite for our cutting edge products.

Our support in 2005 of the Virtual Russian Museum, a multimedia showcase of Russian cultural treasures made accessible through 21st century technology to people across Russia is an example of cutting edge technology working to preserve Russia's rich heritage.

Continued growth and optimizing our business practices will be our focus in 2006 and beyond. Over the course of the year we will be announcing further steps aimed at preserving our market leadership in Russia and the CIS. These steps will continue to build upon the achievements made in 2005. On behalf of the Board of Directors, the executive management and all of the employees of MTS, we thank you for your continued support.

Sincerely,

Sergey D. Schebetov
Chairman of the Board of Directors, MTS

Leonid A. Melamed
President and chief executive officer, MTS

[1] See pages 78 and 79 for definitions and reconsolidation of OIBDA and OIBDA margin to their most directly comparable US GAAP financial measures.

[2] For 2005, MTS witnessed a return on invested capital (ROIC) at 38.2%. See page 79 for definition of return on invested capital.

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

BOARD OF DIRECTORS

The following section reflects the composition of the Board of Directors of Mobile TeleSystems following the annual general meeting of shareholders (AGM) on June 23, 2006.

SERGEY SCHEBETOV
Chairman of the Board, non-executive director

Mr. Schebetov has been the general director of Sistema Telecom since January 2006.

Mr. Schebetov was born in 1966. In 1991, Mr. Schebetov graduated from Novosibirsk State University with a major in quantum optics. He graduated with an MBA from Stanford University Business School (US) in 1994.

Mr. Schebetov previously served as first deputy general director of Sistema Telecom from April 2005. In June 2001, he was named head of the department for corporate development of JSFC Sistema. In this capacity he provided leadership in the development of new business strategies for Sistema's high-technology group companies. From 1999 to 2001, he was the director for development of Integrum-Techno and he also worked in a number of high-tech companies in Russia and the US. From 1997 to 1999 he was the vice president of the corporate finance department at ATON Capital Group. During the period 1994 to 1996, Mr. Schebetov worked as a consultant in the Russian office of global consultancy firm McKinsey and Company.

VLADIMIR LAGUTIN
Deputy chairman of the Board, non-executive director

Mr. Lagutin has served as deputy chairman of the Board of Directors of MTS since March 2006.

Born in 1947, Mr. Lagutin holds a doctorate in technical sciences from the National Electro-Technical Communications University. In 1992, he graduated from the Fuqua Business School at the Duke University (USA). Mr. Lagutin joined the Moscow City Telephone Network (MGTS) in 1967. At MGTS he rose through the ranks, holding a number of engineering and managerial roles, including chief telephone exchange engineer, chief of the telephone exchange, and deputy general director for economics. Beginning in 1994, Mr. Lagutin served as general director of MGTS. From July 2003 to January 2006, he served as general director of Sistema Telecom. Mr. Lagutin is the author of more than 100 published works, including four monographs. From October 2003 to March 2005, he was chairman of the Board of Directors of MTS.

ALEXEI BUYANOV
Non-executive director, member of the Audit Committee

Mr. Buyanov was elected to the Board of Directors of MTS in June 2003.

Born in 1968, Mr. Buyanov graduated from the Moscow Physical-Technical Institute (MFTI) in 1992 with a degree in applied physics and mathematics. Mr. Buyanov worked at Sistema from 1994 to 1995 in property management. In 1995, he was appointed the head of department of Sistema-Invest and later became vice president of Sistema-Invest. Mr. Buyanov served as vice president of MTS from 1998 to 2002. In July 2002, Mr. Buyanov was appointed vice president of Sistema to run the Department for Financial Restructuring. He has served as senior vice president of Sistema since September 2002, heading the company's financial and investment group.

ALEXANDER GORBUNOV
Non-executive director

Mr. Gorbunov is the head of the Corporate Development Department of Sistema.

Born in 1967, Mr. Gorbunov graduated from the Moscow State Physical Engineering Institute in 1992, with a degree in nuclear physics. He earned an MBA degree from the Harvard Business School in 1999.

Mr. Gorbunov was appointed the head of the Corporate Development Department of AFK Sistema in July 2005. Previously, he held the position of director of strategy at MTS from 2003. From 2002, he headed the Strategic Analysis and Planning Department of Sistema Telecom. Prior to this, Mr. Gorbunov was employed by the Moscow and Boston offices of global consultancy firm Bain & Company.

HELMUT REUSCHENBACH
Non-executive independent director, chairman of the Audit Committee

Mr. Reuschenbach was elected to the Board of Directors of MTS in 2004 as an independent director.

Mr. Reuschenbach was born in 1948 and graduated in business and administration from the Fachhochschule des Landes Rheinland-Pfalz in Mainz, and in macroeconomics from the Johannes-Gutenberg-University in Mainz.

He is currently an independent financial advisor.

Mr. Reuschenbach previously was a director at Lazard & Co. Frankfurt, Germany, until the end of 2004. He joined global investment bank Lazard, in January 2001 after serving at Deutsche Telekom as treasurer and senior executive vice president for finance for six years. Mr. Reuschenbach led the privatization of Deutsche Telekom, one of the largest German IPOs during the 1990s. He was also responsible for a number of capital markets transactions within the group. These included the IPOs of several subsidiaries and several global bond issues. Before 1994, he was the CFO and a member of the board at Mercedes-Benz S.A. in Belgium. At the same time he headed the Daimler-Benz Coordination Center and Daimler-Benz Financial Company S.A. as CEO. From 1989 to 1993, Mr Reuschenbach was VP for Finance at Daimler-Benz S.A. in Stuttgart. Earlier he served as director of finance at AEG Aktiengesellschaft in Frankfurt, director of finance and administration at AEG Italiana S.p.A. in Milan, Italy, and corporate finance manager at AEG-Telefunken Aktiengesellschaft in Frankfurt.

SIR PETER MIDDLETON GCB
Non–executive independent director, member of the Audit Committee

Sir Peter Middleton was elected to MTS' Board of Directors in June 2005 as an independent director

Born in 1934, Sir Peter is the chairman of Camelot Group plc, president of the British Bankers Association, chairman of the Barclays Group Asia Pacific Advisory Committee, deputy chairman of United Utilities, chairman of Sheffield Urban Regeneration Company (Sheffield One), chairman of the Centre for Effective Dispute Resolution (CEDR) and chairman of Reyniers & Co. Sir Peter currently serves as a member of the Advisory Board of Sistema.

LEONID MELAMED
President and chief executive officer

Dr. Melamed was born in 1967 in Moscow. He is a graduate of the Sechenov Moscow Medical Academy and holds a PhD in Medicine.

Dr. Melamed joined insurance company ROSNO when it was founded in 1991. From February 1992, he served as director of ROSNO's Centre for Medical Insurance. From mid-1992, he held the position of deputy chairman of the Management Board and from 1993, first deputy chairman of the Management Board. From September 1997, he served as first deputy director general and from March 2001, as first deputy director general and executive director. He held the position of director general and chairman of the Management Board of ROSNO from September 15, 2003 until he joined MTS in April 2006. He is a member of ROSNO's Board of Directors. In 2004, Dr. Melamed was elected chairman of the Expert Council for Insurance Legislation which is part of the State Duma (Parliamentary) Committee on Credit Organizations and Financial Markets.

EXECUTIVE MANAGEMENT

The following section on the executive management of Mobile TeleSystems reflects changes to the composition of senior management announced on April 13, 2006, following a meeting of the Board of Directors. The appointment of Dr. Melamed as president and CEO was confirmed at an Extraordinary General Meeting of Shareholders on June 14, 2006.

LEONID MELAMED
President and chief executive officer

Dr. Melamed was born in 1967 in Moscow. He is a graduate of the Sechenov Moscow Medical Academy and holds a PhD in Medicine.

Dr. Melamed joined insurance company ROSNO when it was founded in 1991. From February 1992, he served as director of ROSNO's Centre for Medical Insurance. From mid-1992, he held the position of deputy chairman of the Management Board and from 1993, first deputy chairman of the Management Board. From September 1997, he served as first deputy director general and from March 2001, as first deputy director general and executive director. He held the position of director general and chairman of the Management Board of ROSNO from September 15, 2003 until he joined MTS in April 2006. He is a member of ROSNO's Board of Directors. In 2004, Dr. Melamed was elected chairman of the Expert Council for Insurance Legislation which is part of the State Duma (Parliamentary) Committee on Credit Organizations and Financial Markets.

VSEVOLOD ROZANOV
Vice president, chief financial officer

Mr. Rozanov was born in 1971. He is a graduate of the Lomonosov Moscow State University, majoring in economics.

From 1993 to 2001, Mr. Rozanov held various consulting positions at Bain & Company, Inc. in Moscow, London and Stockholm. He joined MTU-Inform in 2002 as Deputy General Director for Economics and Finance. In 2004, Mr. Rozanov was appointed Deputy General Director for Economics and Finance of Comstar-United TeleSystems and he coordinated Comstar-UTS's IPO on the London Stock Exchange in 2006. He joined MTS in April 2006.

TATIANA EVTUSHENKOVA
Vice president, strategy and corporate development

Ms. Evtushenkova was born in 1976.

From December 1999 until October 2002, she served as the director of the Department of Investments at Sistema Telecom. Ms. Evtushenkova joined MTS in October 2002.

MIKHAIL SHAMOLIN
Vice president, sales and customer service

Mr. Shamolin was born in 1970.

He worked at McKinsey & Co. from 1998 to 2004. From 2004 to 2005 he worked at Interpipe Corp. (Ukraine) as managing director of the Ferroalloys Division. He joined MTS in 2005.

YURY GROMAKOV
Vice president, technology and development

Mr. Gromakov was born in 1946.

From 1973, he worked in various state enterprises in the telecommunications field of the military-industrial complex. He joined MTS in 1994.

SERGEY ASLANYAN
Vice president, chief information officer

Mr. Aslanyan was born in 1973.

He worked at PriceWaterhouseCoopers from 1999 to 2001 and from 1997 to 1999 at Coopers & Lybrand. Mr. Aslanyan worked at TNK-BP management as the deputy director of information technology from 2001 to 2003. He joined MTS in 2003.

GRZEGORZ ESZ
Vice president, chief marketing officer

Grzegorz Esz was born in 1972.

He graduated from the Faculty of Marketing and Management at the Warsaw University of Technology and earned an MBA from London Business School.
He served as the Deputy Chief Marketing Officer at ERA Company, the largest GSM operator in Poland. Mr. Esz has worked in the IT and telecommunications fields for ten years and joined MTS in 2005.

PAVEL BELIK
Vice president, security

Pavel Belik was born on April 20, 1966 in the city of Shcherbinka, Moscow Region.

In 1987 Mr. Belik graduated from Orel High Command Telecommunication School with qualification as an engineer and a specialty in radio relay and troposphere communication systems. From 1987 to 1992 Mr. Belik served as a officer in the signal corps. Later he served in military counterintelligence roles with the Federal Intelligence Service and Personal Security Agency of the FSB. In 1999, Mr. Belik graduated from the FSB Academy of Russian Federation with a degree in law.

Mr. Belik was decorated with state award – medal "For Services to Motherland, 2nd Grade." In February 2005 he joined MTS in the role of Director of the Security Department, Macro-Region Moscow, and was named Vice President, Security, in October 2005. Mr. Belik is married and has a daughter.

ANDREI TEREBENIN
Vice president, corporate communications

Mr. Terebenin was born in 1962. He graduated from the Moscow State Institute for International Relations (MGIMO) with a major in international economic relations in 1985.

He worked at the Economics Gazette, Dun and Bradstreet CIS and AIG Rossiya management before joining Treugolnik Porter Novelli Communications Agency in 1999 as a partner. Mr. Terebenin held the position of director general and partner of R.I.M. Porter Novelli Communications from 2003 before joining MTS in January 2006.

PAVEL PAVLOVSKY
Acting vice president, foreign subsidiaries

Pavel Pavlovsky was born in 1969 in Saint Petersburg.

In 1993 he graduated from Leningrad State University and earned his MBA from INSEAD in 1999. Mr. Pavlovsky has worked for eight years in management consulting, at AT Kearny in Moscow from 1995 to 1998 and at London-based Mercer Management Consulting in 2000-2001. From 2002 to 2003, Mr. Pavlovsky worked at Finartis – a private equity fund, and then joined MTS in 2003, since 2005 he oversees its foreign subsidiaries operations.

ADAM WOJACKI,
Chief executive officer, UMC

Adam Wojacki joined UMC in 2001, having left a marketing and sales director position in the largest mobile communications company in Poland – Era GSM. A graduate of the South Australia University, Wojacki began his career as a project manager in Yann Campbell Hoare Wheeler, the largest market research company in Australia. After that, he worked as a marketing manager and a trade representative in the Trade Commission of Australia, then – as a marketing manager in the Polish representation of Sun Microsystems. In 1999, Wojacki moved to Era GSM. His hobbies include mountain skiing, tourism and literature.

SVETLANA SHAMZON
Director, MR Moscow

Mrs. Shamzon graduated from the Moscow State Energy Institute in 1983. Until 1998, she worked at MGTS as the Head of Automated Systems Department of Miussky Telephone Node. In 1998 she moved to SONET Cellular Network, first as the Commercial Director and eventually being named Chief Executive Manager. Mrs. Shamzon joined MTS in 2004 and serves in the position of Macro-Region (MR) Moscow Director.

MARKET TRENDS

RUSSIAN MARKET TRENDS

Maturing Marketplace
The Russian mobile telephony market has enjoyed rapid growth as MTS and other operators have expanded rapidly in recent years, both in the country's largest markets, Moscow and St. Petersburg, and in the regional markets. At year-end 2005, the total number of customers, as measured by the number of SIM cards, was approximately 125.8 million, up 70% year-on-year compared to 2004, although an estimated 25–30% of users have more than one SIM card.

MTS was able to increase its Moscow subscriber base by 25% despite increasing saturation of the market. Penetration in Moscow was estimated at 135% and in St. Petersburg at 118%. Mobile penetration for the country as a whole reached 87%[1]. MTS, along with its rivals, saw ARPU decline in Russia in 2005. This trend is attributable to maturation of the market as new users generally enjoy lower levels of disposable income and use of double SIM cards is expected to continue to grow.

Regulatory Challenges
Other challenges in 2005 and early 2006 potentially include new Russian regulatory legislation, such as Calling Party Pays (CPP), Mobile Number Portability (MNP) and mobile virtual network operator (MVNO) regulations. All three present potential growth opportunities for MTS but also represent possible threats to margins (see table 6.1). The emergence of new MVNOs, for instance, could intensify cost competition.

Rising Incomes
Despite these challenges, a decline in ARPU due to high subscriber growth and reduced expenditure by a larger number of customers is believed to be a relatively short-term effect as the market shifts from a phase of rapid growth in raw subscriber numbers to a phase of increased provision of VAS against a backdrop of strong economic growth and rapid increase in real incomes.

According to the official Rostat statistical agency, average wages in Russia grew by around 10% year-on-year from 2004 to 2005. A study by investment bank Renaissance Capital found that in 2005 Russia's gross domestic product (GDP) per capita amounted to 63% of the corresponding average figure for the Czech Republic, Poland, and Hungary, while Russian ARPU over the same period was only 50% of the level in these countries. MTS' management and independent market analysts believe this gap will narrow considerably in the next few years, eventually reversing a decline in Russian ARPU numbers.

Changing Cost Elements
Other market trends put pressure on the margins of MTS and its rivals in 2005 and early 2006. Mobile operators, in common with virtually all major consumer-oriented companies operating in Russia in recent years, face inflation of cost elements associated with Russia's rapid economic development since 2005. These include increased wage and other personnel costs, real estate costs and rising advertising rates. In particular, recent legislation passed in Russia has reduced the total amount of commercial time permitted in national television broadcasts, while parliamentary elections in late 2007 and presidential elections in early 2008 are expected to further squeeze television advertising rates.

Table 6.1: Potential Impact of Regulatory Changes in Russia

Regulatory initiative	Potential "pros"	Potential "cons"
Calling Party Pays (CPP)	■ Penetration growth ■ ARPU growth	■ Incompatibility of billing systems ■ Difficulties with cash collection ■ Additional CAPEX (due to traffic growth) ■ Unfavorable interconnect regime ■ Pressure on margins
Mobile Number Portability (MNP)	■ Attracts subscribers from other networks	■ Higher churn ■ Additional CAPEX/OPEX
Mobile virtual network operator (MVNO)	■ Additional revenues	■ Additional CAPEX ■ ARPU decline; higher churn
Liberalization of long-distance services	■ Additional revenues	■ Compensation for fixed-line operators

[1] Unless otherwise mentioned, mobile penetration statistics for Russia in the Annual Report are based on information from independent research firm AC&M Consulting.

However, the management of MTS believes a number of trends help mitigate these factors over the longer term. The Company's strategy of optimizing its regional subsidiary structure is expected to help contain the growth in both headcount and real-estate costs incurred. While the growth in the advertising market is a challenge to all players in the market, a maturing market will allow the Company to reach target subscriber groups with smaller-scale, focused advertising aimed at a specific demographic and geographic profile. These factors will help the Company stabilize margins in the future.

CAPEX Trends

Capital Expenditure (CAPEX) has been high as a percentage of sales for Russian mobile operators as they have expanded into new markets, built networks and integrated the networks of newly acquired regional companies that were often built by different vendors. MTS management and analysts foresee a gradual reduction in CAPEX for all players. While mobile operators require significant investment to deploy new technologies, the continued integration of regional companies and the network's presence in 83 of 88 Russian regions should translate in the future to lower incremental costs for the deployment of many new technologies and services.

MARKET TRENDS IN UKRAINE AND THE CIS

Ukraine

Ukraine's mobile telephony market saw strong growth in 2005 with mobile penetration reaching 64% by the end of the period. Analysts believe the development of the Ukrainian market is approximately 12 months behind Russia. Therefore ARPU is expected to decline over the short term because additional customers added in a maturing market will generally be lower income consumers. Over the medium to longer term, however, ARPU should begin to grow again as average incomes rise and customers are able to spend more on an increasing array of value-added services.

MTS' Ukrainian subsidiary Ukrainian Mobile Communications continued to lead the market in 2005 although new market entries are expected to intensify competition in 2006. Movement on long-term regulatory issues, such as the privatization of fixed-line monopoly Ukrtelecom and the granting of Universal Mobile Telecommunications System (UMTS) licenses to other players could impact the market in 2006 and beyond.

Trends in Other CIS Countries

With a combined population of just under 90 million and strong GDP growth, the CIS countries (excluding Russia and Ukraine) represent a long-term growth opportunity. Low levels of fixed-line and mobile penetration (see Table 6.2) have created considerable pent-up demand for mobile services and rapid growth and continued market entry by international players are likely in the coming few years.

MTS entered Uzbekistan in 2004 and Turkmenistan in 2005. It acquired incumbent Bitel in Kyrgyzstan in December 2005, although its offices were subject to an illegal seizure. The episode underlines the risk of doing business in the CIS. The 11 CIS markets outside of Russia and Ukraine will contribute to an ever larger share of MTS' revenues while attracting Russian and international competitors in the next few years.

Table 6.2: Mobile & Fixed–Line Penetration in the CIS

Country	Population (mln)	Penetration		MTS presence
		Fixed-Line	Mobile	
Russia	143.2	25%	87%	Yes
Ukraine	47.5	21%	64%	Yes
Uzbekistan	26.5	7%	4%	Yes
Kazakhstan	15.1	16%	37%	No
Belarus	9.8	32%	41%	Yes
Azerbaijan	8.4	13%	25%	No
Tajikistan	6.9	4%	5%	No
Turkmenistan	6.6	6%	1%	Yes
Kyrgyzstan	5.1	8%	10%	Yes
Georgia	4.4	21%	28%	No
Moldova	3.6	21%	29%	No
Armenia	3.2	15%	20%	No

Source: MTS, AC&M-Consulting; data as of December 31, 2005

STRATEGY

MTS' group strategy is focused on leadership, growth and value creation. From primary markets in Russia and Ukraine to the new opportunities the Company has developed throughout Central Asia, MTS employees are dedicated to achieving leadership positions in each of our markets of operation by offering high-quality and high-value products to our customers.

MTS realizes that it is a major operator in an industry that is constantly fluctuating in the face of new technologies, evolving markets and changing regulatory environments. In Russia and Ukraine, MTS management envisions that the year 2006 will witness the nominal maturation of our markets as mobile phone penetration levels reach or exceed 100%. At the same time, the Company must balance an operational portfolio that includes markets in Turkmenistan and Uzbekistan that boast penetration levels of merely 10-20%, and an unconsolidated quickly developing operation in Belarus.

To best prepare for both our present and future, MTS adopted a 3+1 Strategy in 2006, which calls for:

1. Strengthen our leadership in Russia through revenue stimulation, cost efficiency and process excellence;
2. Growth and synergies throughout the CIS by increasing our network in the region, achieving revenue leadership in our markets and implementing operational consistency throughout our operations;
3. Create additional value in growth markets through a deliberate M&A approach, due diligence in establishing market entry criteria and the build-up of our international group organization and corporate headquarters; and

+1. Seek additional opportunities through vertical and horizontal integration.

To best prepare the company as the markets and industry evolve, MTS adopted a series of initiatives in 2005 to transform our organization into a more efficient, more customer-friendly organization. Management began by evaluating each of our business practices, using both internal know-how and external advisors, to adopt benchmarks for operations and key performance indicators (KPIs) for virtually all areas of operations. Similarly, in one of the Company's boldest decisions, management decided to refresh our brand, adopting the distinctive egg logo consistent throughout the Sistema family of telecommunications companies, as a first step in redefining its approach to marketing and in turn the value proposition the Company offers its customers.

In addition, in August 2006 MTS implemented a new corporate structure and management model, MTS Group. At the heart of the new organization is the corporate center, based in Moscow, which will steer the strategic direction of the company by:

- Evaluating and implementing group investment policy;
- Managing the brand on a Group basis;
- Determining operational and functional KPIs; and
- Creating consistent guidelines throughout the organization governing procurement, IT and network development.

Within the organization, markets will be divided into distinct business units: MTS Russia, MTS Ukraine (as of 01 January 2007) and MTS Foreign Subsidiaries, which will include JV MTS in Belarus, Uzdunrobita in Uzbekistan and Barash Communications Technologies, Inc. in Turkmenistan. These business units will have full P&L responsibility in the markets in which they operate, including accountability for both local marketing and capital expenditures based on strict criteria developed at the group level. This structure will allow us to achieve a degree of economies of scale throughout the organization and enable MTS to offer shared resources such as product development, procurement, information technology and administrative support more efficiently to each of our business units. MTS also aims to leverage synergies through brand value and marketing programs. All the while, the Company will build up its group headquarters, encouraging skill transfers and personnel development to ensure that the experience and capabilities of perhaps its greatest asset – the employees – are institutionalized for the benefit of the entire group and the customers whom MTS serves.

The development of our group structure will also allow us to better find those customers who do not benefit from MTS' products and services. The telecommunications industry is a fast-growth sector; new technologies continuously emerge to challenge the status quo. At the same time, Eastern Europe and Central Asia, MTS' core markets, are quickly developing, while new markets in the Company's core region may open. The group structure will provide the flexibility, resources and capability to take advantage of these new markets and technologies as they emerge, empowering MTS with a distinct competitive advantage to safeguard and enhance its leadership.

LEVERAGING **SCALE**

BUSINESS OPERATING REVIEW

8.1 RUSSIA

MTS maintained its leading position in the Russian marketplace with a 35.1% market share at year-end 2005. By the end of the period, Russian mobile penetration reached 87%. During 2005, the Company added 17.68 million subscribers in Russia, a subscriber growth of 66.6%, reaching 44.22 million total subscribers by the end of the year. Subscriber numbers in the key Moscow and Moscow Oblast and St. Petersburg and Leningrad Oblast markets grew 35.6% and 34.8%, respectively. In Russia's other regional markets, the Company achieved 83.6% in total subscriber numbers during 2005.

As expected, the quarterly dynamic in ARPU in 2005 reflected highest use in the summer months, when Russians travel internationally and make use of summer homes (dachas) without fixed-line telephones. Higher subscriber acquisition costs in the fourth quarter reflect the launch of holiday advertising campaigns. For the year, declining ARPU, also experienced by MTS's rivals, reflected a large increase in the number of mass-market subscribers. Prepaid subscribers (under the JEANS brand) accounted for 94% of gross subscriber additions during the year. For the year, subscriber acquisition costs (SAC) declined from USD21.0 in 2004 to USD18.8 in 2005.

While enjoying strong growth in subscriber numbers, the Company implemented a number of strategic measures aimed at boosting efficiency and improving the overall customer service experience for both corporate and private users.

The Company continued to expand its dealer network in Moscow and Russia's regions, with 26,957 points of sale at year-end 2005. At the same time, the Company reduced dealer commissions and continued to improve its distribution network, with improved productivity and the development of a reinvigorated sales office strategy.

MTS continued to focus on the high ARPU corporate segment with the deployment of a single high-quality service standard for corporate sales across Russia. In addition, the Company launched a campaign aimed at the SOHO (small office/home office) segment. As part of the Company's strategy of integrating its regional businesses, MTS merged eight of its 100%-owned subsidiaries. In addition, more than 50 call centers were consolidated into just 10 to both improve efficiency and ensure uniformly excellent standards of customer service.

Table 8.1a: Russian Subscriber Number Development

Consolidated number of subscribers at end of period (mln)	Dec. 31, 2005	Dec. 31, 2004	Subscriber growth	Subscriber growth %
Russia (total)	44.22	26.54	17.68	66.6
Moscow & Moscow Oblast	10.18	7.51	2.67	35.6
St. Petersburg & Leningrad Oblast	2.45	1.82	0.63	34.8
Other Russian regions	31.58	17.20	14.38	83.6

Table 8.1b: Russia — Quarterly Development of Key Indicators

	FY 2005	Q4 2005	Q3 2005	Q2 2005	Q1 2005	Q4 2004
Russia — total (mln subs)	44.22	44.22	38.87	34.09	30.25	26.54
ARPU (USD)	8.4	7.3	8.9	9.3	9.1	11.2
MOU (minutes)[1]	128	123	130	134	138	164
Churn rate (%)[1]	20.7	5.2	2.9	6.8	6.7	6.3
SAC per gross additional subscriber (USD)[1]	18.8	19.8	18.6	18.4	18.2	19.4

[1] See page 79 for definitions of MOU, Churn and SAC.

EXPANDING **MARKETS**

8.2 UKRAINE AND THE CIS

Ukraine

Year-end mobile penetration levels in Ukraine reached 64% according to AC&M-Consulting, twice the level at the beginning of the year. MTS' Ukrainian subsidiary Ukrainian Mobile Communications (UMC) had a 43.9% market share at the end of 2005. The Company increased its total number of subscribers by 81% during 2005, from 7.37 million to 13.33 million.
In December 2005, the most intensive period for subscriber acquisition during the year, UMC led the market by connecting 1.4 million subscribers, reflecting successful marketing promotions and tariff plan offers ahead of the New Year's holidays. As in Russia, declining ARPU in Q4 2005 reflected the addition of mass-market consumers during the holiday period. Subscriptions to UMC's prepaid tariff plans (under the brand names JEANS and SIM-SIM) accounted for 95% of gross subscriber acquisitions during 2005.

SAC for the full year 2005 decreased to USD13.8 from USD18.6 in 2004 as a result of the Company's efforts aimed at reducing dealer commissions and costs of subsidizing handsets and declined to USD9.4 in Q4 2005 due to the successful subscriber acquisition campaign. During 2005, UMC extended its distribution to over 25,000 points of sale and increased the number of payment points to 10,000.

The Company improved the scale and quality of its network with 1,566 base stations and 147 towers constructed during the year. In addition, the company reorganized its call centers to provide better customer service while reducing headcount and management costs. The successful Q4 2005 marketing campaign focused on UMC's leadership in network quality and coverage.

Uzbekistan

MTS' subsidiary in Uzbekistan, Uzdunrobita, continued healthy subscriber growth, with total numbers up 87% year-on-year to 580.300 at the end of 2005. Mobile penetration doubled from 2% to 4% by the end of the period. Competition increased during the year with VimpelCom's entry. MTS became the first company to build its own dealership network in the country and will rebrand Uzdunrobita as MTS during 2006. A key operational goal for the Company's second full-year as an MTS subsidiary is a reduction of the churn rate.

Turkmenistan

MTS entered Turkmenistan for the first time in June 2005, acquiring Barash Communication Technologies, Inc., (BCTI), a U.S. company and leading mobile phone operator in the country. The acquisition of the remaining 49% was completed in November 2005. BCTI holds GSM-900/1800 and AMPS licenses for the entire territory of the country, covering approximately 6.6 million people. Currently, Turkmenistan has a mobile penetration rate of just 1.5%, a strong untapped demand for mobile services and a loyal subscriber base with a very low churn rate. The Company plans to rebrand BCTI as MTS during 2006. In Q4 2005, BCTI's ARPU was at USD88.4, a decrease from USD89.0 in the previous quarter.

Belarus

MTS is present in Belarus through its unconsolidated MTS subsidiary, Joint Venture Mobile TeleSystems Belarus, which is 49% owned by the company. During 2005, the Company increased its subscriber numbers by 76.03% from 1.21 million to 2.13 million. The company's leading market share remained stable at approximately 51%. The Company had a large share of heavy postpaid customers in 2005. The entry of a new GSM operator, BEST, in December 2005 had no noticeable impact on the business, however the Company felt pressure from rival Velcom in December 2005. The Company will continue to focus on provision of VAS given the relative maturity of the market compared to other emerging CIS peers.

Table 8.2a: Ukraine — Quarterly Development of Key Indicators

	FY 2005	Q4 2005	Q3 2005	Q2 2005	Q1 2005	Q4 2004
Ukraine — total (mln subs, eop)	13.33	13.33	10.94	9.52	8.08	7.37
ARPU (USD)	9.5	9.1	10.8	10.8	10.0	12.4
MOU (minutes)	117	120	132	118	130	127
Churn rate (%)	21.8	6.0	6.2	5.7	5.1	1.7[1]
SAC per gross additional subscriber (USD)	13.8	9.4	15.7	14.2	22.1	15.4

Table 8.2b: Uzbekistan — Quarterly Development of Key Indicators

	FY 2005	Q4 2005	Q3 2005	Q2 2005	Q1 2005	Q4 2004
Uzbekistan — total (mln subs, eop)	0.58	0.58	0.49	0.40	0.35	0.31
ARPU (USD)	16.2	15.9	18.3	17.6	16.8	18.4
MOU (minutes)	433	450	437	432	413	419
Churn rate (%)	59.7	18.2	15.7	13.9	14.2	10.4
SAC per gross additional subscriber (USD)	3.5	4.1	1.8	3.5	5.6	4.7

Table 8.2c: Belarus — Quarterly Development of Key Indicators

	FY 2005	Q4 2005	Q3 2005	Q2 2005	Q1 2005	Q4 2004
Belarus — total (mln subs, eop)	2.1	2.1	1.8	1.6	1.4	1.2
ARPU (USD)	10.7	10.5	11.3	11.3	11.0	12.1
MOU (minutes)	433	450	440	448	410	426
Churn rate (%)	17.7	4.1	4.3	4.7	5.4	5.7
SAC (USD)	14.9	15.5	15.0	14.7	14.0	14.2

Table 8.2d: Turkmenistan — Quarterly Development of Key Indicators[2]

	Q4 2004
Turkmenistan — total (thousand subs, eop)	103.2
ARPU (USD)	88.4
MOU (minutes)	256
Churn rate (%)	1.0
SAC per gross additional subscriber (USD)	14.2

[1] The significant decrease in the quarterly churn rate to 1.7% can be largely attributed to the adoption in Ukraine of the churn policy used by MTS in Russia, whereby prepaid customers are defined as churning after six months of inactivity, rather than the previous three month criteria. Under the previous churn calculation, quarterly churn rate in Q4 2004 was at 7.2%.

[2] Barash Communications Technologies, Inc. (BCTI) was acquired in June 2005.

CORPORATE GOVERNANCE

Mobile TeleSystems is committed to best practice in corporate governance. Since 2000, when the Company listed its Level-III American Depository Receipts (ADRs) on the New York Stock Exchange (NYSE), the Company has sought to adhere to the highest standards of governance. As the second Russian company to ever conduct an IPO on the NYSE, MTS has not only been a practitioner of good governance, but a trend-setter as well.

Internal Control and Compliance

In recent years, compliance with U.S. and Russian securities law complex and costly, but MTS believes that the highest standards of governance are critical to maximizing shareholder value and realizing business goals. Good corporate governance is not an end, but rather a means to develop transparent and efficient management structures. It also ensures that MTS can approach global financial markets to access resources for further development. Transparency enables MTS to reduce investment risk, minimize the cost of capital and increase the overall value of the Company.

As a public company with equity and debt traded on global exchanges, MTS complies with the requirements of a number of jurisdictions: U.S. legislation for foreign private issuers and NYSE rules and regulations for its ADR listing; the UK for its listing on the London Stock Exchange; Germany, for securities listed on the Frankfurt, Berlin, and Munich Stock Exchanges; Luxemburg for its debt securities; and it adheres to Russian laws and securities regulations, including rules regarding MTS shares on the MICEX and RTS exchanges.

New regulations, such as the Sarbanes-Oxley Act (2002), requiring certification and independent audit of Company control over financial reporting, necessitate additional work for management and employees. Nevertheless, the Company aims to meet these new requirements starting with the 2006 annual financial statements, expected to be certified in 2007.

Transparency and Value Reporting

Another critical part of the Company's compliance efforts is information disclosure. The Company's information disclosure efforts include:

- Publication of unaudited and audited financial accounts in both U.S. and Russian GAAP with relevant independent auditor opinions and the company annual report;
- Adherence to disclosure requirements of both Russian and U.S. securities laws as well as rules of the NYSE;
- Timely conference calls to discuss quarterly results or other important corporate events;
- Participation in industry conferences and gatherings; and
- Regular meetings with investors, shareholders and related analysts.

Disclosure enables the Company to engage in an ongoing dialogue with audiences around the world, providing the Company's management with invaluable insights into the markets where MTS operates or may enter. Drawing from this pool of experience enables management to better understand factors directly impacting MTS' business. In addition, MTS has endorsed a series of initiatives that complement its market-leading approach to corporate governance, even as the composition of management and the Board of Directors changes over the years. These initiatives include:

- Code of Ethics: established to help directors, executives and employees identify and address potential conflicts of interest, report any suspected or known violations of internal rules or domestic or international laws and practices;
- Whistle-blower policy: created to provide all employees and third-party representatives with an opportunity to report anonymously any cases of known or suspected fraud or other significant violations or irregularities directly to the Board or its Audit Committee, or to internal audit, or management, for an effective and objective investigation;
- Code of Corporate Conduct: provides guidance on proper and improper examples of corporate behavior, references to MTS' policies and procedures on complex issues;
- Charters and Provisions for the Board of Directors, its committees and the President: these set out a clear division of responsibilities while adding effectiveness and transparency to business and management processes across the Company;
- Charters, policies and procedures governing the Board of Directors' Audit Committee, the Revision (Audit) Commission and Internal Audit and other internal control constituents: these ensure an effective design of the Company's internal control system.

Further information about these initiatives is available on MTS' website.

In recognition of these efforts, in 2004, MTS was named the top Russian company in terms of overall corporate governance at the 2nd Annual IR Russia Investor Relations Awards. In 2005, ratings agency Standard & Poor's (S&P) affirmed its corporate governance score (CGS) for MTS of CGS-7 on a global scale of one to ten. Concurrently, S&P raised MTS' score on the Russian national scale to CGS-7.4 from CGS-7.0.

FINANCIAL REVIEW

This section provides a brief summary of Mobile TeleSystem's financial results for the year 2005. A full discussion of the year's results, including definitions and reconciliation of certain non-GAAP financial measures can be found in Chapter 15 of this report.

Highlights of Financial Results for Full Year 2005
The year 2005 saw strong financial results and growth for MTS. Consolidated revenues grew by 28.9% from USD3,887.0 million in 2004 to USD5,011.0 million in 2005. Operational Income Before Depreciation and Amortization (OIBDA) grew by 21.2% year-on-year, from USD2,094.8 million to USD2,539.1 million. Net income grew by 14% from USD987.9 million to USD1,126.4 million over the same period.

Financial Position
During 2005, cash expenditure on property, plant and equipment amounted to USD1,758.0 million, of which USD1,145.4 million was invested in Russia, USD571.1 million in Ukraine, and USD40.0 million in Uzbekistan. Cash expenditure on intangible assets during the year amounted to USD423.4 million (USD302.5 million in Russia, USD104.6 million in Ukraine, and USD16.3 million in Uzbekistan).

In line with the Company's strategy to expand the geography of its operations, MTS continued to consolidate its operations in Russia and acquire operators in other countries. The Company spent USD178.9 million (net of cash in acquired companies) on acquisitions during the year, comprised of USD138.1 million in the regions of Russia and USD46.7 million on acquiring the business in Turkmenistan.

As of December 31, 2005, MTS' total debt[1] was at USD2.85 billion, resulting in a ratio of total debt[1] to OIBDA of 1.1 times, compared to 0.8 times in 2004. The Company's cash and cash equivalents amounted to USD78.3 million at the end of 2005 and net debt amounted to USD2.74 billion.

After the reporting period, on April 21, 2006, MTS signed a USD1.33 billion syndicated loan facility with a number of leading international financial institutions.

The mandated lead arrangers were: The Bank of Tokyo-Mitsubishi UFJ Ltd., Bayerische Landesbank, HSBC Bank plc, ING Bank N.V., Raiffeisen Zentralbank Oesterreich AG and Sumitomo Mitsui Banking Corporation Europe Limited.

HSBC Bank plc, ING Bank N.V. and Raiffeisen Zentralbank Oesterreich AG are bookrunners, with ING Bank N.V., London Branch acting as the facility agent. The Company expects that the loan will be used for debt refinancing, specifically USD420 million of the current syndicated loan, and for corporate needs such as acquisitions.

The Facility is divided into two tranches. The first tranche of USD630 million has a maturity of three years and annual interest is LIBOR+0.8%. The second tranche of USD700 million has a maturity of five years and annual interest is LIBOR+1.0% during the first three years and LIBOR+1.15% during the last two years.

Table 10.1: Summary of Financial Results for FY 2005 Compared to FY 2004

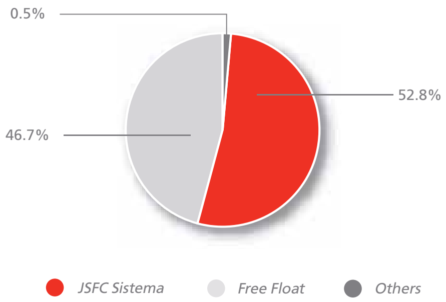
USD million	FY 2005	FY 2004	Change year-on-year (%)
Revenues	5,011.0	3,887.0	28.9
Net operating income	1,632.0	1,419.1	15.0
Net operating margin	32.6%	36.5%	–
Net income	1,126.4	987.9	14.0
OIBDA	2,539.1	2,094.8	21.2
OIBDA margin	50.7%	53.9%	–

[1] Total debt is comprised of the current portion of debt, current capital lease obligations, long-term debt and long-term capital lease obligations; net debt is the difference between the total debt and cash, cash equivalents and short-term investments; see page 79 for reconciliation of net debt to our consolidated balance sheet.

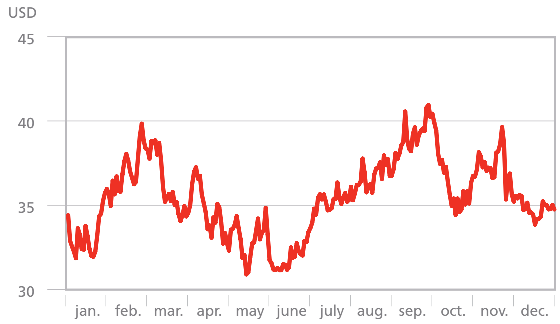
CREATING **VALUE**

SHARE STRUCTURE AND PERFORMANCE

SHAREHOLDERS' STRUCTURE



MTS ADS SHARE PRICE PERFOMANCE



Source: Yahoo Finance

Share Structure

The shareholding chart reflects share ownership following the sale of a 10.1% stake, or approximately 200 million shares by Deutsche Telekom in September 2005. The sale marked Deutsche Telekom's exit from the Company's shareholding.

As of December 31, 2004, a total of 1,993,326,138 common shares have been issued with a par value of RUR0.1. Mobile TeleSystems' Level-III ADR issue was successfully placed during its initial public offering on the New York Stock Exchange (ticker: MBT) on June 30, 2000.

Effective January 3, 2005, the Company's ADR ratio was changed from the previous ratio of 1 ADR per 20 ordinary shares to the current ratio of 1 ADR per 5 ordinary shares; a 1:4 ADR split. ADR holders thus received 3 additional ADRs for every 1 ADR held as of the record date (December 27, 2004).

The current ADR to ordinary share ratio remains 1:5 with J.P. Morgan Chase Bank as the depositary bank.

At present, the Company's depositary receipts are also traded on the London Stock Exchange (ticker: MBLD), Frankfurt Stock Exchange (ticker: MKY), Berlin Stock Exchange and Munich Stock Exchange. MTS' major trading volumes are on the NYSE.

MTS shares have been traded as a non-listed security on the Moscow Interbank Currency Exchange (MICEX) since October 2003. On November 28, 2003, common shares of MTS were included into MICEX "B" Quotation List (ticker: MTSI). On September 19, 2005, MTS shares began trading on the Russian Trading System (RTS) exchange as a non-listed security.

Share Performance

The management of MTS believes that a number of developments in 2005 have provided increased liquidity for the Company's shares. These include the disposal of Deutsche Telekom's remaining stake in MTS OJSC in September 2005 and MTS' addition to the RTS exchange as a non-listed security in the same month. In May 2005, MTS was added to the Morgan Stanley Capital International Emerging Markets Index (MSCI EM), effective May 31, 2005. According to MSCI, more than USD3 trillion in capital is benchmarked to its indices globally.

After the reporting period, MTS was added to Russian Trading System (RTS) index in March 2006 with a 5.7% weighting, and this is expected to add to the liquidity of the shares.

Dividends

On May 19, 2005, the Company announced that the Board of Directors had recommended to the annual general meeting (AGM) of shareholders to pay yearly dividends, based on 2004 financial results, of RUR5.75 per ordinary share of MTS OJSC (approximately USD1.03)[1]. Therefore the total amount of dividend payment recommended to the AGM was RUR11.47 billion (USD409.48 million)[2].

In accordance with Russian tax legislation, MTS must withhold a tax of up to 15% on the dividend amount when payable, depending on the recipient's legal status and jurisdiction.

Debt Instruments

MTS has three Eurobonds currently traded (amounting to USD400 million each, with maturities in 2008, 2010 and 2012). These are listed on the Luxembourg Stock Exchange.

Credit Ratings

Leading international credit ratings agencies, Moody's and Standard & Poor's, have assigned the following ratings to the Company's debt:

Moody's	Ba3, outlook stable
S&P	BB–, outlook stable

[1] Calculated ccording to the Russian Central Bank exchange rate of 28.0 RUR/USD as of May 19, 2005.

[2] The amount is 75.4% of the Company's net income in 2004 in accordance with Russian Accounting Standards and 40.0% of net income under U.S. GAAP.

CONSOLIDATED FINANCIAL STATEMENTS

As of December 31, 2005 and 2004 and for the years ended December 31, 2005, 2004 and 2003

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Shareholders of OJSC Mobile TeleSystems:

We have audited the accompanying consolidated balance sheets of Mobile TeleSystems, a Russian Open Joint-Stock Company, and subsidiaries ("the Group") as of December 31, 2005 and 2004, and the related consolidated statements of operations, changes in shareholders' equity and cash flows for each of the three years in the period ended December 31, 2005. These financial statements are the responsibility of the Group's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. The Group is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Group's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such consolidated financial statements present fairly, in all material respects, the financial position of the Group as of December 31, 2005 and 2004, and the results of its operations and its cash flows for each of the three years in the period ended December 31, 2005, in conformity with accounting principles generally accepted in the United States of America.

Deloitte & Touche

March 27, 2006, except for Note 24,
as to which the date is April 21, 2006

CONSOLIDATED BALANCE SHEETS
as of December 31, 2005 and 2004
(Amounts in thousands of U.S. dollars, except share and per share amounts)

	2005	2004
CURRENT ASSETS:		
Cash and cash equivalents (Note 4)	78,284	274,150
Short-term investments, including related party amounts of USD23,100 and USD73,100 as of December 31, 2005 and 2004, respectively (Note 5)	28,059	73,360
Trade receivables, net (Note 6)	209,320	162,525
Accounts receivable, related parties (Note 17)	7,661	17,768
Inventory and spare parts (Note 7)	156,660	89,518
Prepaid expenses	234,345	79,971
Deferred tax asset (Note 14)	83,336	49,850
VAT receivable	398,021	272,578
Other current assets	95,567	21,235
Total current assets	1,291,253	1,040,955
PROPERTY, PLANT AND EQUIPMENT, net of accumulated depreciation of USD1,350,783 and USD901,416, respectively (Note 8)	4,482,679	3,234,318
LICENSES, net of accumulated amortization of USD561,137 and USD385,664, respectively (Notes 3 and 21)	603,116	687,272
GOODWILL (Note 3)	155,221	108,329
OTHER INTANGIBLE ASSETS, net of accumulated amortization of USD505,098 and USD309,399, respectively (Notes 3 and 9)	681,025	412,532
DEBT ISSUANCE COSTS, net of accumulated amortization of USD23,692 and USD9,345, respectively (Note 11)	74,527	16,546
INVESTMENTS IN AND ADVANCES TO ASSOCIATES (Note 19)	107,959	81,235
OTHER INVESTMENTS (Note 20)	150,000	–
Total assets	7,545,780	5,581,187

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

CONSOLIDATED BALANCE SHEETS (CONTINUED)

as of December 31, 2005 and 2004

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

	2005	2004
CURRENT LIABILITIES:		
Accounts payable, related parties (Note 17)	40,829	17,009
Trade accounts payable	363,723	242,495
Deferred connection fees, current portion (Note 10)	44,361	45,083
Subscriber prepayments and deposits	344,493	308,859
Debt, current portion (Note 11)	765,881	370,845
Capital lease obligation, current portion (Notes 12 and 17)	2,793	8,561
Income tax payable	7,565	22,567
Accrued liabilities (Note 13)	276,291	180,677
Other payables	76,890	33,872
Total current liabilities	1,922,826	1,229,968
LONG-TERM LIABILITIES:		
Notes payable (Note 11)	1,199,052	800,000
Debt, net of current portion (Note 11)	879,903	753,795
Capital lease obligation, net of current portion (Notes 12 and 17)	2,928	3,947
Deferred connection fees, net of current portion (Note 10)	57,824	47,665
Deferred taxes (Note 14)	158,414	160,390
Total long-term liabilities	2,298,121	1,765,797
Total liabilities	4,220,947	2,995,765
COMMITMENTS AND CONTINGENCIES (Note 22)	–	–
MINORITY INTEREST	30,744	62,099
SHAREHOLDERS' EQUITY:		
Common stock: (2,096,975,792 shares with a par value of 0.1 rubles authorized and 1,993,326,138 shares issued as of December 31, 2005 and 2004, 763,554,870 and 432,414,940 of which are in the form of ADS, respectively (Note 1))	50,558	50,558
Treasury stock (5,400,486 and 7,202,108 common shares at cost as of December 31, 2005 and 2004)	(5,534)	(7,396)
Additional paid-in capital	568,104	564,160
Unearned compensation (Note 16)	(1,210)	(1,780)
Shareholder receivable (Note 11)	(7,182)	(18,237)
Accumulated other comprehensive income (Note 2)	50,614	22,444
Retained earnings	2,638,739	1,913,574
Total shareholders' equity	3,294,089	2,523,323
Total liabilities and shareholders' equity	7,545,780	5,581,187

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

CONSOLIDATED STATEMENTS OF OPERATIONS

for the years ended December 31, 2005, 2004, and 2003

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

	2005	2004	2003
NET OPERATING REVENUE			
Services revenue and connection fees	4,942,288	3,800,271	2,465,089
Sales of handsets and accessories	68,730	86,723	81,109
	5,011,018	**3,886,994**	**2,546,198**
Cost of services, excluding depreciation and amortization shown separately below (including related party amounts of USD78,253, USD61,770 and USD37,680, respectively)	732,867	481,097	301,108
Cost of handsets and accessories	254,606	218,590	173,071
General and administrative expenses (including related party amounts of USD9,486, USD9,509 and USD11,002, respectively) (Note 18)	758,729	575,296	355,230
Provision for doubtful accounts (Note 6)	50,407	26,459	32,633
Other operating expenses	67,173	29,777	18,859
Sales and marketing expenses (including related party amounts of USD80,146, USD59,113 and USD23,668, respectively)	608,092	460,983	326,783
Depreciation and amortization expenses	907,113	675,729	415,916
Net operating income	**1,632,031**	**1,419,063**	**922,598**
CURRENCY EXCHANGE AND TRANSACTION GAINS	(10,319)	(6,529)	(693)
OTHER EXPENSES/(INCOME) (including related party amounts of USD2,070, USD5,303 and USD6,161, respectively)			
Interest income	(24,828)	(21,792)	(18,076)
Interest expense, net of capitalized interest	132,474	107,956	106,551
Equity in net income of associates (Note 19)	(42,361)	(24,146)	(2,670)
Other expenses/(income), net	13,211	(9,310)	6,090
Total other expenses, net	**78,496**	**52,708**	**91,895**
Income before provision for income taxes and minority interest	**1,563,854**	**1,372,884**	**831,396**
PROVISION FOR INCOME TAXES (Note 14)	410,590	354,664	242,480
MINORITY INTEREST	26,859	30,342	71,677
NET INCOME	**1,126,405**	**987,878**	**517,239**
Weighted average number of common shares outstanding	1,986,819,999	1,984,497,348	1,983,374,949
Earnings per share, basic and diluted			
Net income	0.57	0.50	0.26

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

CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

for the years ended December 31, 2005, 2004, and 2003

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

	Common stock		Treasury stock		Other comprehensive income	Additional paid-in capital	Unearned compen-sation	Shareholder receivable	Retained earnings	Total
	Shares	Amount	Shares	Amount						
BALANCES, January 1, 2003	1,993,326,138	50,558	(9,966,631)	(10,206)		558,102	(212)	(34,412)	738,214	1,302,044
Receivable from Sistema (Note 11):										
Increases for interest	–	–	–	–	–	807	–	(807)	–	–
Payments from Sistema	–	–	–	–	–	–	–	7,609	–	7,609
Issuance of stock options (Note 16)	–	–	–	–	–	1,002	(1,002)	–	–	–
Stock options exercised (Note 16)	–	–	37,557	9	–	–	–	–	–	9
Amortization of deferred compensation (Note 16)	–	–	–	–	–	–	345	–	–	345
Dividends declared (Note 1)	–	–	–	–	–	–	–	–	(110,931)	(110,931)
Translation adjustment	–	–	–	–	7,595	–	–	–	–	7,595
Net income	–	–	–	–	–	–	–	–	517,239	517,239
BALANCES, December 31, 2003	1,993,326,138	50,558	(9,929,074)	(10,197)	7,595	559,911	(869)	(27,610)	1,144,522	1,723,910
Receivable from Sistema (Note 11):										
Increases for interest	–	–	–	–	–	1,190	–	(1,190)	–	–
Payments from Sistema	–	–	–	–	–	–	–	10,563	–	10,563
Issuance of stock options (Note 16)	–	–	–	–	–	1,811	(1,811)	–	–	–
Stock options exercised (Note 16)	–	–	2,726,966	2,801	–	1,248	–	–	–	4,049
Amortization of deferred compensation (Note 16)	–	–	–	–	–	–	900	–	–	900
Dividends declared (Note 1)	–	–	–	–	–	–	–	–	(218,826)	(218,826)
Translation adjustment	–	–	–	–	15,361	–	–	–	–	15,361
Change in fair value of interest rate swaps,										
net of tax	–	–	–	–	(512)	–	–	–	–	(512)
Net income	–	–	–	–	–	–	–	–	987,878	987,878
BALANCES, December 31, 2004	1,993,326,138	50,558	(7,202,108)	(7,396)	22,444	564,160	(1,780)	(18,237)	1,913,574	2,523,323
Receivable from Sistema (Note 11):										
Increases for interest	–	–	–	–	–	643	–	(643)	–	–
Payments from Sistema	–	–	–	–	–	–	–	11,698	–	11,698
Issuance of stock options (Note 16)	–	–	–	–	–	907	(907)	–	–	–
Stock options exercised (Note 16)	–	–	1,801,622	1,862	–	2,394	–	–	–	4,256
Amortization of deferred compensation (Note 16)	–	–	–	–	–	–	1,477	–	–	1,477
Dividends declared (Note 1)	–	–	–	–	–	–	–	–	(401,240)	(401,240)
Translation adjustment	–	–	–	–	24,898	–	–	–	–	24,898
Change in fair value of interest rate swaps, net of tax	–	–	–	–	3,272	–	–	–	–	3,272
Net income	–	–	–	–	–	–	–	–	1,126,405	1,126,405
BALANCES, December 31, 2005	1,993,326,138	50,558	(5,400,486)	(5,534)	50,614	568,104	(1,210)	(7,182)	2,638,739	3,294,089

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

CONSOLIDATED STATEMENTS OF CASH FLOWS

for the years ended December 31, 2005, 2004, and 2003
(Amounts in thousands of U.S. dollars)

	2005	2004	2003
CASH FLOWS FROM OPERATING ACTIVITIES:			
Net income	1,126,405	987,878	517,239
Adjustments to reconcile net income to net cash provided by operating activities:			
Minority interest	26,859	30,342	71,677
Depreciation and amortization	907,113	675,729	415,916
Amortization of deferred connection fees	(44,207)	(46,978)	(29,372)
Equity in net income of associates	(42,361)	(24,146)	(2,670)
Inventory obsolescence expense	9,112	4,610	3,307
Provision for doubtful accounts	50,407	26,459	32,633
Deferred taxes	(64,959)	(76,023)	(43,001)
Non-cash expenses associated with stock bonus and stock options	1,477	900	213
Changes in operating assets and liabilities:			
Increase in accounts receivable	(86,008)	(101,223)	(64,384)
Increase in inventory	(74,557)	(24,179)	(14,737)
Increase in prepaid expenses and other current assets	(163,630)	(18,571)	(19,151)
Increase in VAT receivable	(125,186)	(55,044)	(50,230)
Increase in trade accounts payable, accrued liabilities and other current liabilities	276,915	331,835	148,544
Net cash provided by operating activities	1,797,380	1,711,589	965,984
CASH FLOWS FROM INVESTING ACTIVITIES:			
Acquisitions of subsidiaries, net of cash acquired	(178,917)	(355,744)	(667,206)
Purchases of property, plant and equipment	(1,757,980)	(1,204,400)	(839,165)
Purchases of intangible assets	(423,367)	(154,544)	(119,606)
Purchases of short-term investments	(37,375)	(114,440)	(215,000)
Proceeds from sale of short-term investments	82,724	286,340	–
Purchase of other investments	(150,000)	–	–
Payments from associates	12,245	–	–
Investments in and advances to associates	553	(413)	(69,110)
Net cash used in investing activities	(2,452,117)	(1,543,201)	(1,910,087)

CONSOLIDATED STATEMENTS OF CASH FLOWS (CONTINUED)

for the years ended December 31, 2005, 2004, and 2003

(Amounts in thousands of U.S. dollars)

	2005	2004	2003
CASH FLOWS FROM FINANCING ACTIVITIES:			
Proceeds from stock options exercise	4,256	4,049	–
Proceeds from issuance of notes	398,944	–	1,097,000
Repayment of notes	–	(600,000)	–
Notes and debt issuance cost	(59,163)	(12,039)	(9,556)
Capital lease obligation principal paid	(8,129)	(15,274)	(22,646)
Dividends paid including taxes	(407,210)	(232,662)	(110,864)
Proceeds from loans	1,012,613	1,177,556	712,716
Loan principal paid	(491,481)	(320,511)	(677,374)
Payments from Sistema	11,698	9,654	8,269
Net cash provided by financing activities	461,528	10,773	997,545
Effect of exchange rate changes on cash and cash equivalents	(2,657)	4,613	2,273
NET (DECREASE)/INCREASE IN CASH AND CASH EQUIVALENTS	(195,866)	183,774	55,715
CASH AND CASH EQUIVALENTS, beginning of year	274,150	90,376	34,661
CASH AND CASH EQUIVALENTS, end of year	78,284	274,150	90,376
SUPPLEMENTAL INFORMATION:			
Income taxes paid	588,105	430,109	286,016
Interest paid	145,081	142,899	79,824
Non-cash investing activities:			
Additions to network equipment and software under capital lease	4,091	2,861	10,928
Payable related to business acquisition (Note 3)	23,618	–	27,500
Additions to network through ING BHF Bank and Commerzbank AG financing (Note 11)	–	8,800	–

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

NOTES TO CONSOLIDATED STATEMENTS

for the years ended December 31, 2005, 2004, and 2003

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

1. DESCRIPTION OF BUSINESS

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

Open Joint-Stock Company Mobile TeleSystems (MTS OJSC or "the Company") was created on March 1, 2000, through the merger of Closed Joint-Stock Company Mobile TeleSystems (MTS CJSC) and RTC CJSC, a wholly-owned subsidiary. MTS CJSC was formed in 1993 to design, construct and operate a cellular telecommunications network in Moscow and Moscow Oblast. The development of the network was achieved through green-field build-out in the regions for which the Company was granted 900 or 1800 MHz ("GSM-900" and "GSM-1800") cellular licenses or through the acquisition of majority stakes in local GSM operators (see Note 21 Operating Licenses and Note 3 Businesses Acquired).

A part of the Company's shares is traded in the form of American Depositary Shares (ADS). Each ADS initially represented 20 shares of common stock of the Company. Effective January 3, 2005, the first trading day in 2005, the ratio was changed from 1 ADS per 20 ordinary shares to 1 ADS per 5 ordinary shares. The Company initially issued a total of 17,262,204 ADS, representing 345,244,080 common shares. Subsequently, as described below, due to sales of shares by shareholders on the open market the number of ADS increased to 152,710,974 and 86,482,988 as of December 31, 2005 and 2004, respectively (representing underlying ownership of 763,554,870 and 432,414,940 shares as of December 31, 2005 and 2004, respectively).

Ownership — As of December 31, 2005 and 2004, MTS' shareholders on record and their respective percentage direct interests were as follows:

	2005	2004
Joint-stock financial corporation "Sistema" ("Sistema")	41.7%	41.0%
T-Mobile Worldwide Holding GmbH ("T-Mobile")	–	10.1%
VAST, limited liability company (VAST)	3.0%	3.0%
Invest-Svyaz-Holding, closed joint-stock company	8.1%	8.1%
ADS holders	38.4%	21.7%
Free float, GDR holders and others	8.8%	16.1%
	100.0%	100.0%

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

In December 2004, T-Mobile sold a 15.09% stake in MTS on the open market in the form of GDRs. On September 12, 2005, T-Mobile sold its remaining holding of 10.1% in MTS on the open market. Concurrently GDRs were converted into the form of ADS, that increased the number of ADS.

At December 31, 2004, Sistema owned a 51.0% equity interest in VAST, a limited liability company incorporated under the laws of the Russian Federation; the remaining 49.0% interest was held by ASVT, a Russian open joint-stock company. Sistema's effective ownership in MTS was 50.6% at December 31, 2004. In December 2005, Sistema acquired the 49.0% stake in VAST bringing its total interest to 100.0%. Additionally, Sistema acquired a 0.7% stake in MTS on the open market during 2005. Collectively, those transactions increased Sistema's effective ownership in MTS to 52.8% by December 31, 2005.

In April 2003, Sistema issued USD350.0 million 10.25% notes, due in 2008. These notes are collateralized by 193,473,900 shares of common stock of MTS OJSC.

On June 30, 2003, the Group approved cash dividends of USD1.12 per ADS (USD0.056 per share) for a total of USD111.0 million. As of December 31, 2004, these dividends were fully paid.

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

On June 24, 2004, MTS' shareholders approved cash dividends of USD2.2 per ADS (USD0.110 per share) for a total of USD220.0 million, which were fully paid by December 31, 2004.

On June 22, 2005, MTS' shareholders approved cash dividends of USD1.01 per ADS (USD0.202 per share) for a total of USD402.6 million, which were fully paid by December 31, 2005.

On July 1, 2005, the Company completed a merger of eight of its wholly-owned subsidiaries in Russia. These subsidiaries were Telecom XXI, Kuban-GSM, Udmurtia Digital Network-900 (UDN-900), Dontelecom, MTS-Barnaul, MTS-Nizhniy Novgorod (MTS-NN), Telecom-900 and Amur Cellular Communication (ACC). The merger process was approved by an extraordinary general meeting of shareholders on November 9, 2004, and by the Russian registration authority on June 30, 2005.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES AND NEW ACCOUNTING PRONOUNCEMENTS

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

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

Basis of consolidation — Wholly-owned subsidiaries and majority-owned subsidiaries where the Company has operating and financial control are consolidated. Those ventures where the Company exercises significant influence, but does not have operating and financial control are accounted for using the equity method. All significant intercompany accounts and transactions are eliminated upon consolidation. Investments in which the Company does not have the ability to exercise significant influence over operating and financial policies are accounted for under the cost method and included in other investments in our consolidated balance sheets. The Company's share in net income of unconsolidated associates is included in other income in the accompanying consolidated statements of operations and disclosed in Note 19. Results of operations of subsidiaries acquired are included in the consolidated statements of operations from the date of their acquisition.

As of December 31, 2005 and 2004, MTS has investments in the following significant legal entities:

	Accounting method	2005	2004
ACC[2]	Merged/consolidated	–	100.0%
Telecom XXI[2]	Merged/consolidated	–	100.0%
Telecom-900[2]	Merged/consolidated	–	100.0%
SCS-900	Consolidated	100.0%	100.0%
FECS-900	Consolidated	100.0%	100.0%
Uraltel	Consolidated	100.0%	99.8%
MTS Finance[1]	Consolidated	100.0%	100.0%
BM Telecom	Consolidated	100.0%	100.0%
Kuban-GSM[2]	Merged/consolidated	–	100.0%
Dontelecom[2]	Merged/consolidated	–	100.0%
MTS-Barnaul[2]	Merged/consolidated	–	100.0%
BIT[3]	Consolidated	–	100.0%
MTS-Capital	Consolidated	100.0%	100.0%
UMC	Consolidated	100.0%	100.0%
Sibchallenge	Consolidated	100.0%	100.0%
TSS	Consolidated	100.0%	100.0%
Volgograd Mobile	Consolidated	100.0%	100.0%
Astrakhan Mobile	Consolidated	100.0%	100.0%
Mar Mobile GSM	Consolidated	100.0%	100.0%
Primtelefon	Consolidated	100.0%	100.0%
MSS	Consolidated	91.0%	91.0%
ReCom	Consolidated	100.0%	53.9%
TAIF-Telcom	Consolidated	100.0%	100.0%
UDN-900[2]	Merged/consolidated	–	100.0%
Novitel	Consolidated	100.0%	100.0%
MTS-Kostroma	Consolidated	100.0%	100.0%
MTS-NN[2]	Merged/consolidated	–	100.0%
Uzdunrobita	Consolidated	74.0%	74.0%
Sibintertelecom	Consolidated	100.0%	93.5%
Gorizont-RT	Consolidated	100.0%	76.0%
Telesot Alania	Consolidated	100.0%	52.5%
BCTI	Consolidated	100.0%	–
Sweet-Com	Consolidated	74.9%	–
MTS-Komi Republic	Consolidated/equity	100.0%	26.0%
MTS Belarus	Equity	49.0%	49.0%
MTS-Tver	Consolidated/equity	100.0%	26.0%

[1] Represents beneficial ownership
[2] Represents wholly-owned entities merged with MTS OJSC on July 1, 2005
[3] Disposed of in 2005

Translation methodology — Effective January 1, 2003, the Russian economy ceased to be considered hyperinflationary. Management believes that the U.S. dollar is the appropriate functional currency for most of its subsidiaries because the majority of their revenues, costs, property and equipment purchased, and debt are either priced, incurred, payable or otherwise measured in U.S. dollars. Each of the legal entities domiciled in Russia, Ukraine, Uzbekistan, Turkmenistan, and Belarus maintains its records and prepares its financial statements in the local currency, either Russian ruble, Ukrainian hryvnia, Uzbek som, Turkmenian manat or Belarusian ruble, in accordance with the requirements of local statutory accounting and tax legislation.

Translation (remeasurement) of financial statements denominated in local currencies into U.S. dollars has been performed in accordance with the provisions of Statement of Financial Accounting Standard (SFAS) No. 52 "Foreign Currency Translation":

- For subsidiaries of the Group where the functional currency is the U.S. dollar, monetary assets and liabilities have been translated at the period end exchange rates. Non-monetary assets and liabilities have been translated at historical rates. Revenues, expenses and cash flows have been translated at historical rates. Translation differences resulting from the use of these rates have been accounted for as currency exchange and transaction gains and losses in the accompanying consolidated statements of operations.
- For UMC, Kuban-GSM and BCTI where the functional currency is the local currency being the Ukrainian hryvnia, Russian ruble and Turkmenian manat, respectively, all year-end balance sheet items have been translated into U.S. dollars at the period-end exchange rate. Revenues and expenses have been translated at period average exchange rate. In addition, a "new cost basis" for all non-monetary assets of Kuban-GSM has been established as of January 1, 2003, when the Russian economy ceased to be considered hyperinflationary. Cumulative translation adjustment related to use of local currency as functional in the amount of USD24,898, USD15,361 and USD7,595 were recorded directly in the consolidated statement of shareholders' equity as of December 31, 2005, 2004, and 2003, respectively.

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

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

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

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

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

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

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

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

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

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

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

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

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

Interest expense incurred during the construction phase of the MTS' network under development is capitalized as part of property, plant and equipment until the projects are completed and placed into service.

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

These corrections resulted in a cumulative net charge to net income of USD34.9 million, net of income tax in the fourth quarter of 2004, of which USD21.5 million relates to the years 1998 through 2003. The net cumulative charge is comprised of a USD44.5 million increase in depreciation expense related primarily to depreciation of capitalized leasehold improvements expenses for base stations; a decrease of USD1.4 million in the equity net income from the MTS-Belarus also related to depreciation of capitalized leasehold improvements expense for base station sites; and an increase of USD11.0 million related to an additional deferred tax benefit due to the change in accounting base for property, plant, and equipment.

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

Asset retirement obligations — In accordance with Statement of Financial Accounting Standards, or SFAS, No. 143, "Accounting for Asset Retirement Obligations", the Group calculates an asset retirement obligation and an associated asset retirement cost when the Group has a legal obligation in connection with the retirement of tangible long-lived assets.

The Group's obligations under SFAS No. 143 relate primarily to the cost of removing its equipment from sites. As of December 31, 2005, the estimated assets retirement obligations were not significant to the Group's consolidated financial position and results of operations.

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

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

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

Software and other intangible assets are amortized over three to fifteen years. Acquired customer bases commencing January 1, 2005, are amortized over their estimated average subscriber life from 32 to 60 months. In 2004 the average subscriber life ranged from 20 to 76 months, the effect of change in estimate in 2005 was not material. Rights to use radio frequencies are amortized over the period of contractual life from three to fifteen years. All finite-life intangible assets are being amortized using the straight-line method.

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

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

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

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

Investments impairment — Management periodically assesses the realizability of the carrying values of the investments and if necessary records impairment losses to write the investment down to fair value. For the three years in the period ended December 31, 2005, no such impairment has occurred.

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

Impairment of long-lived assets — MTS periodically evaluates the recoverability of the carrying amount of its long-lived assets in accordance with SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets." Whenever events or changes in circumstances indicate that the carrying amounts of those assets may not be recoverable, MTS compares undiscounted net cash flows estimated to be generated by those assets to the carrying amount of those assets. When these undiscounted cash flows are less than the carrying amounts of the assets, MTS records impairment losses to write the asset down to fair value, measured by the estimated discounted net future cash flows expected to be generated from the use of the assets. No impairment of long-lived assets has occurred during the three years in the period ended December 31, 2005.

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

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

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

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

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

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

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

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

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

Following management analysis of the subscriber base in the regions where the Group operates, effective January 1, 2004, average subscriber lives have been changed. Commencing January 1, 2004, the Group calculates an average expected term of the subscriber relationship for each region and amortizes regional connection fees accordingly. Average expected subscriber life ranged from 20 to 76 months in 2004 and from 12 to 60 months in 2005. The effect of change in estimate was approximately USD8.5 million, net of income tax or USD0.004 per share, in 2004 and not material in 2005.

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

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

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

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

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

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

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

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

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

Advertising costs — Advertising costs are expensed as incurred. Advertising costs for the years ended December 31, 2005, 2004, and 2003, were USD248,610, USD159,035 and USD102,018, respectively, and are reflected as a component of sales and marketing expenses in the accompanying consolidated statements of operations.

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

In Russia, starting from January 1, 2001, all social contributions, including contributions to the pension fund, were substituted with a unified social tax (UST) calculated by the application of a regressive rate from 35.6% to 2% of the annual gross remuneration to each employee, that was changed, starting January 1, 2005, to a rate from 26% to 2%. UST is allocated to three social funds, including the pension fund, where the rate of contributions to the pension fund vary from 28% to 2% (from 20% to 2% starting January 1, 2005), depending on the annual gross salary of each employee. The contributions are expensed as incurred. Payments of the unified social tax in Russia amounted to USD43.6 million, USD33.7 million and USD27.8 million in 2005, 2004, and 2003, respectively.

In Ukraine, Uzbekistan, and Turkmenistan, the subsidiaries of the Group are required to contribute a specified percentage of each employee's payroll up to a fixed limit to the local pension fund, unemployment fund and social security fund. Payments to the pension fund in Ukraine amounted to USD6.6 million, USD2.9 million and USD1.7 million in 2005, 2004, and 2003, respectively. Amounts contributed to the pension funds in Uzbekistan and Turkmenistan are not material.

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

Earnings per share — Basic earnings per share (EPS) have been determined using the weighted average number of shares outstanding during the year. Diluted EPS reflect the potential dilutive effect of stock options granted to employees.

There are 3,187,240, 3,530,970 and 4,797,410 stock options outstanding as of December 31, 2005, 2004, and 2003, respectively.

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

	2005	2004	2003
Weighted average number of common share outstanding	1,986,819,999	1,984,497,348	1,983,374,949
Dilutive effect of stock options, as if exercised	290,040	1,168,573	1,727,131
Weighted average number of common shares and potential shares outstanding	1,987,110,039	1,985,665,921	1,985,102,080

Fair value of financial instruments — The fair market value of financial instruments, consisting of cash and cash equivalents, accounts receivable and accounts payable, which are included in current assets and liabilities, approximates the carrying value of these items due to the short-term nature of these amounts. As of December 31, 2005, the USD400 million Notes due in 2008 had a fair value of 105.7% or USD423 million, the USD400 million Notes due in 2010 had a fair value of 104.6% or USD418 million, and the USD400 million Notes due in 2012 had a fair value of 101.9% or USD408 million. As of December 31, 2005, the fair value of other fixed rate debt including capital lease obligations approximated its carrying value. The fair value of variable rate debt approximates carrying value.

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

The Group accounts for its derivative financial instruments following the provisions of SFAS No. 133 "Accounting for Derivative Instruments and Hedging Activities" and SFAS No. 149 "Amendment of Statement 133 on Derivative Instruments and Hedging Activities". All derivatives are recorded as either assets or liabilities in the consolidated balance sheets and measured at their respective fair values. The Group's interest rate swap agreements are designated as a cash flow hedge and the hedging relationship qualifies for hedge accounting. The effective portion of the change in fair value of interest rate swap agreements is, accordingly, recorded in other comprehensive income and reclassified to interest expense in the same period that the related cash flows of the hedge transaction affect the interest expense. Changes in the fair value of other derivative instruments are recognized in net income as those instruments were not designated as hedges.

At the inception of the hedge and on a quarterly basis, the Group performs an analysis to assess whether changes in cash flows of its interest rate swap agreements are deemed highly effective in offsetting changes in cash flows of the hedged debt. If at any time the correlation assessment will indicate that the interest rate swap agreements are no longer effective as a hedge, the Group will discontinue hedge accounting and all subsequent changes in fair value will be recorded in net income. As of December 31, 2005 the hedge is highly effective. Approximately USD0.7 million is expected to be reclassified in net income during the next twelve months.

Comprehensive income — Comprehensive income is defined as net income plus all other changes in net assets from non-owner sources. The following is the reconciliation of other comprehensive income, net of tax for the years ended December 31, 2005, 2004, and 2003:

	2005	2004	2003
	USD, 000's	USD, 000's	USD, 000's
Net income	1,126,405	987,878	517,239
Translation adjustment	24,898	15,361	7,595
Change in fair value of interest rate swaps, net of tax of USD1,033 and USD123 as of December 31, 2005 and 2004, respectively	3,272	(512)	–
Total comprehensive income	1,154,575	1,002,727	524,834

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

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

	2005	2004	2003
	USD	USD	USD
Net income as reported (000's)	1,126,405	987,878	517,239
Pro-forma effect of the application of fair value method of accounting (000's)	(1,716)	(1,078)	(727)
Pro-forma net income (000's)	1,124,689	986,800	516,512
Earnings per share — basic and diluted			
As reported	0.57	0.50	0.26
Pro-forma	0.57	0.50	0.26

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

New and 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 is effective for the Group beginning January 1, 2006. The Group is currently assessing the impact of Interpretation No. 47 on its consolidated financial position and results of operations.

In December 2004, the FASB issued Statement of Financial Accounting Standards No. 123 (revised) "Share-Based Payment" (SFAS No. 123R), which requires all companies to measure compensation cost for all share-based payments (including employee stock options) at fair value. In April 2005, the Securities and Exchange Commission announced that it would provide a phased-in implementation process for SFAS No. 123R. As a result of this phased-in process, the provisions of SFAS No. 123R must be adopted by most public entities no later than the beginning of the first fiscal year commencing after June 15, 2005. SFAS No. 123R applies to all awards granted after the required effective date and to awards modified, repurchased, or cancelled after that date. Effective for the fiscal year beginning January 1, 2006, the Company will adopt the provisions of SFAS No. 123R using a modified version of prospective application. Under this transition method, compensation cost will be recognized on or after the effective date for the portion of outstanding awards for which the requisite service has not yet been rendered, based on the grant date fair value of those awards previously calculated under SFAS No. 148 for pro forma disclosures. The Company does not expect the adoption of SFAS No. 123R to have a material impact on its consolidated financial position or results of operations.

In March 2005, the Securities and Exchange Commission (SEC) issued Staff Accounting Bulletin (SAB) No. 107, "Share Based Payment" ("SAB 107"). SAB 107 summarizes the views of the SEC staff regarding the interaction between SFAS 123R and certain SEC rules and regulations, and provides the staff's views regarding the valuation of share-based payment arrangements for public companies. The Group will adopt SAB 107 concurrently with the adoption of SFAS 123(R) with effect from January 1, 2006. The Company does not expect the adoption of this SAB to have a material impact on its consolidated financial position or results of operations.

In May 2005, the FASB issued Statement of Financial Accounting Standards No. 154, "Accounting Changes and Error Corrections" ("SFAS No. 154"), 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 shall be effective for accounting changes and corrections of errors made in fiscal years beginning after December 15, 2005.

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." As part of a business combination, the acquiring entity will often assume existing lease agreements of the acquired entity and acquire the related leasehold improvements. The issues are whether the "lease term" should be reevaluated at consummation of a purchase business combination and whether the amortization period for acquired leasehold improvements should be reevaluated by the acquiring entity in a business combination. The consensus reached by EITF No. 05-6 is effective for leasehold improvements that are purchased or acquired in reporting periods beginning 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 starting with the first reporting period beginning after December 15, 2005. The Group is currently assessing the impact of FSP FAS 13-1 on its consolidated financial position and results of operations.

3. BUSINESSES ACQUIRED

BCTI acquisition — In June 2005, MTS entered into an agreement to acquire 100.0% of the outstanding stock of BCTI, which is a leading cellular operator in Turkmenistan with a customer base of approximately 59,100 subscribers (unaudited). BCTI holds a license to provide GSM-900/1800 services for the whole territory of Turkmenistan and a license for provision of AMPS services. The agreement provided for the acquisition of a 51.0% stake and included a forward commitment to complete the acquisition of the remaining 49.0% stake within eight months of the date of the original agreement subject to certain conditions.

MTS acquired the 51.0% stake in BCTI for cash consideration of USD28.2 million, including a finder's fee of USD2.5 million. The Group accounted for the purchase of the remaining 49.0% stake in BCTI as a financing of the minority interest and, consequently, consolidated 100.0 % of the subsidiary starting from June 30, 2005. In November 2005, MTS completed the acquisition of the remaining 49.0% stake in BCTI for a cash consideration of USD18.5 million.

This acquisition was accounted for using the purchase method of accounting. Total purchase price amounted to USD46.7 million. The purchase price allocation for the acquisition was as follows:

	USD, 000's
Current assets	7,808
Non-current assets	3,804
License costs	50,503
Deferred taxes	(10,862)
Current liabilities	(4,566)
Purchase price	46,687

In accordance with certain provisions of the license agreement with the government of Turkmenistan, the Group shares net profit derived from the operations of the BCTI branch located in Turkmenistan. The amount of shared net profit is calculated based on the financial statements prepared in accordance with local GAAP subject to certain adjustments. The Group shared 49% of net profit since the date of acquisition and until December 21, 2005, and 20% of net profit commencing December 21, 2005.

ReCom acquisition — In December 2005, MTS purchased the remaining 46.1% stake in ReCom for USD110.0 million. Previously MTS owned 53.9% of ReCom; as a result of the transaction, MTS' ownership in the subsidiary increased to 100.0%. The acquisition was accounted for using the purchase method of accounting. The allocation of purchase price increased recorded license cost by USD43.9 million, customer base cost by USD15.0 million and resulted in recognition of goodwill in the amount of USD16.2 million.

Goodwill is mainly attributable to economic potential of the market assuming low regional penetration level as of the date of acquisition. License costs are amortized over the remaining contractual terms of the licenses of approximately 3 to 8 years and customer base is amortized over the average subscriber's life of approximately 60 months.

Gorizont-RT acquisition — In December 2004, MTS completed the acquisition of a 76.0% stake in Gorizont-RT, a mobile phone operator in the Republic of Sakha (Yakutia) in the Far East of Russia, for cash consideration of USD53.2 million. Gorizont-RT holds licenses to provide GSM-900/1800 services in the Republic of Sakha (Yakutia). The Gorizont-RT's customer base as of the date of acquisition was approximately 100,000 subscribers (unaudited). Commencing from the date of acquisition, MTS consolidates financial results of Gorizont-RT.

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

	USD, 000's
Current assets	3,820
Non-current assets	17,501
License costs	26,362
Customer base cost	1,050
Trademark	153
Goodwill	20,214
Current liabilities	(4,949)
Non-current liabilities	(529)
Deferred taxes	(6,814)
Minority interest	(3,604)
Purchase price	53,204

Goodwill is mainly attributable to economic potential of the market assuming low regional penetration level as of the date of acquisition. License costs are amortized over the remaining contractual terms of the licenses of approximately 10 years and customer base is amortized over the average subscriber's life of approximately 60 months.

In June 2005, MTS acquired the remaining 24.0% stake in Gorizont-RT, increasing its ownership to 100.0%. The purchase price paid was USD13.5 million. The acquisition was accounted for using the purchase method of accounting. The allocation of purchase price increased recorded license cost by USD7.5 million.

Sibintertelecom acquisition — In November 2004, MTS acquired a 93.53% stake in Sibintertelecom, a mobile phone operator in the Chita Oblast and Agin-Buryat Autonomous Okrug in the Far East of Russia, for a cash consideration of USD37.4 million. Sibintertelecom holds license to provide 900 MHz services in Chita Oblast and Agin-Buryat Autonomous Okrug. Sibintertelecom is the sole mobile service provider in the two regions with a total population of 1.23 million. Commencing from the date of acquisition, MTS consolidates financial results of Sibintertelecom. The company's customer base as of the date of acquisition was approximately 100,000 subscribers (unaudited).

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

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

Goodwill is mainly attributable to economic potential of the market assuming low regional penetration level as of the date of acquisition. License costs are amortized over the remaining contractual terms of the licenses of approximately 5 years for Chita Oblast and 7 years for Agin-Buryat Autonomous Okrug and customer base is amortized over the average subscriber's life of approximately 44 months.

In December 2005, MTS aquired the remaining 6.47% stake in Sibintertelecom, which resulted in increase of MTS' ownership in Sibintertelecom to 100.0%. The amount paid for the stake amounted to USD2.8 million. The acquisition was accounted for using the purchase method of accounting. The allocation of purchase price increased recorded license cost by USD1.4 million.

Telesot Alania acquisition — In December 2004, MTS purchased a 52.5% stake in Telesot Alania, a GSM mobile phone operator in the Republic of North Ossetia in the southern part of Russia, for cash consideration of USD6.2 million. Telesot Alania holds license to provide 1800/900 MHz services in the Republic of North Ossetia in the Southern Federal District of Russia. Commencing from the date of acquisition, MTS consolidates financial results of Telesot Alania. Telesot Alania's customer base as of the date of acquisition was approximately 54,000 subscribers (unaudited).

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

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

License costs are amortized over the remaining contractual terms of the licenses of approximately 2 years and customer base is amortized over the average subscriber's life of approximately 60 months.

In December 2005, MTS acquired the remaining 47.5% stake in Telesot Alania, increasing its ownership in the company to 100.0%. In accordance with the purchase agreement the purchase price amounted to USD32.6 million of which USD9.0 million was paid in cash in December 2005 and USD23.6 million was recorded as liability as of December 31, 2005, and included in other payables in the consolidated balance sheet. The liability was fully settled in February 2006. The acquisition was accounted for using the purchase method of accounting. The preliminary allocation of purchase price increased recorded license cost by USD2.7 million and USD26.3 million was recognized as goodwill. Goodwill is mainly attributable to economic potential of the market assuming low regional penetration level as of the date of acquisition. The purchase price allocation for this acquisition has not yet been finalized at the date of these financial statements.

Uzdunrobita acquisition — In July 2004, MTS entered into an agreement to acquire 74.0% of Uzbekistan mobile operator JV Uzdunrobita ("Uzdunrobita") for a cash consideration of USD126.4 million, including transaction costs of USD5.4 million. The acquisition was completed on August 1, 2004, and starting from this date Uzdunrobita's financial results are consolidated. Uzdunrobita holds licenses to provide GSM-1800 mobile communication services on the whole territory of Uzbekistan, which has a population of approximately 25.2 million. Uzdunrobita's customer base as of the date of acquisition was approximately 230,000 subscribers (unaudited).

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

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

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

MTS also entered into call and put option agreements with the existing shareholders of Uzdunrobita to acquire the remaining 26.0% of common shares of the company. The exercise period for the call and put option is 48 months from the acquisition date. The call and put option agreements stipulate a minimum purchase price of USD37.7 million plus 5% per annum commencing from the acquisition date. Fair value of the option was USD5.9 million and USD4.0 million as of December 31, 2005 and 2004, respectively, and was included in other current assets on the accompanying consolidated balance sheets.

Primtelefon acquisition — In June 2004, MTS purchased 50.0% of Far-Eastern operator CJSC Primtelefon ("Primtelefon") for a cash consideration of USD31.0 million, increasing its effective ownership to 100.0%, as 50.0% of Primtelefon's shares were controlled through Vostok Mobile, a wholly-owned subsidiary of MTS. Commencing from the date of acquisition of the second stake, MTS consolidates financial results of Primtelefon. Primtelefon holds licenses to provide GSM-900/1800 mobile cellular communications in the Far East Federal District of Russia. The company's subscriber base as of the date of acquisition of the controlling stake was approximately 216,000 subscribers (unaudited).

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

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

License costs acquired are amortized over the remaining contractual terms of the licenses of approximately 7 years and customer base is amortized over the average remaining subscriber's life of approximately 41 months.

On August 13, 2003, Telecom-900, a subsidiary of MTS, completed the purchase of the 43.7% and 2.95% stakes in Uraltel for a cash consideration of USD35.7 million. The transaction increased Telecom-900's ownership in Uraltel to 99.85%. The acquisition was accounted using purchase method of accounting. The allocation of purchase price increased recorded license cost by USD24.5 million.

In November 2003, the Group completed the purchase of the 30.0% stake in SCS-900 from Sibirtelecom for cash consideration of USD28.6 million. The Group's acquisition of this stake increased its ownership in SCS-900 to 81.0%. On December 29, 2003, the Group acquired for cash consideration of USD9.3 million a 100.0% stake in ILIT LLC, a company which owns a 7.5% stake in SCS-900, increasing its ownership in SCS-900 to 88.5%. The acquisition was accounted using purchase method of accounting. The allocation of purchase price increased recorded license cost by USD25.7 million.

In March 2004, the Group acquired 11.0% stake in SCS-900 from CJSC Sibirskie Zvezdy for cash consideration of USD8.5 million, increasing its ownership in SCS-900 to 99.5%. The acquisition was accounted for using a purchase method of accounting. The allocation of purchase price increased recorded license cost by USD2.6 million.

In April 2004, the Group acquired 40.0% stake in FECS-900 from OJSC Dalnevostochnaya Kompaniya Electrosvyazi for cash consideration of USD8.3 million, increasing its ownership in FECS-900 to 100.0%. The acquisition was accounted for using a purchase method of accounting. The allocation of purchase price increased recorded license cost by USD4.1 million.

License costs are amortized over the remaining contractual terms of the respective license, ranging from 6 to 10 years at the date of the first acquisition. Customer base is amortized over the average remaining subscribers life ranging from 32 to 40 months.

Tomsk Cellular Communications acquisition — In September 2003, MTS purchased 100.0% of Siberian operator Tomsk Cellular Communications (TSS) for cash consideration of USD47.0 million. TSS holds licenses to provide GSM-900/1800 mobile cellular communications in the Tomsk Oblast. The company's customer base as of the date of acquisition was approximately 183,000 subscribers (unaudited).

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

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

License costs acquired are amortized over the remaining contractual terms of the licenses of approximately 8 years and customer base is amortized over the average remaining subscribers life of approximately 76 months.

Sibchallenge acquisition — On August 22, 2003, MTS completed the purchase of 100.0% of Sibchallenge, a cellular operator in the Krasnoyarsk Krai, for cash consideration of USD45.5 million, paid a finder's fee of USD2.0 million and assumed net debt of approximately USD6.6 million. Sibchallenge holds licenses to provide GSM 900/1800 and DAMPS mobile services in the Krasnoyarsk Krai of Siberia, the Republic of Khakassia, and in the Taimyr Autonomous Okrug, all of which are located in the Siberian part of Russia. At the date of acquisition, Sibchallenge had approximately 132,000 subscribers (unaudited).

The purchase price allocation was as follows:

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

License costs acquired are amortized over the remaining contractual terms of the licenses of approximately 8 years and customer base is amortized over the average remaining subscribers life of approximately 36 months.

UMC acquisition — On March 4, 2003, MTS acquired 57.7% of the outstanding voting interest of UMC, a provider of mobile services in Ukraine, for cash consideration of USD199.0 million, including the acquisition of 16.3% of the outstanding voting interest from Deutsche Telekom AG, a related party, for USD55.0 million. Acquisition costs relating to the transaction of USD1.4 million were capitalized. In connection with the acquisition, MTS also assumed debt of UMC with face value of approximately USD65.0 million, with the fair value of approximately USD62.0 million. At the date of acquisition, UMC had approximately 1.8 million subscribers (unaudited) and was one of the two leading mobile operators in Ukraine, operating under nationwide GSM-900/1800 and NMT 450 licenses.

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

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

MTS paid USD171.5 million of the purchase price in cash and agreed to pay the balance of the purchase price of USD27.5 million to Cetel B.V., a wholly-owned subsidiary of Deutsche Telekom AG, within one year. The amount payable accrued interest of 9.0% per annum. In March 2004, MTS settled in cash the balance payable to Cetel B.V.

MTS also had an option agreement with Ukrtelecom to purchase its remaining 26.0% stake in UMC, exercisable from February 5, 2003 to November 5, 2005, with an exercise price of USD87.6 million. On June 4, 2003, MTS exercised its call option. As a result of the transaction, MTS' ownership in UMC increased from 57.7% to 83.7%. The acquisition was accounted for using purchase method of accounting. The allocation of purchase price increased recorded license cost by USD10.2 million, increased customer base cost by USD13.9 million, and decreased minority interest by USD66.4 million.

In addition, MTS entered into a put and call option agreement with TDC Mobile International A/S (TDC) for the purchase of its 16.3% stake in UMC. The exercise period of the call option was from May 5, 2003 to November 5, 2004, and the put option was exercisable from August 5, 2003 to November 5, 2004. The call option price was USD85.0 million plus interest accrued from November 5, 2002 to the date of the exercise at 11% per annum; the price of the put option was calculated based on reported earnings of UMC prior to the exercise and was subject to a minimum amount of USD55.0 million. On June 25, 2003, MTS notified TDC of its intent to exercise its rights under the put and call option agreement. The purchase was completed during July 2003. MTS paid cash consideration of approximately USD91.7 million to purchase the remaining 16.3%

stake in UMC. The acquisition was accounted for using purchase method of accounting. The allocation of purchase price increased recorded license cost by USD52.7 million, increased customer base cost by USD8.7 million, and decreased minority interest by USD43.8 million.

The UMC license costs are amortized over the remaining contractual terms of the licenses of approximately 9 to 13 years as of the date of the acquisition, acquired customer base is amortized over the average remaining subscriber's life of approximately 32 months. Other acquired intangible assets, represented mostly by software, are amortized over their respective useful lives of 3 to 10 years.

In accordance with SFAS No. 141 "Business Combinations," the Group recognized USD8.0 million of goodwill relating to workforce-in-place.

TAIF–Telcom acquisition — In April 2003, MTS acquired 51.0% of the common shares of TAIF-Telcom, a Russian open joint-stock company, for cash consideration of USD51.0 million and 50.0% of the preferred shares of TAIF-Telcom for cash consideration of USD10.0 million. In May 2003, MTS acquired an additional 1.7% of the common shares of TAIF-Telcom for cash consideration of USD2.3 million. In connection with the acquisitions, MTS also assumed indebtedness of approximately USD16.6 million that was collateralized by telecom equipment.

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

The exercise period for the call option on common shares was 48 months from the acquisition date and for the put option on common shares was 36 months following an 18 months period after the acquisition date. The call and put option agreements for the common shares stipulated a minimum purchase price of USD49.0 million plus 8% per annum commencing from the acquisition date. The exercise period for the call option on preferred shares was 48 months following a 24 months period after the acquisition date and for the put option on preferred shares it was a 24 months period after the acquisition date. The call and put option agreements for the preferred shares stipulated a minimum purchase price of USD10.0 million plus 8% per annum commencing from the acquisition date. Fair value of the option was USD3.5 million at December 31, 2003.

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

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

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

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

In September 2004, MTS exercised its option to acquire the remaining 47.3% of common shares and 50.0% of preferred shares in TAIF-Telcom for cash consideration of USD63.0 million, increasing its ownership to 100.0%. The Group received title to the acquired shares in October 2004. The purchase price allocation increased recorded license cost by USD35.8 million, increased acquired customer base by USD4.2 million; goodwill was recorded in the amount of USD21.2 million. Goodwill is mainly attributable to economic potential of the market.

Acquisitions of various regional companies — In August 2003, the Group reached an agreement to acquire, in a series of related transactions, equity interests in five Russian regional mobile phone operators from MCT Corporation for a total of USD71.0 million. The Group agreed to purchase a 43.7% stake in Uraltel (described above) and 100.0% of Vostok Mobile B.V., which holds a 50.0% stake in Primtelefon.

The Group also agreed to purchase Vostok Mobile South, which holds 50.0% stakes in Astrakhan Mobile and Volgograd Mobile, as well as an 80.0% stake in Mar Mobile GSM. The Group also entered into agreements to acquire the remaining

20.0% of Mar Mobile GSM and another 2.95% stake in Uraltel from existing shareholders unrelated to MCT Corporation for approximately USD1.0 million.

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

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

In August 2004, MTS acquired from UTK the remaining 50.0% stakes in Astrakhan Mobile and Volgograd Mobile, increasing its ownership to 100.0%. An acquisition price was paid in cash and amounted to USD1.1 million and USD2.9 million, respectively. Commencing from the date of acquisition financial results of both companies are consolidated into MTS financial statements. Astrakhan Mobile holds a 800/1800 MHz licenses covering Astrakhan region (population of approximately 1 million) and Volgograd Mobile holds a 800/1800 MHz licenses covering Volgograd region (population of approximately 2.7 million). As of July 31, 2004, the two companies provided AMPS/DAMPS services to around 10 thousand subscribers (unaudited). The acquisition was accounted for using a purchase method of accounting. The allocation of purchase price for the first and second stakes in both companies resulted in increase in license cost by USD16.5 million.

In April 2004, MTS acquired from OJSC Sibirtelecom additional 7.5% stake in MSS, a company operating in Omsk Oblast, for USD2.2 million in cash. This acquisition increased MTS' ownership in MSS to 91.0%. The acquisition was accounted for using a purchase method of accounting. The allocation of purchase price increased recorded license cost by USD1.1 million.

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

- 35.0% of MTS-NN (a service provider in Nizhny Novgorod) for USD0.5 million, and
- 49.0% of Novitel (handsets dealer in Moscow) for USD1.3 million.

Both acquisitions increased MTS' share in the respective companies to 100.0%. The acquisitions were accounted for using the purchase method of accounting. The allocation of purchase price increased recorded goodwill by USD1.8 million.

In August 2004, MTS acquired from OJSC Volgatelecom remaining 49.0% stake in UDN-900 for USD6.4 million in cash. This acquisition increased MTS' ownership in UDN to 100.0%. The allocation of purchase price increased recorded license cost by USD0.3 million. UDN-900 provides GSM-900 services under the MTS brand in Udmurtia Republic (population 1.6 million). UDN's subscriber base as of July 31, 2004 was 219,760 (unaudited).

In February 2005, MTS completed the acquisition of 74.9% stake in Sweet-Com LLC for a cash consideration of USD2.0 million. Sweet-Com LLC is a holder of 3.5 GHz radio frequency allocation for Moscow Oblast. The Company is providing wide-band radio access services for the "last mile" based on the Radio-Ethernet technology. The acquisition was accounted for using purchase method of accounting. As the result of the purchase price allocation license cost was increased by USD2.4 million.

In February 2005, MTS acquired 74.0% stake in MTS-Komi Republic increasing its ownership to 100.0%. The consideration paid under the transaction amounted to USD1.2 million. The acquisition was accounted for using the purchase method of accounting.

In December 2005, MTS acquired an additional 74.0% stake in MTS-Tver for USD1.4 million. As a result of the transaction, MTS' ownership in the company increased to 100.0%. The acquisition was accounted for using the purchase method of accounting.

Pro forma results of operations (unaudited) — The following unaudited pro forma financial data for the years ended December 31, 2005 and 2004, give effect to the acquisitions of BCTI and other various regional companies as if they had occurred as of January 1, 2004:

	2005	2004
	USD, 000's	USD, 000's
Pro forma:		
Net revenues	5,038,735	3,919,782
Net operating income	1,642,363	1,419,518
Net income	1,128,567	980,416
Earnings per share, basic and diluted	0.57	0.49

The pro forma information is based on various assumptions and estimates. The pro forma information is not necessarily indicative of the operating results that would have occurred if the Group's acquisitions had been consummated as of January 1, 2004, nor is it necessarily indicative of future operating results. The pro forma information does not give effect to any potential revenue enhancements or cost synergies or other operating efficiencies that could result from the acquisitions. The actual results of operations of these companies are included in the consolidated financial statements of the Group only from the respective dates of acquisition.

4. CASH AND CASH EQUIVALENTS

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

	2005	2004
	USD, 000's	USD, 000's
U.S. dollar current accounts	4,599	107,172
U.S. dollar time deposits	751	45,295
Ruble current accounts	46,119	90,527
Ruble deposits	6,775	2,596
Hryvnia current accounts	4,540	10,190
Uzbek som current accounts	920	715
Uzbek som deposit accounts	3,812	15,106
Turkmen manat current accounts	10,651	–
Other	117	2,549
Total cash and cash equivalents	78,284	274,150

5. SHORT-TERM INVESTMENTS

Short-term investments, denominated in U.S. dollars, as of December 31, 2005, comprised the following:

	Annual interest rate	Maturity date	December 31, 2005
			USD, 000's
East-West United Bank S.A.	2.0%	February 15, 2006	23,100
Other			4,959
Total short-term investments			28,059

In 2005, the deposit agreement with East-West United Bank S.A., a related party, whose shareholder is Sistema, was amended to change the maturity date from April 2005 to February 2006. Short-term investments, denominated in U.S. dollars, as of December 31, 2004 comprised the following:

	Annual interest rate	Maturity date	December 31, 2004
			USD, 000's
OJSC Moscow Bank of Reconstruction and Development	8.4%	December 9, 2005	30,000
East-West United Bank S.A.	2.0%	April 4, 2005	23,100
OJSC Moscow Bank of Reconstruction and Development	8.4%	October 10, 2005	10,000
OJSC Moscow Bank of Reconstruction and Development	8.4%	December 14, 2005	10,000
Other			260
Total short-term investments			73,360

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

6. TRADE RECEIVABLES, NET

Trade receivables as of December 31, 2005 and 2004, were as follows:

	2005	2004
	USD, 000's	USD, 000's
Accounts receivable, subscribers	147,138	113,869
Accounts receivable, roaming	30,863	24,731
Accounts receivable, other	71,238	40,584
Allowance for doubtful accounts	(39,919)	(16,659)
Trade receivables, net	209,320	162,525

The following table summarizes the changes in the allowance for doubtful accounts for the year ended December 31, 2005, 2004, and 2003:

	2005	2004	2003
	USD, 000's	USD, 000's	USD, 000's
Balance, beginning of the year	16,659	13,698	6,270
Provision for doubtful accounts	50,407	26,459	32,633
Accounts receivable written off	(27,147)	(23,498)	(25,205)
Balance, end of the year	39,919	16,659	13,698

7. INVENTORY AND SPARE PARTS

Inventory as of December 31, 2005 and 2004 comprised the following:

	2005	2004
	USD, 000's	USD, 000's
Spare parts for base stations	48,998	14,775
Handsets and accessories	39,147	30,574
Other inventory	68,515	44,169
Total inventory and spare parts	156,660	89,518

Other inventory mainly consists of SIM cards and advertising materials. Obsolescence expense for the years ended December 31, 2005, 2004, and 2003 amounted to USD9,112, USD4,610, and USD3,307, respectively, and was included in general and administrative expenses in the accompanying consolidated statements of operations. Spare parts for base stations included in inventory are expected to be utilized within a 12 month period.

8. PROPERTY, PLANT AND EQUIPMENT

The net book value of property, plant and equipment as of December 31, 2005 and 2004 was as follows:

	2005	2004
	USD, 000's	USD, 000's
Network, base station equipment (including leased network and base station equipment of USD58,664 and USD67,905, respectively) and related leasehold improvements	3,534,574	2,538,240
Office equipment, computers, software and other (including leased office equipment, computers and software of USD402 and USD1,613, respectively)	339,788	249,458
Buildings and related leasehold improvements	225,726	202,095
Vehicles	21,830	15,658
Property, plant and equipment, at cost	4,121,918	3,005,451
Accumulated depreciation (including accumulated depreciation on leased equipment of USD27,424 and USD30,304)	(1,350,783)	(901,416)
Equipment for installation	621,346	275,010
Construction in progress	1,090,198	855,273
Property, plant and equipment, net	4,482,679	3,234,318

Interest costs of USD54.2 million and USD33.2 million were capitalized in property, plant and equipment during the years ended December 31, 2005 and 2004, respectively.

Depreciation expenses during the years ended December 31, 2005, 2004, and 2003, amounted to USD510.5 million, USD385.7 million and USD233.1 million, respectively, including depreciation expenses for leased property, plant and equipment in the amount of USD7.7 million, USD5.4 million and USD7.6 million, respectively.

9. OTHER INTANGIBLE ASSETS

Intangible assets as of December 31, 2005 and 2004 comprised the following:

		December 31, 2005			December 31, 2004		
	Useful lives	Gross carrying value	Accumulated amortization	Net carrying value	Gross carrying value	Accumulated amortization	Net carrying value
		USD, 000's	USD, 000's	USD, 000's	USD, 000's	USD, 000's	USD, 000's
Amortized intangible assets							
Acquired customer base	32–60 months	110,360	(78,219)	32,141	94,632	(50,276)	44,356
Rights to use premises	5–9 years	8,749	(2,573)	6,176	19,638	(12,393)	7,245
Radio frequencies	3–15 years	130,839	(31,227)	99,612	115,493	(31,494)	83,999
Numbering capacity with finite contractual life	5–10 years	65,763	(50,325)	15,438	52,630	(39,746)	12,884
Software and other	3–15 years	850,068	(342,754)	507,314	422,291	(175,490)	246,801
		1,165,779	(505,098)	660,681	704,684	(309,399)	395,285
Unamortized intangible assets							
Numbering capacity with indefinite contractual life		20,344	–	20,344	17,247	–	17,247
Total other intangible assets		1,186,123	(505,098)	681,025	721,931	(309,399)	412,532

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

A significant component of MTS' rights to use premises was obtained in the form of contributions to its charter capital in 1993. These premises included MTS' administrative offices and facilities utilized for mobile switching centers. By December 31, 2005, these rights are fully amortized and written off due to the expiration. In addition, simultaneously with acquisition of UMC in 2003, MTS obtained additional property rights in the amount of USD8.7 million.

Amortization expense for the years ended December 31, 2005, 2004, and 2003 amounted to USD202.3, USD138.1 and USD77.1 million, respectively. Based on the amortizable intangible assets existing as of December 31, 2005, the estimated amortization expense is USD173.5 million during 2006, USD164.4 million during 2007, USD141.0 million during 2008, USD89.5 million during 2009, USD27.5 million during 2010, and USD64.8 million thereafter. Actual amortization expense to be reported in future periods could differ from these estimates as a result of new intangible assets acquisitions, changes in useful lives and other relevant factors.

10. DEFERRED CONNECTION FEES

Deferred connection fees for the years ended December 31, 2005 and 2004 were as follows:

	2005	2004
	USD, 000's	USD, 000's
Balance at beginning of the year	92,748	46,644
Payments received and deferred during the year	53,644	93,082
Amounts amortized and recognized as revenue during the year	(44,207)	(46,978)
Balance at end of the year	102,185	92,748
Less current portion	(44,361)	(45,083)
Non-current portion	57,824	47,665

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

11. DEBT

As of December 31, 2005 and 2004, debt comprised the following:

	Currency	Annual interest rate (actual rate as of December 31, 2005)	2005	2004
			000's	000's
9.75% Notes due 2008	USD	9.75%	400,000	400,000
8.38% Notes due 2010	USD	8.38%	400,000	400,000
8.00% Notes due 2012	USD	8.00%	399,052	–
Total notes, long-term			**1,199,052**	**800,000**
Syndicated loan	USD	LIBOR+2.50% (7.20%)	460,000	600,000
Citibank N.A., ING Bank N.V. and Raiffeisen AG	USD	LIBOR+0.75%–2.25% (5.29%–6.79%)	200,000	–
HSBC Bank plc and ING BHF-BANK AG	USD	LIBOR+0.43% (5.13%)	171,816	77,003
ING Bank N.V.	USD	LIBOR+0.75% (5.14%)	150,000	–
Citibank International plc and ING Bank N.V.	USD	LIBOR+0.30% (5.00%)	111,009	–
EBRD	USD	LIBOR+3.10% (7.80%)	138,462	150,000
Commerzbank AG, ING Bank AG and HSBC Bank plc	USD	LIBOR+0.30% (5.00%)	92,826	–
ABN AMRO N.V.	USD/EUR	EURIBOR+0.35% (2.99%) LIBOR+0.35% (5.05%)	83,179	–
Barclays Bank plc	USD	LIBOR+0.13%–0.15% (4.83%–4.85%)	80,086	–
HSBC Bank plc, ING Bank AG and Bayerische Landesbank	USD	LIBOR+0.30% (5.00%)	63,338	–
ING BHF-BANK and Commerzbank AG	EUR	EURIBOR+0.65% (3.29%)	43,168	63,851
ING Bank (Eurasia)	USD	LIBOR+2.25%–4.15% (6.79%–8.69%)	20,000	46,667
Commerzbank Belgium S.A./N.V.	USD	LIBOR+0.40% (5.10%)	13,314	–
HSBC	USD	LIBOR+2.75% (7.23%)	7,500	17,500
West LB International	EUR	EURIBOR+2.00% (4.64%)	4,000	4,000
Nordea Bank Sweden	USD	LIBOR+0.40% (5.10%)	3,249	6,499
Ericsson	USD	LIBOR+4.00% (8.54%)	3,150	14,850
CSFB	USD	LIBOR+2.20% (6.74%)	–	140,000
KFW	EUR	EURIBOR+0.95% (3.59%)	–	1,478
Other debt		–	687	2,792
Total debt			**1,645,784**	**1,124,640**
Less current portion			**765,881**	**370,845**
Total long-term debt			**879,903**	**753,795**

Notes — On January 30, 2003, MTS Finance S.A. ("MTS Finance"), a 100% beneficially owned subsidiary of MTS, registered under the laws of Luxembourg, issued USD400.0 million 9.75% Notes at par. These Notes are fully and unconditionally guaranteed by MTS OJSC and mature on January 30, 2008. MTS Finance is required to make interest payments on the Notes semi-annually in arrears on January 30 and July 30, commencing on July 30, 2003. The Notes are listed on the Luxembourg Stock Exchange. Proceeds received from the Notes' issue were USD400.0 million and related issuance costs of USD3.9 million were capitaized.

On October 14, 2003, MTS Finance issued USD400.0 million Notes bearing interest at 8.375% at par. The cash proceeds from the Notes were USD395.4 million and related issuance costs of approximately USD4.6 million were capitalized. These Notes are fully and unconditionally guaranteed by MTS OJSC and will mature on October 14, 2010. MTS Finance is required to make interest payments on the Notes semi-annually in arrears on April 14 and October 14 of each year, commencing on April 14, 2004. The Notes are listed on the Luxembourg Stock Exchange.

On January 27, 2005, MTS Finance issued USD400.0 million 8.0% unsecured Notes at 99.736%. These Notes are fully and unconditionally guaranteed by MTS OJSC and mature on January 28, 2012. MTS Finance is required to make interest payments on the Notes semi-annually in arrears on January 28 and July 28, commencing on July 28, 2005. The Notes are listed on the Luxembourg Stock Exchange. Proceeds received from the Notes were USD398.9 million and related debt issuance cost of USD2.5 million were capitalized.

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

- Incur debt;
- Create liens;
- Lease properties sold or transferred by the Group;
- Enter into loan transactions with affiliates;
- Merge or consolidate with another person or convey its properties and assets to another person; and
- Sell or transfer any of its GSM licenses for the Moscow, St. Petersburg, Krasnodar and Ukraine license areas.

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

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

Management believes that the Group is in compliance with all restrictive debt covenants provisions during the three year period ended December 31, 2005.

Syndicated loan — In July 2004, MTS OJSC entered into a USD500.0 million syndicated loan agreement with international financial institutions: ING Bank N.V., ABN AMRO Bank N.V., HSBC Bank PLC, Raiffeisen Zentralbank Österreich AG, Bank Austria Creditanstalt AG, Commerzbank Aktiengesellschaft and others. The credit facility bears interest of LIBOR+2.50% per annum and matures in three years. The proceeds were used by MTS OJSC for corporate purposes, including refinancing of its existing indebtedness. In September 2004, MTS extended the total amount available under the syndicated loan for an additional USD100.0 million to the total amount of USD600.0 million. The commitment fee for the syndicated loan amounted to USD0.5 million. The debt issuance costs in the amount of USD10.2 million were capitalized. As of December 31, 2005 and 2004, the outstanding balances under the syndicated loan were USD460.0 million and USD600.0 million, respectively. The loan facility is subject to certain restrictive covenants including, but not limited to, certain financial ratios. Management believes that as of December 31, 2005, the Group is in compliance with all existing covenants.

Citibank N.A., ING Bank N.V. and Raiffeisen AG — In December 2005, UMC signed an agreement with Citibank N.A., ING Bank N.V. and Raiffeisen Zentralbank Österreich AG, for a USD200.0 million aggregated loan facility to be made available in two tranches of USD103.0 million and USD97.0 million. These funds will be used for general corporate purposes, including financing of capital expenditure and refinancing of existing indebtedness. The amount outstanding under the first tranche is guaranteed by MTS OJSC. The first and the second tranche bear interest at LIBOR+0.75% and LIBOR+2.25% per annum, respectively. The commitment fee is calculated on a daily basis at the rate of 45% of the applicable margin established for each tranche. The loan is subject to certain restrictive covenants including financial ratios and covenants limiting the Group's ability to convey or dispose its properties and assets to another person. Management believes that as of December 31, 2005, the Group is in compliance with all existing covenants. Each tranche is redeemable in four equal installments within a year after the signing date. As of December 31, 2005, the outstanding balances under the loan were USD103.0 million and USD97.0 million, respectively.

In March 2006, MTS OJSC guaranteed the amount outstanding under the second tranche and the lenders agreed to reduce the interest rate applicable to it to LIBOR+0.75% per annum.

HSBC Bank plc and ING BHF-BANK AG — In October 2004, MTS OJSC entered into two credit facility agreements with HSBC Bank plc and ING BHF-BANK AG for the total amount USD121.4 million. The facilities also allow uncommitted additional borrowing up to USD36.5 million. In April 2005, the lenders agreed to increase the amount of available credit facility by USD28.3 million. The funds received under the facilities were used to purchase telecommunication equipment and software from Siemens AG and Alcatel SEL AG for technical upgrade and expansion of network. The facility bears interest at LIBOR+0.43% per annum. A commitment fee of 0.20% per annum and an arrangement fee of 0.25% will be paid in accordance with the loan agreement. The principal and interest amounts are to be repaid in seventeen equal half-year installments, starting July 2005 for the first agreement and September 2005 for the second one. The debt issuance costs in the amount of USD25.9 million were capitalized. As of December 31, 2005 and 2004, the outstanding balances under these agreements were USD171.8 million and USD77.0 million, respectively. The facilities mature in July and September 2013 and are subject to certain restrictive covenants, including, but not limited to, covenants restricting the Group's ability to convey or dispose its properties and assets to another person.

Management believes that as of December 31, 2005, the Group is in compliance with all existing covenants. The available credit facility as of December 31, 2005, was USD3.8 million.

ING Bank N.V. — In November 2005, MTS Finance entered into a credit facility agreement with ING Bank N.V. that allows it to borrow up to USD150.0 million. These funds will be used for general corporate purposes. The loan bears interest of LIBOR+0.75% per annum. The arrangement fee totaled USD0.8 million. The loan is subject to certain restrictive covenants including, but not limited to, certain financial ratios. Management believes that as of December 31, 2005, the Group is in compliance with all existing covenants. The facility matures in 6 months after the first utilization of available loan amount. As of December 31, 2005, USD150.0 million was outstanding under the facility.

Citibank International plc and ING Bank N.V. — In December 2005, MTS OJSC signed an agreement with Citibank International plc and ING Bank N.V. for a USD130.8 million committed credit facility and a USD36.6 million uncommitted additional facility. These funds will be used to purchase telecommunication equipment from Ericsson AB. The loan bears interest of LIBOR+0.30% per annum. An arrangement fee of 0.20% of the original facility amount and agency fee of USD0.01 million per annum will be paid in accordance with the agreement. The commitment fee is 0.10% per annum on the undrawn facility. The loan is subject to certain covenants, including, but not limited to, covenants restricting the Group's ability to convey or dispose its properties and assets to another person. Management believes that as of December 31, 2005, the Group is in compliance with all existing covenants. The facilities are repayable on a biannual basis in equal installments over nine years. As of December 31, 2005, the balance outstanding under the loan was USD111.0 million. The available credit facility as of December 31, 2005, was USD19.7 million.

EBRD — In December 2004, MTS OJSC entered into a credit facility agreement with European Bank for Reconstruction and Development (EBRD) for the total amount of USD150.0 million. The facility bears interest at LIBOR+3.10% per annum. A commitment fee of 0.50% per annum should be paid in accordance with the credit agreement. The final maturity of this agreement is December 15, 2011. The debt issuance costs in the amount of USD1.5 million were capitalized. As of December 31, 2005 and 2004, the balances outstanding under the loan were USD138.5 million and USD150.0 million, respectively. The loan is subject to certain restrictive covenants including, but not limited to, certain financial ratios. Management believes that as of December 31, 2005, the Group is in compliance with all existing covenants.

Commerzbank AG, HSBC Bank plc, and ING Bank Deutschland AG — In October 2005, MTS OJSC entered into an agreement with Commerzbank AG, HSBC Bank plc, and ING Bank Deutschland AG for a USD125.8 million committed credit facility. The agreement also allows the Company to borrow up to USD28.3 million under an uncommitted additional facility. These funds will be used to purchase telecommunication equipment from Siemens AG. The loan bears interest of LIBOR+0.30% per annum. An arrangement fee of 0.20% of the original facility amount and USD0.01 million per annum will be paid in accordance with the agreement. The commitment fee is 0.10% per annum on the undrawn facility. The loan is subject to certain covenants, including, but not limited to, covenants restricting the Group's ability to convey or dispose its properties and assets to another person. Management believes that as of December 31, 2005, the Group is in compliance with all existing covenants. The facilities are repayable on a biannual basis in equal installments over nine years. As of December 31, 2005, the balance outstanding under the loan was USD92.8 million. The available credit facility as of December 31, 2005, was USD33.0 million.

ABN AMRO N.V. — In November 2004, MTS OJSC signed a loan agreement with ABN AMRO Bank N.V. for USD56.6 million and EUR8.4 million (USD9.9 million as of December 31, 2005). In March 2005, the agreement was amended to expand the euro facility up to EUR31.3 million (USD37.2 million as of December 31, 2005).These funds were used to acquire telecommunication equipment from Ericsson AB to expand the network. The loan is repayable on a biannual basis in equal installments over nine years and has an interest rate of USD LIBOR/EURIBOR+0.35% per annum. The debt issuance costs in the amount of USD9.8 million have been capitalized. The loan is subject to certain covenants, including, but not limited to, covenants restricting the Group's ability to make any substantial change to general nature or scope of its business. Management believes that as of December 31, 2005, the Group is in compliance with all existing covenants. As of December 31, 2005 and 2004, USD83.2 million and nil, respectively, were outstanding under the facility.

Barclays Bank plc — In February 2005, MTS OJSC entered into a credit facility with Barclays Bank plc to finance the acquisition of equipment from Motorola Limited. The facility allows borrowing up to USD25.7 million and uncommitted additional borrowing of up to USD64.3 million. In December 2005, the agreement with Barclays Bank plc was amended to increase the amount of available uncommitted additional facility by USD23.3 million. The original facility bears interest of LIBOR+0.15% per annum and additional uncommitted facility bears interest of LIBOR+0.13% per annum. An arrangement fee of 0.4% of the original facility amount and of 0.4% of each additional commitment facility amount will be paid in accordance with the agreement. The commitment fee is 0.175% per annum. The debt issuance costs in the amount of USD10.4 million have been capitalized. The facilities are redeemable in equal semi-annual installments by January 31, 2014. The loan is subject to certain covenants, including, but not limited to, covenants restricting the Group's ability to convey or dispose its properties and assets to another person. Management believes that as of December 31, 2005, the Group is in compliance with all existing covenants. As of December 31, 2005, the outstanding balance under the facility was USD80.1 million. The available credit facility as of December 31, 2005, was USD31.7 million.

HSBC Bank plc, ING Bank Deutschland AG, and Bayerische Landesbank — In November 2005, MTS OJSC entered into credit facility with HSBC Bank plc, ING Bank Deutschland AG, and Bayerische Landesbank for up to USD123.8 million and up to USD17.3 million of uncommitted additional borrowing. The funds received will be used to finance the acquisition of telecommunication equipment from Alcatel SEL AG. The loan bears interest of LIBOR+0.30% per annum. An arrangement fee of 0.20% of the original facility amount and an agency fee of USD0.01 million per annum will be paid in accordance with the agreement. The commitment fee is 0.10% per annum on the undrawn facility. The debt issuance costs in the amount of USD19.3 million were capitalized. The loan is subject to certain covenants, including, but not limited to, covenants restricting the Group's ability to convey or dispose its properties and assets to another person. Management believes that as of December 31, 2005, the Group is in compliance with all existing covenants. The facilities are repayable on a biannual basis in equal installments over nine years. As of December 31, 2005, the outstanding amount under the loan was USD63.3 million. The available credit facility as of December 31, 2005, was USD60.5 million.

ING BHF Bank and Commerzbank AG — On December 30, 2003, UMC entered into a credit facility with ING BHF Bank and Commerzbank AG to finance the acquisition of telecommunication equipment from Siemens AG. The aggregate amount available under this credit facility is EUR 47.4 million (USD56.3 million as of December 31, 2005). In 2004, the agreement was amended to increase the amount available under the facility by EUR 9.2 million (USD10.9 million as of December 31, 2005). The loan is guaranteed by MTS OJSC and bears interest at EURIBOR+0.65% per annum. The amount outstanding is redeemable in ten equal semi-annual installments starting on July 31, 2004. As of December 31, 2005 and 2004, the amounts outstanding under the loan were USD43.2 million and USD63.9 million, respectively.

ING Bank (Eurasia) — In September 2003, UMC entered into a USD60.0 million syndicated credit facility with ING Bank (Eurasia) ZAO, ZAO Standard Bank and Commerzbank AG with an interest rate of LIBOR+2.25%–4.15% per annum. The loan is guaranteed by MTS OJSC. The proceeds were used by UMC to refinance its existing indebtedness. The loan is payable in eight equal quarterly installments starting from September 2004. As of December 31, 2005 and 2004, USD20.0 million and USD46.7 million were outstanding, respectively, under this credit facility.

Commerzbank Belgium S.A./N.V. — In October 2004, MTS OJSC entered into a loan agreement with Commerzbank Belgium S.A./N.V. The aggregate amount under the agreement is USD18.3 million.

The loan proceeds were used to finance the purchase of telecommunication equipment from Alcatel Bell N.V. and bears interest of LIBOR+0.4% per annum. A commitment fee at rate of 0.225% per annum and flat management fee of 0.25% on the loan amount should be paid in accordance with the terms of agreement. Related debt issuance costs amounted to USD1.3 million were capitalized.

As of December 31, 2005 and 2004, the outstanding balances were USD13.3 million and nil, respectively. The available credit facility as of December 31, 2005 was USD5.0 million.

HSBC Bank LLC — In October 2003, TAIF-Telcom entered into a USD25.0 million credit facility with HSBC Bank LLC, which is guaranteed by MTS OJSC. The facility bears interest at LIBOR+2.75% per annum and is redeemable in ten equal quarterly installments commencing on June 2004. The funds were used to purchase telecommunication equipment and general corporate purposes. The loan is subject to certain restrictive covenants including, but not limited to, restriction on the Group's ability to encumbrance on its properties and assets. Management believes that as of December 31, 2005, the Group is in compliance with all existing covenants. As of December 31, 2005 and December 31, 2004, the outstanding balances under the credit facility were USD7.5 million and USD17.5 million, respectively.

West LB International — In July 2002, MTS-P entered into a credit facility agreement with West LB International S.A. Amounts outstanding under this agreement bear interest of EURIBOR+2.00% per annum for the first two years for each advance and 4.00% per annum for the remaining interest periods for each advance until maturity. The final maturity of this agreement is December 28, 2006. The loan is guaranteed by MTS OJSC. The balance outstanding under the loan was USD4.0 million as of December 31, 2005 and 2004.

Nordea Bank Sweden — In September 2003, Primtelefon entered into a long-term loan facility with Nordea Bank Sweden for the total amount of USD9.8 million. Amounts outstanding under the loan agreement bear interest at LIBOR+0.40% per annum and mature in October 2006. The loan is guaranteed by MTS OJSC. As of December 31, 2005 and 2004, the amounts outstanding under the loan were USD3.2 million and USD6.5 million, respectively.

Ericsson debt restructuring — In December 1996, Rosico, a wholly-owned subsidiary merged into MTS OJSC in June 2003, entered into a credit agreement with Ericsson Project Finance AB ("Ericsson") that provided for a credit facility with an aggregate principal amount of USD60.0 million and had a maximum term of five years (the "Ericsson Loan"). The loan was repayable in ten equal consecutive quarterly payments of USD6.0 million commencing in 1999. On July 24, 2001, MTS, Rosico and Ericsson signed an amendment to the credit agreement rescheduling Rosico principal payments in nineteen consecutive quarterly installments. The amounts advanced under the agreement bear interest of LIBOR+4.00%. If Rosico fails to pay any amount under this facility, the overdue interest would bear interest at a rate of additional 6.00% per annum. The credit agreement contains covenants restricting Rosico's ability to encumber its present and future assets and revenues without the lender's express consent.

Concurrent with the Group's acquisition of Rosico, Sistema agreed to fund the full and timely repayment of the Ericsson Loan and to indemnify Rosico and MTS for any costs incurred by either Rosico or MTS in connection with the repayment of the Ericsson Loan. During 2000, Sistema and MTS agreed on a method that would allow Sistema to fund its obligation in a manner that minimizes the total costs of meeting this obligation (including related tax costs). Under this method, MTS enters into a long-term, ruble-denominated promissory notes with 0% interest and maturities from 2049 to 2052 to repay a portion of the funding from Sistema. The carrying value of these notes is insignificant as of December 31, 2005 and December 31, 2004. The Group records interest expense on these notes over the term such that the full amount of the obligation will be reflected as a liability at the date of repayment. Through December 31, 2005, Sistema has made payments under this obligation in the amount of USD60.0 million, USD56.9 million of which are repayable in the form of long-term, ruble-denominated promissory notes with 0% interest. Amounts receivable from Sistema under this indemnification are recorded as shareholder receivable in the accompanying consolidated balance sheets.

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

As of December 31, 2005 and 2004, USD3.2 million and USD14.9 million were outstanding, respectively, under the Ericsson Loan.

CSFB — In October 2004, MTS Finance entered into a short-term loan facility with CSFB for the total amount of USD140.0 million. Amounts outstanding under the loan agreement bore interest at LIBOR+2.20% per annum. The debt was fully repaid in April 2005.

KFW — On December 21, 1998, UMC entered into two loan agreements with KFW, a German bank, for EUR 1.9 million and EUR 10.9 million. These loans bore interest at EURIBOR+0.95% per annum and matured on March 31, 2004, and February 28, 2005, respectively. As of December 31, 2005, the debt was fully repaid.

The following table presents aggregate scheduled maturities of debt principal outstanding as of December 31, 2005:

	USD, 000's
Payments due in the year ended December 31,	
2006	765,881
2007	290,815
2008	510,693
2009	104,526
2010	498,359
Thereafter	674,562
	2,844,836

In December 2004, the Group entered into two variable-to-fixed interest rate swap agreements with ABN AMRO Bank N.V. and with HSBC Bank plc to hedge MTS' exposure to variability of future cash flows caused by the change in LIBOR related to the syndicated loan. MTS agreed with ABN AMRO to pay a fixed rate of 3.27% and receive a variable interest of LIBOR on USD100.0 million for the period from October 7, 2004, up to July 27, 2007. MTS agreed with HSBC Bank plc to pay a fixed rate of 3.25% and receive a variable interest of LIBOR on USD150.0 million for the period from October 7, 2004 up to July 27, 2007. These instruments qualify as cash flow hedges under the requirements of SFAS No. 133 as amended by SFAS No. 149. As of December 31, 2005, the Group recorded an asset of USD3.6 million in relation to these contracts in the accompanying consolidated balance sheet and an income of USD2.8 million, net of tax of USD0.8 million, as other comprehensive income in the accompanying consolidated statement of changes in shareholders equity in relation to the change in fair value of these agreements. In 2005, there were no amounts reclassified from other comprehensive income to income due to hedge ineffectiveness.

12. CAPITAL LEASE OBLIGATIONS

The following table presents future minimum lease payments under capital leases together with the present value of the net minimum lease payments as of December 31, 2005:

	USD, 000's
Payments due in the year ended December 31,	
2006	3,413
2007	2,484
2008	676
2009	7
2010	5
Thereafter	2
Total minimum lease payments (undiscounted)	6,587
Less amount representing interest	(866)
Present value of net minimum lease payments	5,721
Less current portion of lease payable	(2,793)
Non-current portion of lease payable	2,928

For a schedule by years of future minimum lease payments under capital leases to Invest-Svyaz-Holding, a related party, together with the present value of the net minimum lease payments as of December 31, 2005, see Note 17 "Related parties".

13. ACCRUED LIABILITIES

Accrued liabilities as of December 31, 2005 and 2004, comprised the following:

	2005	2004
	USD, 000's	USD, 000's
Accrued payroll and vacation	60,732	44,673
Interest payable on debt	51,403	31,177
VAT	34,139	32,174
Taxes other than income	28,553	23,706
Accruals for advertising services	6,728	4,782
Other accruals	94,736	44,165
Total accrued liabilities	**276,291**	**180,677**

14. INCOME TAX

MTS' provision for income taxes was as follows for the year ended December 31, 2005, 2004, and 2003:

	2005	2004	2003
	USD, 000's	USD, 000's	USD, 000's
Current provision for income taxes	475,549	430,687	285,481
Deferred income tax benefit	(64,959)	(76,023)	(43,001)
Total provision for income taxes	410,590	354,664	242,480

The statutory income tax rate in Russia in 2003–2005 was 24%. From January 1, 2004, UMC statutory income tax rate changed from 30% to 25% as a result of changes in Ukranian tax legislation.

The statutory income tax rate reconciled to MTS' effective income tax rate is as follows for the year ended December 31, 2005, 2004, and 2003:

	2005	2004	2003
Statutory income tax rate for year	24.0%	24.0%	24.0%
Adjustments:			
Expenses not deductible for tax purposes	3.0	1.0	2.3
Effect of higher tax rate of UMC	0.3	0.2	0.9
Currency exchange and transaction gains (losses)	(0.8)	1.2	1.6
Other	(0.2)	(0.6)	0.4
Effective income tax rate	26.3%	25.8%	29.2%

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

	2005	2004
	USD, 000's	USD, 000's
Assets/(liabilities) arising from tax effect of:		
Deferred tax assets		
Depreciation of property, plant and equipment	64,113	48,829
Deferred connection fees	24,784	22,598
Subscriber prepayments	23,153	18,151
Accrued expenses	33,803	18,934
Allowance for doubtful accounts	7,027	5,220
Inventory obsolescence	7,122	2,759
Loss carry-forward (Rosico and MSS)	–	7,171
Other	8,013	4,328
	168,015	127,990
Valuation allowance	–	(7,171)
Total deferred tax assets	168,015	120,819
Deferred tax liabilities		
Licenses acquired	(140,167)	(160,358)
Depreciation of property, plant and equipment	(42,394)	(31,429)
Customer base	(7,584)	(10,746)
Other intangible assets	(20,428)	(20,226)
Debt issuance cost	(17,836)	(3,829)
Other	(14,684)	(4,771)
Total deferred tax liabilities	(243,093)	(231,359)
Net deferred tax liability	(75,078)	(110,540)
Net deferred tax assets, current	83,336	49,850
Net deferred tax liability, long-term	(158,414)	(160,390)

As of December 31, 2004, the Group had taxable loss carry-forward in the amount of USD29.9 million related to operations of Rosico that resulted in deferred tax assets in the amounts of USD7.2 million. While Rosico was merged into MTS OJSC in June 2003, the Group recorded a valuation allowance for the entire amount of the available tax loss carry-forward related to Rosico as of December 31, 2004, as MTS OJSC had not yet performed all procedures necessary to determine what amounts will be available for deductions in the future as of that date. As of December 31, 2005, the possibility of the claim for the tax loss carry-forward was assessed as remote and therefore no deferred tax asset was recorded.

The Group does not record a deferred tax liability related to undistributed earnings of UMC, Uzdunrobita and BCTI, as it intends to permanently reinvest these earnings. The undistributed earnings of UMC amounted to USD994.0 million (unaudited) and USD559.5 million as of December 31, 2005 and 2004, respectively.

15. SHAREHOLDERS' EQUITY

In accordance with Russian laws, earnings available for dividends are limited to profits determined in accordance with Russian statutory accounting regulations, denominated in rubles, after certain deductions. Net income of MTS OJSC for the years ended December 31, 2005, 2004, and 2003 that is distributable under Russian legislation totaled 12,544 million rubles (USD444.4 million), 15,209 million rubles (USD527.9 million), and 13,423.0 million rubles (USD437.4 million), respectively.

16. STOCK BONUS AND STOCK OPTION PLANS

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

Since 2002, MTS made several grants pursuant to its stock option plan to employees and directors of the Group. These options generally vest over a two year period from the date of the grant, contingent on continued employment of the grantee with the Company. A summary of the status of the Group's Option Plan is presented below:

	Shares	Weighted average exercise price
		USD
Outstanding as of December 31, 2002	4,648,421	1.42
Granted	1,952,632	2.43
Exercised	(37,557)	1.31
Exchanged for cash award	(1,746,310)	1.31
Forfeited	(19,776)	1.31
Outstanding as of December 31, 2003	4,797,410	1.87
Granted	1,665,256	5.95
Exercised	(2,726,966)	1.49
Forfeited	(204,730)	1.92
Outstanding as of December 31, 2004	3,530,970	4.09
Granted	1,778,694	6.89
Exercised	(1,801,622)	2.43
Forfeited	(320,802)	5.25
Outstanding as of December 31, 2005	3,187,240	6.47

As of December 31, 2005, the Group had the following stock options outstanding:

Exercise price	Number of shares	Remaining weighted average life (years)
5.95	1,417,546	0.54
6.89	1,769,694	1.54
	3,187,240	

None of the options granted in 2004 and 2005 outstanding at December 31, 2005 were exercisable.

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

The Group's Option Plan does not routinely allow a grantee to receive cash in lieu of shares, however due to the lack of liquidity for the Group's stock in the Russian market, 1,746,310 options were cancelled by MTS in 2003 and exchanged for a cash award of USD2.9 million.

The fair value of options granted during the three years in the period ended December 31, 2005 were estimated using the binomial option pricing model using the following assumptions:

	2005	2004	2003
Risk-free rate	4.7%	4.5%	5.2%
Expected dividend yield	3%	3%	3%
Expected volatility	40.0%	48.8%	40.0%
Expected life (years)	2	2	2
Fair value of options (per share)	USD1.74	USD2.36	USD1.02

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

17. RELATED PARTIES

Related party balances as of December 31, 2005 and 2004, comprised the following:

	2005	2004
	USD, 000's	USD, 000's
Accounts receivable:		
ROSNO for insurance	3,663	9,065
Maxima for advertising	1,689	884
Mediaplanning for advertising	1,400	–
MTT for interconnection	862	1,497
Kvazar-Micro for information systems consulting	–	2,161
T-Mobile for roaming	–	1,198
Receivables from investee companies	–	2,963
Other	47	–
Total accounts receivable, related parties	7,661	17,768
Accounts payable:		
Strom Telecom for software	25,378	7,070
Kvazar-Micro for information systems consulting	6,564	–
MTT for interconnection	4,262	2,964
MTU-Inform for interconnection	2,430	2,398
Maxima for advertising	1,082	–
MGTS for interconnection	588	607
T-Mobile for roaming	–	1,580
Other	525	2,390
Total accounts payable, related parties	40,829	17,009

Transactions with major related parties are described below.

Moscow Bank of Reconstruction and Development (MBRD) — Starting August 2000, MTS has been maintaining certain bank and deposit accounts with MBRD, whose major shareholder is Sistema. As of December 31, 2005 MTS' cash position at MBRD amounted to USD18.0 million in current accounts. As of December 31, 2004, MTS' cash position at MBRD amounted to USD72.0 million in current accounts. The related interest accrued and collected on the deposits for the years ended December 31, 2005 and 2004 amounted to USD5.4 million and USD6.8, respectively, and was included as a component of interest income in the accompanying consolidated statements of operations.

Borrowing transactions with MBRD are described in Note 11.

ROSNO OJSC (ROSNO) — MTS arranged medical insurance for its employees and property insurance with ROSNO, whose significant shareholder is Sistema. Insurance premium paid to ROSNO for the years ended December 31, 2005, 2004, and 2003 amounted to USD12.6 million, USD7.6 million, and USD16.9 million, respectively. Management believes that all of the insurance contracts with ROSNO have been entered into at market terms.

Maxima Advertising Agency ("Maxima") — In 2005, 2004, and 2003, MTS Group had agreements for advertising services with Maxima, a subsidiary of Sistema. Advertising costs related to Maxima for the years ended December 31, 2005, 2004, and 2003 amounted to USD58.6 million, USD48.9 million and USD23.7 million, respectively. Management believes that these agreements are at market terms.

Kvazar-Micro Corporation ("Kvazar") — Kvazar, a Ukrain-based company providing solutions, services, and business consulting in the field of information and communication technologies. Since July 2004, Sistema is a controlling shareholder in Kvazar. In 2004, MTS signed agreements for software implementation services with Kvazar. Pursuant to agreements with Kvazar, in years 2005 and 2004 MTS purchased software systems and related equipment in total amount of approximately USD62.0 million and USD9.7 million, respectively. Management believes that these agreements are at market terms.

Telmos — In 2005, 2004, and 2003, MTS had interconnection arrangements with and received domestic and international long-distance services from Telmos, a subsidiary of Sistema. Interconnection and line rental expenses for the years 2005, 2004, and 2003 comprised USD1.2 million, USD1.6 million, and USD1.6 million, respectively. Management believes that these arrangements are at market terms.

Moscow City Telephone Network (MGTS) — In 2005, 2004, and 2003, MTS had line rental agreements with MGTS and rented a cable plant from MGTS for the installation of optic-fiber cable. MTS also rented buildings for administrative offices as well as premises for switching and base station equipment. Rental expenses for the years 2005, 2004, and 2003 amounted to USD8.3 million, USD5.9 million and USD4.5 million, respectively. Management believes that all these transactions were made at market terms. Sistema is the majority shareholder of MGTS.

MTU-Inform — In 2005, 2004, and 2003, MTS had interconnection and line rental agreements with MTU-Inform, a subsidiary of Sistema. Interconnection and rental expenses for the years 2005, 2004, and 2003, were USD24.0 million USD25.7 million, and USD23.3 million, respectively. In 2003 MTS also purchased telephone numbering capacity from MTU-Inform for USD2.0 million. Management believes that these agreements are at market terms.

Comstar — In 2005, 2004, and 2003, MTS had interconnection and line rental agreements with Comstar, a subsidiary of Sistema. Cost of interconnecton and line rental services rendered by Comstar for the years 2005, 2004, and 2003 amounted to USD4.7 million, USD3.1 million, and USD3.6 million, respectively. Management believes that these agreements are at market terms.

T-Mobile — In 2005, T-Mobile ceased to be a related party (see Note 1). In 2004 and 2003, the Group had non-exclusive roaming agreements with T-Mobile, a shareholder of the Group. Roaming expenses for the years ended December 31, 2004 and 2003 amounted to USD6.1 million and USD1.7 million, respectively. Management believes that these agreements are at market terms.

Invest-Svyaz-Holding — In 2005 and 2004, MTS entered into agreements with Invest-Svyaz-Holding, a shareholder of MTS and a wholly-owned subsidiary of Sistema, for leasing of network equipment and billing system. These leases were recorded as capital leases in compliance with requirements of SFAS No. 13, "Accounting for Leases". The present value of future lease payments due within one year are classified as current liabilities and the remaining balance as long-term liabilities. The interest rate implicit in these leases varies from 14% to 44%, which management believes are market terms.

The following table summarizes the future minimum lease payments under capital leases to Invest-Svyaz-Holding together with the present value of the net minimum lease payments as of December 31, 2005:

	USD, 000's
Payments due in the year ended December 31,	
2006	3,233
2007	653
2008	–
Total minimum lease payments (undiscounted)	**3,886**
Less amount representing interest	(540)
Present value of net minimum lease payments	**3,346**
Less current portion of lease obligations	(2,740)
Non-current portion of lease obligations	**606**

In addition to the above lease transactions, the Group guarantees debt of Invest-Svyaz-Holding in the amount of USD3.5 million to a third party, which is used by Invest-Svyaz-Holding primarily to finance its leases to the Group (see Note 22 Commitments and contingencies).

For the year ended December 31, 2005 principal and interest paid to Invest-Svyaz-Holding were USD6.1 million and USD2.0 million, respectively. Principal and interest paid to Invest-Svyaz-Holding for the year ended December 31, 2004 were USD6.4 million and USD4.1 million, respectively. Principal and interest paid for the year ended December 31, 2003 were USD5.4 million and USD3.3 million, respectively. Management believes that these agreements are at market terms.

Strom Telecom — During 2005, 2004, and 2003 the Group entered into a number of agreements with Strom Telecom, a subsidiary of Sistema, for total amounts up to USD166.5 million, USD116.5 million and USD32.3 million, respectively. Pursuant to these contracts, the Group purchased in 2005, 2004, and 2003 billing systems and communication software support systems for approximately USD179.2 million, USD9.1 million, and USD23.7 million, respectively. Advances paid under these agreements and outstanding as of December 31, 2005 and 2004, amount to USD45.7 million and USD51.0 million, respectively.

Mediaplanning — During 2005 and 2004, MTS entered into a number of agreements to purchase advertising services with Mediaplanning, a subsidiary of Sistema. Related advertising costs recorded for the year ended December 31, 2005 and 2004, amounted to USD21.5 million and USD11.3 million, respectively.

MTT — In 2005 and 2004, MTS had interconnection and line rental agreements with MTT, a subsidiary of Sistema. Interconnection expenses for the year 2005 and 2004 amounted to USD41.1 million and USD16.1 million, respectively. Management believes that these agreements are at market terms.

18. GENERAL AND ADMINISTRATIVE EXPENSES

General and administrative expenses for the years ended December 31, 2005, 2004, and 2003, consisted of the following:

	2005	2004	2003
	USD, 000's	USD, 000's	USD, 000's
Salaries and social contributions	336,203	256,989	156,808
General and administrative	100,257	72,586	42,530
Repair and maintenance	90,609	81,538	39,406
Rent	79,869	54,054	31,968
Taxes other than income	62,102	50,033	40,432
Billing and data processing	37,287	28,238	22,067
Consulting expenses	26,486	19,694	11,361
Insurance	16,804	7,554	7,351
Inventory obsolescence expense	9,112	4,610	3,307
General and administrative expenses	758,729	575,296	355,230

19. INVESTMENTS IN AND ADVANCES TO ASSOCIATES

At December 31, 2005 and 2004, the Group's investments in and advances to associates comprised the following:

	2005	2004
	USD, 000's	USD, 000's
MTS Belarus — equity investment	66,288	27,699
MTS Belarus — loans receivable	41,341	51,894
Receivables from other investee companies	330	1,642
Total investments in and advances to associates	107,959	81,235

MTS Belarus — As of December 31, 2005 and 2004, the Group provided MTS Belarus with a total of USD41.3 million and USD51.9 million in loans, respectively. These loans bear interest of 3.00% to 11.00% per annum. In addition, the Group guarantees the debt of MTS Belarus in the amount of USD9.0 million to Citibank International plc (see Note 22 Commitments and contingencies).

The Company's share in net income of associates is included in other income in the accompanying consolidated statements of operations. For the years ended December 31, 2005, 2004, and 2003, this share amounted to USD42.4 million, USD24.1 million, and USD2.7 million, respectively.

20. OTHER INVESTMENTS

In December 2005, MTS acquired a 51.0% stake in Tarino Limited ("Tarino") for USD150.0 million in cash. Tarino was at that time the indirect owner, through its wholly-owned subsidiaries, of Bitel LLC, a Kyrgyz company holding a GSM-900/1800 license for the entire territory of Kyrgyzstan.

Concurrently with the purchase of 51.0% stake, the Group entered into a put and call option agreement with the shareholder of Tarino to acquire the remaining 49.0% interest in Tarino. The call option is exercisable by the Group from November 22, 2005 to November 17, 2006, and the put option is exercisable by the seller from November 18, 2006 to December 8, 2006. The call and put option price is USD170.0 million. The put and call option was recorded at fair value, which approximated nil as of December 31, 2005 in the consolidated balance sheet.

After a decision of the Kyrgyz Supreme Court on December 15, 2005, Bitel's offices were seized. The Group could not regain operating control over Bitel's operations in 2005 and therefore accounted for its 51.0% investment in Bitel at cost as of December 31, 2005.

On March 3, 2006, Mr. Glenn Harrigan, the court-appointed receiver of Fellowes International Holdings Limited ("Fellowes"), a British Virgin Islands corporation, which alleges rights on Bitel, filed a claim with the Supreme Court of the Kyrgyz Republic seeking a review and reversal of the Supreme Court's ruling of December 15, 2005, in favor of Fellowes upholding a first instance court's decision, whereby the shares in Bitel were transferred to Fellowes. Mr. Harrigan seeks a reversal of the Kyrgyz Supreme Court ruling on the grounds that the persons who had represented Fellowes before the Kyrgyz Supreme Court were not authorized to represent Fellowes. Fellowes is not affiliated with MTS. MTS will continue to vigorously assert its rights with respect to Bitel in the courts of Kyrgyzstan.

Currently, MTS is working with Tarino Limited's 49% shareholder to recover ownership and operational control of Bitel. Also, there is an ongoing litigation in the British Virgin Islands and arbitration in the United Kingdom related to Tarino's ownership of Bitel. These matters are likely to be subject of continued and/or new legal disputes and litigation, including the agreements with respect to Tarino Limited. It is not possible at this time to predict the outcome or resolution of any such disputes or litigation; however, MTS believes that its position is meritorious. The Group's management believes that no impairment of its investment in Bitel has occurred as of December 31, 2005.

21. OPERATING LICENSES

In connection with providing telecommunication services, the Group has been issued various operating GSM licenses by the Russian Ministry of Information Technologies and Communications. In addition to the licenses received directly from the Russian Ministry of Information Technologies and Communications, the Group was granted access to various telecommunication licenses through acquisitions. In foreign subsidiaries, the licenses are granted by the local communication ministries. As of December 31, 2005 and 2004, recorded values of the Group's telecommunication licenses were as follows:

	2005	2004
	USD, 000's	USD, 000's
Moscow license area	258,226	255,812
Krasnodar and Adygeya regions	124,396	124,396
Republic of Tatarstan	104,159	104,159
Five Asian regions of Russia	91,202	91,202
North-Western region	74,639	74,639
Seven European regions of Russia	62,266	19,503
Ukraine	61,717	56,322
Krasnoyarsk Krai, Taimyr Autonomous Okrug and Republic of Khakassia	52,625	52,625
Turkmenistan	50,503	–
Tomsk Oblast	49,282	49,282
Republic of Bashkortostan	48,932	48,932
Russia's Far East	48,107	48,107
Uzbekistan	40,861	40,861
Other	97,338	107,096
Licenses, at cost	1,164,253	1,072,936
Accumulated amortization	(561,137)	(385,664)
Licenses, net	603,116	687,272

Amortization expense for the years ended December 31, 2005, 2004, and 2003, amounted to USD194.3 million, USD151.9 million and USD105.7 million, respectively.

Based on the amortizable operating licenses existing as of December 31, 2005, the estimated future amortization expenses are USD207.8 million during 2006, USD163.1 million during 2007, USD102.0 million during 2008, USD41.8 million during 2009, USD37.4 million during 2010 and USD51.0 million thereafter. Actual amortization expense to be reported in future periods could differ from these estimates as a result of new intangible assets acquisitions, changes in useful lives, and other relevant factors.

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

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

22. COMMITMENTS AND CONTINGENCIES

Capital commitments — As of December 31, 2005, the Group had executed non-binding purchase agreements in the amount of approximately USD388.2 million to subsequently acquire property, plant, and equipment.

Operating leases — The Group has entered into lease agreements of space for telecommunication equipment and offices, which expire in various years up to 2054. Rental expenses under these operating leases of USD73.2 million, USD54.0 million, and USD32.0 million for the years ended December 31, 2005, 2004, and 2003, respectively, are included in operating expenses in the accompanying statements of operations. Future minimum lease payments due under non-cancelable leases at December 31, 2005 are as follows:

	USD, 000's
Payments due in the years ended December 31,	
2006	54,155
2007	23,780
2008	19,782
2009	16,311
2010	11,722
Thereafter	34,308
Total	160,058

Operating licenses — Since the commencement of MTS' operations in 1994, a number of telecommunication licenses for the Russian Federation were issued to MTS and its consolidated subsidiaries. These license agreements stipulated that certain fixed "contributions" be made to a fund for the development of telecommunication networks in the Russian Federation. According to the terms of licenses, such contributions were to be made during the license period upon the decision and as defined by the Board of Directors of the Association of GSM-900 Operators ("the Association"). The Association is a nongovernmental, non-profit association, and their Board of Directors comprises representatives of the major cellular communications companies, including MTS. On January 1, 2004, a new Federal Law on Communications came into effect in the Russian Federation. According to the Law the Group was required to update operating licenses as requirements to make certain fixed contributions discussed above have been abandoned with the new Law on Communications. As of December 31, 2005, MTS' potential liability according to the terms of licenses that still provide for the payment of such fees, could total approximately USD18.1 million.

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

Issued guarantees — As of December 31, 2005, the Group has issued guarantees to third party banks for the loans taken by Invest-Svyaz-Holding, a shareholder of the Group for a total amount of USD3.5 millions (see also Note 18). The guarantees expire by May 2006. The Group issued additional guarantees on behalf of MTS Belarus, an equity investee, for the total amount of USD9.0 million. The guarantees expire by April 2007. The issued guarantees are recorded at fair value in the accompanying consolidated balance sheet.

As of December 31, 2005, no event of default has occurred under any of the guarantees issued by the Group.

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

The new Federal Law on Communications sets the legal basis for the telecommunications business in Russia and defines the status that state bodies have in the telecommunications sector. In addition, the law created a universal service fund (USF) charge, which became effective May 3, 2005, calculated as 1.2% of revenue from services provided to customers, excluding interconnection and other operators' traffic routing revenue. The Company has incurred approximately USD30.3 million in USF charges for May through December 2005 which is recorded in other operating expenses.

In addition, a recent amendment to the Federal Law on Communications became effective on July 1, 2006. It implements the so-called "calling party pays," or CPP principle prohibiting mobile operators from charging their subscribers for incoming calls. Generally, operators charge subscribers for incoming calls. Under the new system, however, fixed-line operators charge their subscribers for such calls and transfer a percentage of the charge to mobile operators terminating such calls while mobile operators will not. The introduction of CPP may have a negative impact on the Group's service revenues depending on the settlement rate between mobile and fixed line operators set by the government and potential changes in customer behaviour. While the impact of this regulatory change at this point is uncertain, management believes it will not have a material adverse effect for the Group.

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

In March 2005, the Russian tax authorities audited MTS OJSC's compliance with tax legislation for the year ended December 31, 2002. Based on the results of this audit, the Russian tax authorities assessed that 372,153 thousand rubles (approximately USD12.9 million as of December 31, 2005) of additional taxes, penalties and fines were payable by the Group. The Group has prepared and filed with the Arbitrary Court of Moscow a petition to recognize the tax authorities' resolution to be partially invalid. The amount of disputed taxes and fines equals 281,504 thousand rubles (approximately USD9.8 million). The Group has already passed three court hearings which resulted in court judgments in favour of the Group, while one sitting remains. Generally, tax declarations remain open and subject to inspection for a period of three years following the tax year. As of December 31, 2005, tax declarations of the Group for the preceding three fiscal years were open for further review.

There are regulatory uncertainties in Ukraine related to treatment for VAT purposes of contributions payable to the Ukrainian pension fund ("Pension Fund") in respect of the consumption of telecommunication services by customers. The additional VAT calculated on the Pension Fund contribution could be up to USD38.1 million as of December 31, 2005. This amount includes USD13.5 million which was claimed by the tax authorities during their recent tax audit. In 2005, UMC initiated a litigation case in respect of this issue against the tax authorities, and has received favorable rulings from the courts of two instances, which are expected to become subject to further appeal from the tax authorities. Management believes that VAT was not applicable to the Pension Fund contribution during the period under review. Further, management believes that UMC is in line with industry practice and intends to defend its position. As of December 31, 2005, no VAT in relation to the above had been accrued in the Group's consolidated financial statements or paid to the tax authorities.

During 2005, a number of amendments to the Law on VAT were introduced, which resulted in uncertainty in respect of treatment of Pension Fund charges for the purposes of VAT and corporate income tax. As a result of this uncertainty, the accompanying consolidated financial statements reflect a provision for VAT charges of USD6.0 million, which is included within accrued liabilities. The maximum exposure of this risk on UMC's income tax position as of December 31, 2005, amounts to USD7.5 million plus penalties of up to 100% of tax liability. No provision was created in the accompanying consolidated financial statements as a result of this risk.

In the ordinary course of business, MTS may be party to various legal and tax proceedings, and subject to claims, certain of which relate to the developing markets and evolving fiscal and regulatory environments in which MTS operates. In the opinion of management, the MTS'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 MTS.

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

The Group's operations in Turkmenistan are subject to certain restrictions in accordance with local regulatory environment including, but not limited to, hard currency sale on the local market and hard currency repatriation. The effect of those restrictions on the financial statements is not material.

23. 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.

As a result of a reorganization of the Group's management structure launched in 2004, the Company created a new intermediate management level known as macro-regions, which is intended to replace the legal entities-based management structure. Each macro-region (MR) consists of three to eight operational regions, excluding macro-region Moscow, which consists of one region. Since January 2005, the Group's business has been organized and managed by ten Russian macro-regions and foreign subsidiaries. Management of the Group regularly reviews certain operational and financial information by macro-regions, therefore segment information below is presented on macro-regional basis. Discrete financial information on this basis is available starting from 2005. The Group has restated the corresponding items of segment information for the year 2004, however it is impracticable to do so for the year 2003.

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

As of December 31, 2005, the Group has several operating segments, of which six are reportable segments — macro-regions Moscow, North-West, South, Siberia, Far East, and Ukraine.

	2005	2004
	USD, 000's	USD, 000's
Revenue:		
MR Moscow	1,867,435	1,693,685
MR Ukraine	1,201,827	832,313
MR North-West	384,743	347,881
MR South	347,819	260,173
MR Siberia	296,353	225,188
MR Far East	282,925	110,562
Other	1,054,871	810,855
Intercompany eliminations	(424,955)	(393,663)
Total revenue	5,011,018	3,886,994
Depreciation and amortization:		
MR Moscow	224,653	194,873
MR Ukraine	153,795	124,935
MR North-West	86,244	64,036
MR South	91,407	81,749
MR Siberia	54,846	39,548
MR Far East	42,776	15,572
Other	257,944	158,333
Intercompany eliminations	(4,552)	(3,317)
Total depreciation and amortization	907,113	675,729
Operating income:		
MR Moscow	630,300	585,735
MR Ukraine	431,292	317,860
MR North-West	131,397	126,791
MR South	80,929	67,209
MR Siberia	71,376	71,437
MR Far East	78,510	37,856
Other	213,861	217,021
Intercompany eliminations	(5,634)	(4,846)
Total operating income	1,632,031	1,419,063

As of December 31, 2005, the Group has several operating segments, of which six are reportable segments — macro-regions Moscow, North-West, South, Siberia, Far East, and Ukraine.

2004	2005	
	USD, 000's	USD, 000's
Currency exchange and transaction gains	(10,319)	(6,529)
Interest income	(24,828)	(21,792)
Interest expense	132,474	107,956
Equity in net income of associates	(42,361)	(24,146)
Other expenses /(income)	13,211	(9,310)
Income before provision for income taxes and minority interest	1,563,854	1,372,884
Additions to long-lived assets:		
MR Moscow	632,659	493,086
MR Ukraine	719,279	303,761
MR North-West	150,570	158,494
MR South	144,449	198,287
MR Siberia	112,062	90,277
MR Far East	90,326	241,716
Other	488,891	343,529
Total additions to long-lived assets	2,338,236	1,829,150
Goodwill:		
MR Moscow	–	–
MR Ukraine	8,000	8,000
MR North-West	–	–
MR South	26,302	–
MR Siberia	–	–
MR Far East	33,494	30,590
Other	87,425	69,739
Total goodwill	155,221	108,329
Long-lived assets:		
MR Moscow	1,855,619	1,434,101
MR Ukraine	1,390,966	838,020
MR North-West	398,739	344,691
MR South	430,197	362,772
MR Siberia	294,195	227,112
MR Far East	292,414	248,566
Other	1,306,951	1,024,597
Intercompany eliminations	(47,040)	(37,408)
Total long-lived assets	5,922,041	4,442,451
Total assets:		
MR Moscow	2,729,964	2,348,288
MR Ukraine	1,560,762	993,997
MR North-West	458,829	418,131
MR South	491,352	498,695
MR Siberia	448,320	307,408
MR Far East	384,020	303,384
Other	1,934,150	1,172,691
Intercompany eliminations	(461,617)	(461,407)
Total assets	7,545,780	5,581,187

For comparative purposes the segment information is presented below on a prior years basis.

	2005	2004	2003
	USD, 000's	USD, 000's	USD, 000's
Revenue:			
MTS OJSC	2,360,542	2,129,544	1,471,198
UMC[1]	1,201,827	832,313	394,038
Telecom XXI[2]	382,897	297,194	210,460
Kuban GSM[2]	270,157	225,350	168,401
Other	1,220,550	796,256	432,770
Intercompany eliminations	(424,955)	(393,663)	(130,669)
Total revenue	5,011,018	3,886,994	2,546,198
Depreciation and amortization:			
MTS OJSC	331,642	253,485	199,946
UMC	153,795	124,935	66,392
Telecom XXI	86,138	57,265	36,782
Kuban GSM	67,927	68,140	32,299
Other	272,163	175,221	82,185
Intercompany eliminations	(4,552)	(3,317)	(1,688)
Total depreciation and amortization	907,113	675,729	415,916
Operating income:			
MTS OJSC	672,666	728,101	527,837
UMC	431,292	317,860	131,704
Telecom XXI	131,318	104,936	80,632
Kuban GSM	99,904	74,622	74,599
Other	302,485	198,390	123,577
Intercompany eliminations	(5,634)	(4,846)	(15,751)
Total operating income	1,632,031	1,419,063	922,598
Currency exchange and transaction gains	(10,319)	(6,529)	(693)
Interest income	(24,828)	(21,792)	(18,076)
Interest expense	132,474	107,956	106,551
Equity in net income of associates	(42,361)	(24,146)	(2,670)
Other expenses/(income)	13,211	(9,310)	6,090
Income before provision for income taxes and minority interest	1,563,854	1,372,884	831,396
Additions to long-lived assets:			
MTS OJSC	760,471	679,023	389,446
UMC[1]	719,279	303,761	900,465
Telecom XXI	214,207	62,333	174,128
Kuban GSM	50,570	69,689	172,949
Other	593,709	714,344	393,526
Total additions to long-lived assets	2,338,236	1,829,150	2,030,514

[1] Acquired in March 2003
[2] Merged with MTS OJSC on July 1, 2005

	2005	2004
	USD, 000's	USD, 000's
Long-lived assets:		
MTS OJSC	2,371,664	1,891,869
UMC, including goodwill in the amount of USD8,398 as of December 31, 2005 and 2004	1,390,966	838,020
Telecom XXI	398,217	295,505
Kuban GSM	263,684	279,883
Other, including goodwill in amounts of USD146,823 and USD100,329 as of December 31, 2005 and 2004, respectively	1,544,550	1,174,582
Intercompany eliminations	(47,040)	(37,408)
Total long-lived assets	5,922,041	4,442,451
Total assets:		
MTS OJSC	5,224,821	2,717,814
UMC	1,560,762	993,997
Telecom XXI	456,469	363,888
Kuban GSM	317,841	393,656
Other	447,504	1,573,239
Intercompany eliminations	(461,617)	(461,407)
Total assets	7,545,780	5,581,187

24. SUBSEQUENT EVENTS

Merger — On March 31, 2006, the Russian registration authority approved the merger of nine wholly-owned MTS subsidiaries in Russia into MTS OJSC. These subsidiaries are Gorizont RT, TAIF-Telcom, MTS-RTK, Sibchallenge, Tomsk Cellular Communications (TSS), BM Telekom, Far East Cellular Systems-900 (FECS-900), Siberian Cellular Systems-900 (SCS-900) and Uraltel. The merger was completed in line with the Group's strategy to consolidate administratively all its majority-owned subsidiaries and improve management efficiency.

HSBC Bank plc — In January 2006, MTS OJSC entered into a credit facility agreement with HSBC Bank plc. The facility allows borrowing of up to USD100.0 million. The funds received will be used for general corporate purposes. The loan bears interest of LIBOR+0.75% per annum. An arrangement fee in the amount of USD0.6 million should be paid in accordance with the agreement. The facility was repaid by July 2006.

Syndicated loan — On April 21, 2006, MTS OJSC signed a syndicated loan facility with the following international financial institutions: The Bank of Tokyo-Mitsubishi UFJ, Ltd., Bayerische Landesbank, HSBC Bank plc, ING Bank N.V., Raiffeisen Zentralbank Österreich AG and Sumitomo Mitsui Banking Corporation Europe Limited. The facility allows the Group to borrow up to USD1,330.0 million and is available in two tranches of USD630.0 million and USD700.0 million. The proceeds will be used by OJSC MTS for general corporate purposes, including acquisitions and refinancing of existing indebtedness. The first tranche bears interest of LIBOR+0.80% per annum and matures in three years. The second tranche matures in April 2011, bears interest of LIBOR+1.00% per annum within the first three years and LIBOR+1.15% per annum thereafter and is repayable in 13 equal quarterly installments, commencing in April, 2008. The loan is subject to certain restrictive covenants, including, but not limited to, certain financial ratios, limitations on dispositions of assets and limitations on transactions with associates.

NON–GAAP FINANCIAL MEASURES

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

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

RECONCILIATION OF NON–GAAP FINANCIAL MEASURES TO GAAP FINANCIAL MEASURES

For the years ended December 31, 2005 and 2004 OIBDA and OIBDA margin can be reconciled to MTS' consolidated statements of operations as follows:

	2005	2004	Change
Operating income (USD million)	1,632.0	1,419.1	15%
Add: depreciation and amortization (USD million)	907.1	675.7	34%
OIBDA (USD million)	2,539.1	2,094.8	21%
Operating margin	32.6%	36.5%	(390BP)
Add: depreciation and amortization as a percentage of revenues	18.1%	17.4%	70BP
OIBDA margin	50.7%	53.9%	(320BP)

For the year ended December 31, 2005 free cash flow and free cash flow before acquisitions can be reconciled to MTS' consolidated statements of cash flows as follows:

	2005
	USD million
Net cash provided by operating activities	1,797.4
Less:	
Purchases of property, plant and equipment	1,758.0
Purchases of intangible assets	423.4
Purchases of other investments	150.0
Investment in and advances to associates	(12.8)
Free cash flow before acquisitions	(521.2)
Acquisitions of subsidiaries, net of cash acquired	178.9
Free cash flow	(700.1)

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

For the years ended December 31, 2005 and 2004 Net debt can be reconciled to our consolidated balance sheets as follows:

	2005	2004
Debt, current portion (USD million)	765.9	370.8
Notes payable, current portion (USD million)	–	–
Capital lease obligations, current portion (USD million)	2.8	8.6
Notes payable, net of current portion (USD million)	1,199.1	800.0
Debt, net of current portion (USD million)	879.9	753.8
Capital lease obligations, net of current portion (USD million)	2.9	3.9
Total debt (USD million)	2,850.6	1,937.1
Less: cash and cash equivalents (USD million)	78.3	274.2
short-term investments (USD million)	28.1	73.4
Net debt (USD million)	2,744.2	1,589.5
Total debt to OIBDA	1,1x	0,9x
Net debt to OIBDA	1,1x	0,8x

Return on invetsed capital (ROIC). Return on invested capital is calculated as (net income + interest expense + depreciation expense) / (equity + minority interest + long-term financial obligations).

DEFINITIONS

Subscriber. We define a "subscriber" as an individual or organization whose account shows chargeable activity within sixty one days, or one hundred and eighty three days in the case of our Jeans brand tariff, or whose account does not have a negative balance for more than this period.

Average monthly service revenue per subscriber (ARPU). We calculate our ARPU by dividing our service revenues for a given period, including guest roaming fees, by the average number of our subscribers during that period and dividing by the number of months in that period.

Average monthly minutes of usage per subscriber (MOU). MOU is calculated by dividing the total number of minutes of usage during a given period by the average number of our subscribers during the period and dividing by the number of months in that period.

Churn. We define our "churn" as the total number of subscribers who cease to be a subscriber as defined above during the period (whether involuntarily due to non-payment or voluntarily, at such subscriber's request), expressed as a percentage of the average number of our subscribers during that period.

Subscriber acquisition cost (SAC). We define SAC as total sales and marketing expenses and handset subsidies for a given period. Sales and marketing expenses include advertising expenses and commissions to dealers. SAC per gross additional subscriber is calculated by dividing SAC during a given period by the total number of gross subscribers added by us during the period.

CORPORATE INFORMATION

CORPORATE HEADQUARTERS

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