

- (11) Subscriber acquisition costs are calculated as total sales and marketing expenses and handset subsidies for a given period divided by the total number of gross subscribers added during that period. Effective January 1, 2001, we changed our accounting policy and began expensing dealer commissions on new connections as incurred instead of amortizing them over the estimated average subscriber life. For Ukraine, the 2003 figure has been calculated based on the months of March through December 2003.
- (12) 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. For Ukraine, the 2003 figure has been annualized based on the months of March through December 2003. The significant decrease in the 2004 churn rate in Ukraine is largely attributable to the change in our churn policy for "Jeans" and "Sim-Sim" subscribers in Ukraine. See note 8 above. Under the previous churn policy, the 2004 churn rate in 2004 was 23%.

## **B. Capitalization and Indebtedness**

Not applicable.

## **C. Reasons for the Offer and Use of Proceeds**

Not applicable.

## **D. Risk Factors**

*An investment in our securities involves a high degree of risk. You should carefully consider the following information about these risks, together with other information contained in this document, before you decide to buy our securities. If any of the following risks actually occur, our business, prospects, financial condition or results of operations could be materially adversely affected. In that case, the value of our securities could also decline and you could lose all or part of your investment.*

*We have described the risks and uncertainties that our management believes are material, but these risks and uncertainties may not be the only ones we face. Additional risks and uncertainties, including those we currently are not aware of or deem immaterial, may also result in decreased revenues, increased expenses or other events that could result in a decline in the value of our securities.*

### **Risks Relating to Business Operations in Emerging Markets**

***Emerging markets such as the Russian Federation, Ukraine and other CIS countries are subject to greater risks than more developed markets, including significant legal, economic and political risks.***

Investors in emerging markets such as the Russian Federation, Ukraine and other CIS countries should be aware that these markets are subject to greater risk than more developed markets, including in some cases significant legal, economic and political risks. Investors should also note that emerging economies such as the economies of the Russian Federation and Ukraine are subject to rapid change and that the information set out herein may become outdated relatively quickly. Accordingly, investors should exercise particular care in evaluating the risks involved and must decide for themselves whether, in light of those risks, their investment is appropriate. Generally, investment in emerging markets is only suitable for sophisticated investors who fully appreciate the significance of the risks involved and investors are urged to consult with their own legal and financial advisors before making an investment in our securities.

### **Risks Relating to Our Business**

***If our purchase of UMC is found to have violated Ukrainian law or the purchase is unwound, our business, prospects and results of operations would be materially adversely affected.***

On June 7, 2004, the General Prosecutor of Ukraine filed a claim against us and others in the Kiev Commercial Court seeking to unwind the sale by Ukrtelecom of its 51% stake in UMC to us. The complaint also sought an order prohibiting us from alienating 51% of our stake in UMC until the claim

was resolved on the merits. The claim was based on a provision of the Ukrainian privatization law that included Ukrtelecom among a list of "strategic" state holdings prohibited from alienating or encumbering its assets during the course of its privatization. While the Cabinet of Ministers of Ukraine in May 2001 issued a decree specifically authorizing the sale by Ukrtelecom of its entire stake in UMC, the General Prosecutor asserted that the decree contradicted the privatization law and that the sale by Ukrtelecom was therefore illegal and should be unwound. On August 12, 2004, the Kiev Commercial Court rejected the General Prosecutor's claim.

On August 26, 2004, the General Prosecutor requested the Constitutional Court of Ukraine to review whether certain provisions of the Ukrainian privatization law limiting the alienation of assets by privatized companies were applicable to the sale by Ukrtelecom of UMC shares to us. As of the date of this document, the Constitutional Court of Ukraine has yet to respond to the General Prosecutor's request.

If the Constitutional Court of Ukraine determines that Ukrtelecom's sale of its stake in UMC contradicted the terms of the Ukrainian privatization law, the General Prosecutor would be able to request the Kiev Commercial Court to reopen the case based on new circumstances and could potentially include additional plaintiffs that were not parties to the original proceeding and/or additional claims.

In addition, as UMC was formed during the time when Ukraine's legislative framework was developing in an uncertain legal environment, its formation and capital structure may also be subject to challenges. In the event that our purchase of UMC is found to have violated Ukrainian law or the purchase is unwound, in whole or in part, our business, prospects and results of operations would be materially adversely affected.

***Our controlling shareholder has the ability to control our operations and its interests may conflict with those of holders of our securities, and it may make decisions that materially adversely affect your investment.***

Sistema controls 50.6% of our outstanding shares. As a result, Sistema has the ability to implement actions requiring shareholder approval, including the election of a majority of our directors and the declaration of dividends, and has the ability to control our operations. Therefore, decisions made by Sistema will influence our business, results of operations and financial condition, and these decisions may conflict with the interests of the holders of our securities.

Sistema has outstanding a significant amount of indebtedness, including \$350.0 million of notes maturing in 2008 and \$350.0 million of notes maturing in 2011. In addition, the notes maturing in 2011 can be redeemed at the option of the noteholders in 2007. Therefore, Sistema will require significant funds to meet its obligations, which may come in part from dividends paid by its subsidiaries, including us.

Sistema voted in favor of declaring dividends of \$111.4 million in 2003 and \$220.0 million in 2004. The indentures relating to our outstanding notes do not restrict our ability to pay dividends. As a result of paying dividends, our reliance on external sources of financing may increase, and our cash flow and ability to repay our debt obligations, or make capital expenditures, investments and acquisitions could be materially adversely affected.

Sistema also owns an interest in Sky Link CJSC, which operates on a CDMA-2000 standard in a number of key regions, including Moscow and St. Petersburg. Sky Link may pursue business strategies that specifically target high-end businesses and residential customers, which could result in increased competition for us.

***Increased competition and a more diverse subscriber base have resulted in decreasing average monthly service revenues per subscriber, which may materially adversely affect our results of operations.***

While our subscriber base and revenues are growing as we continue to grow our operations, our average monthly service revenues per subscriber are decreasing. For example, our average monthly service revenues per subscriber in Russia for 2002, 2003 and 2004 was \$23, \$17 and \$12, respectively. We expect our average monthly service revenues per subscriber to continue to decrease due to tariff decreases, lower tariffs in the regions outside of the Moscow license area and the increase of mass-market subscribers as a proportion of our overall subscriber mix. See "Item 5. Operating and Financial Review and Prospects." In addition, the Russian government may consider the introduction of a "calling party pays," or CPP, scheme. The introduction of CPP may have a negative impact on our average monthly service revenues per subscriber and margins depending on the settlement rate between mobile and fixed line operators set by the government. A decrease in our average monthly service revenues per subscriber may materially adversely affect our results of operations.

***We are in the process of transferring to a new billing system, which could have a material adverse effect on our business and results of operations in the short term.***

We are in the process of implementing a new billing system, which we expect to complete in December 2005. We expect the new billing system will ultimately increase our overall efficiency and reduce our expenses in the long term. During the transition period, however, we will be required to run both the old and new billing systems simultaneously, creating additional burdens on our technical support staff. We may also experience technical problems with the new billing system during the transition period. These factors may increase our operational risks and expenses and inconvenience subscribers in the short term and, consequently, have a material adverse effect on our business and results of operations.

***Our failure to implement the necessary infrastructure to manage our growth could have a material adverse effect on our business and results of operations.***

Our billing system registers and debits the account of a subscriber for calls made by such subscriber after such calls are made. There could be potential delays between the time that a subscriber's balance reaches zero and the disconnection of such subscriber from our network and, to the extent that this occurs, there would be an increase in our doubtful accounts receivable. During the first quarter of 2003, certain dealers and subscribers together fraudulently exploited these billing time lags by placing a sizeable amount of domestic and international long distance calls using subscriber accounts registered under false names. We discovered this fraud in March 2003, and we incurred approximately \$16.7 million in losses during 2003 as a result of this dealer fraud. We have taken measures that we believe will prevent further use of this scheme, such as requiring our subscribers to activate their long distance services in person at our service centers. This, in turn, may cause us to lose subscribers who view the new requirement as burdensome and materially adversely affect our market share. We have also canceled our contracts with certain dealers who had the highest numbers of fraudulent accounts. In 2004, we did not incur any significant losses as a result of subscriber or dealer fraud.

The failure or breakdown of key components of our infrastructure in the future, including our billing system, could have a material adverse effect on our business and results of operations.

***If we cannot successfully develop our network or integrate our acquired businesses, we will be unable to expand our subscriber base and maintain our profitability.***

We plan to expand our network infrastructure in the following ways:

- extend coverage and increase the capacity of our existing network in the Moscow and regional license areas;
- further develop our operations in Ukraine and Uzbekistan and make investments in MTS Belarus; and

- introduce service in the regions in which we have licenses and have not yet commenced operations.

Our ability to increase our subscriber base depends upon the success of our network expansion. We have expended considerable amounts of resources to enable this expansion. Limited information regarding the markets into which we have or are considering expanding, either through acquisitions or new licenses, complicates accurate forecasts of future revenues from those regions, increasing the risk that we may overestimate these revenues.

In addition, we have expanded our network through acquisitions and we may continue to engage in further acquisitions. We may not be able to integrate previous or future acquisitions successfully or operate them profitably. Such integration requires significant time and effort from our senior management, who are also responsible for managing our existing operations. Such integration may also be difficult as our technical systems may differ from those of the acquired businesses. In addition, unpopular cost cutting measures may be required and control of cash flow may be difficult to establish. Any difficulties encountered in the transition and integration process could have a material adverse effect on our results of operations.

We also may face risks during the course of our expansion into countries outside of the Russian Federation. Differing cultures and more uncertain business operating environments could lead to lower profitability and higher risks to our business.

The buildout of our network is also subject to risks and uncertainties, which could delay the introduction of service in some areas and increase the cost of network construction, including difficulty in obtaining base station sites on commercially attractive terms. In addition, telecommunications equipment used in Russia and Ukraine is subject to governmental certification, which must be renewed at least every three years. The failure of any equipment we use to receive timely certification or re-certification could also hinder our expansion plans. To the extent we fail to expand our network on a timely basis, we could experience difficulty in expanding our subscriber base.

***Rapid growth and expansion may cause us difficulty in obtaining adequate managerial and operational resources and strain our financial resources, restricting our ability to successfully expand our operations.***

We have experienced substantial growth and development in a relatively short period of time, and we believe that our businesses may continue to grow for the foreseeable future. The operating complexity of our business, as well as the responsibilities of management, have increased as a result of this growth, placing significant strain on our managerial and operational resources. Our future operating results depend, in significant part, upon the continued contributions of a small number of our key senior management and technical personnel.

We will need to continue to improve our operational and financial systems and managerial controls and procedures to keep pace with our growth. We will also have to maintain close coordination among our logistical, technical, accounting, finance, marketing and sales personnel. Management of growth will require, among other things:

- stringent control of network buildout, operating and other costs;
- the ability to integrate new acquisitions into our operations;
- continued development of financial and management controls and information technology systems, and their implementation in newly acquired businesses;
- implementation of adequate internal control over financial reporting and disclosure controls and procedures; and
- hiring and training of new personnel.

Our success will depend, in part, on our ability to continue to attract, retain and motivate qualified personnel. Competition in Russia, Ukraine and in the other CIS countries where we operate for personnel with relevant expertise is intense due to the small number of qualified individuals. We are not insured against damage that we may incur in case of loss or dismissal of our key personnel. Our inability to successfully manage our growth or personnel needs could have a material adverse effect on our business, financial condition and results of operations.

***If we cannot interconnect cost-effectively with other telecommunications operators, we may be unable to provide services at competitive prices and therefore lose market share and revenues.***

Our ability to provide commercially viable services depends on our ability to continue to interconnect cost-effectively with the Moscow City Telephone Network, or MGTS, and other incumbent fixed-line operators in Russia, Ukrtelecom, in Ukraine, and other local, domestic and international telecommunications operators. Fees for interconnection are established by agreements with network operators and vary, depending on the network used, the nature of the call and the call destination. We have entered into interconnection agreements with several local, domestic and international telecommunications operators, including MGTS and Rostelecom in Russia and UTEL and Ukrtelecom in Ukraine. Interconnection with these operators is required to complete calls originating on our network but terminating outside of it and to complete calls to our subscribers originating outside of our network.

In Russia, the government plans to privatize Svyazinvest, a holding company that controls several regional fixed-line operators. In Ukraine, the government plans to privatize Ukrtelecom, which has a market share of over 80% of all fixed-line telecommunications services in Ukraine. The timing of these privatizations is not yet known, and it is unclear how these privatizations will affect our interconnection arrangements and costs.

Although Russian legislation requires that operators of public switched telephone networks may not refuse to provide interconnections or discriminate against one operator over another, we believe that, in practice, some public network operators attempt to impede wireless operators by delaying interconnection applications and by charging varying interconnect rates to different wireless operators and, in particular, more favorable rates to local wireless operators, potentially enabling our competitors to offer lower prices. Any difficulties or delays in interconnecting cost-effectively with other networks could hinder our ability to provide services at competitive prices or at all, causing us to lose market share and revenues, which could have a material adverse effect on our business and results of operations.

***Governmental regulation of our interconnect rates in Ukraine could adversely affect our results of operations.***

Under the Ukrainian Telecommunications Law adopted in November 2003, the National Commission for the Regulation on Communications, or the NCRC, commencing January 1, 2005, has been entitled to regulate the tariffs for public telecommunications services rendered by fixed-line operators, whereas the mobile cellular operators (including UMC) are entitled to set their retail tariffs and negotiate interconnect rates with other operators. However, the NCRC would be entitled to regulate the interconnect rates of any mobile cellular operator declared a "dominant market force" by the Antimonopoly Committee of Ukraine, or the AMC. Government regulation of our interconnect rates could cause our interconnect revenues to decrease or be limited, which could have a material adverse effect on our results of operations.

In addition, we believe that the state-owned fixed-line operator monopolies, Ukrtelecom and UTEL, are currently able to influence telecommunications policy and regulation and may cause substantial increases in interconnect rates for access to fixed-line operators' networks by the mobile cellular operators. Such increases could cause our costs to increase, which could have a material

adverse effect on our results of operations. Similarly, Urktelecom and UTEL may cause substantial decreases in interconnect rates for access to mobile cellular operators' networks by the fixed-line operators, which could cause our revenues to decrease and materially adversely affect our results of operations.

***If frequencies currently assigned to us are reassigned to other users or if we fail to obtain renewals of our frequency allocations, our network capacity will be constrained and our ability to expand limited, resulting in a loss of market share and lower revenues.***

There is a limited number of frequencies available for wireless operators in each of the regions in which we operate or hold licenses to operate. We are dependent on access to adequate spectrum allocation in each market in which we operate in order to maintain and expand our subscriber base. While we believe that our current spectrum allocations are sufficient, frequency may not be allocated to us in the future in the quantities, with the geographic span and for time periods that would allow us to provide wireless services on a commercially feasible basis throughout all of our license areas. For example, the availability of frequencies in the GSM 900 MHz band in Ukraine is limited by the fact that the Ukrainian military has a number of frequencies for its exclusive use. While future capacity constraints could be reduced by an increase in the GSM frequencies allocated to us, including additional frequencies in the GSM 1800 MHz band, we may not be awarded some or any of the remaining GSM spectrum. In addition, the Ukrainian government is currently delaying the allocation of new frequencies to wireless communications operators in Ukraine which, in turn, may constrain our network capacity in those areas of Ukraine characterized by high subscriber usage.

A loss of assigned spectrum allocation, which is not replaced by other adequate allocations, could also have a substantial adverse impact on our network capacity. For example, on September 5, 2000, we received a letter from the State Service for Communication Control, a department of the Ministry of Information Technologies and Communications, informing us of the cancellation of the approval the State Service for Communication Control had given it in May 2000 for certain frequencies within the 900 MHz band in order to install base stations with restricted emanation, which we used primarily for the development of our network in the underground stations of the Moscow subway system. While the Department of Communications Control, also under the Ministry of Information Technologies and Communications, halted the implementation of this letter on September 14, 2000, and the Ministry of Information Technologies and Communications reinstated these frequency allocations to us on November 14, 2000, such future attempts may be made to remove frequency allocations from us. In addition, frequency allocations are often issued for periods that are shorter than the terms of the licenses, and such allocations may not be renewed in a timely manner or at all. If our frequencies are revoked or we are unable to renew our frequency allocations, our network capacity would be constrained and our ability to expand limited, resulting in a loss of market share and lower revenues.

***Because we lack a comprehensive back-up system for our network and insurance for our computer systems, a network or computer systems failure could prevent us from operating our business and lead to a loss of subscribers, damage to our reputation and violations of the terms of our licenses and subscriber contracts and penalties.***

We have back-up capacity for our network management, operations and maintenance systems, but automatic transfer to back-up capacity is limited. In the event that the primary network management center was unable to function, significant disruptions to our systems would occur, including our inability to provide services. Disruptions in our services occurred in the Moscow license area on May 30, 2003, in the Kiev license area on August 31, 2004 and September 1-2, 2004, in the Nizhny Novgorod license area on December 10, 2004 and in the Kirov license area on December 21, 2004. See "Item 4. Information on Our Company—B. Business Overview—Regulation in Ukraine—Competition" for a description of the recommendation issued by the AMC to UMC following the Kiev area disruptions.

These types of disruptions may recur, which could lead to a loss of subscribers, damage to our reputation, violations of the terms of our licenses and subscriber contracts and penalties.

Our computer and communications hardware is protected through physical and software safeguards. However, it is still vulnerable to fire, storm, flood, loss of power, telecommunications failures, interconnection failures, physical or software break-ins, viruses and similar events. Although we have insured our computer and communications hardware against fires, storms and floods, we do not carry business interruption insurance to protect us in the event of a catastrophe, even though such an event could have a material adverse effect on our business.

***Failure to fulfill the terms of our licenses, including the payment of license contributions, could result in their suspension or termination, which could have a material adverse effect on our business and results of operations.***

Our licenses contain various requirements. These include participation in a federal communications network, adherence to technical standards, investment in network infrastructure and employment of Russian technical personnel.

In addition, some of our current licenses in Russia provide for payments to be made pursuant to a decision by the Association of GSM Operators, or the Association, to finance telecommunication infrastructure improvements, which in the aggregate could total up to \$103.0 million as of December 31, 2004. The Association is a nongovernmental not-for-profit organization comprised of representatives from the major cellular communications companies, including us. Neither the Association nor Russian lawmakers have established a procedure for enforcing and collecting such payments and the new Federal Law on Communications, which came to effect on January 1, 2004, does not provide for such payments to be made. Accordingly, we have made no payments to date pursuant to any of the current licenses which could require such payments. Each of our licenses also requires service to be started by a specific date and most contain further requirements as to network capacity and territorial coverage to be reached by specified dates.

If we fail to comply with the requirements of applicable Russian, Ukrainian or other legislation or we fail to meet any terms of our licenses, our licenses and other authorizations necessary for our operations may be suspended or terminated. A suspension or termination of our licenses or other necessary governmental authorizations could have a material adverse effect on our business and results of operations.

***If we are unable to maintain our favorable brand image, we may be unable to attract new subscribers and retain existing subscribers, leading to loss of market share and revenues.***

Our ability to attract new subscribers and retain existing subscribers depends in part on our ability to maintain what we believe to be our favorable brand image. Negative publicity or rumors regarding our company or shareholders and affiliates or our services could negatively affect this brand image, which could lead to loss of market share and revenues.

***We may be unable to obtain licenses for third-generation, or UMTS, wireless services on commercially reasonable terms or at all, which would hinder us from competing effectively with operators who are able to provide these services and limit our ability to expand our services.***

During the past few years, the Ministry of Information Technologies and Communications has stated its intention to announce the procedures for the award of licenses for UMTS wireless services. To date, however, no procedures have been announced. Depending upon the procedures adopted, we may be unable to obtain UMTS licenses on commercially reasonable terms or at all. Failure to obtain UMTS licenses for the Moscow and other license areas or Ukraine (although we do not believe that the award of UMTS licenses in Ukraine is imminent) would hinder us from competing effectively with

operators who are able to provide these services and limit our ability to expand our services, which could have a material adverse effect on our prospects, business and results of operations.

In addition, we employ technology based primarily on the Global System for Mobile Communications, or GSM, standard. The UMTS standard is significantly superior to existing second-generation standards such as GSM. The adoption of UMTS may consequently increase the competition we face. The technology we currently use may become obsolete or uncompetitive and, if we are not able to develop a strategy compatible with this or any other new technology, we may not be able to acquire new technologies necessary to compete on reasonable terms. In addition, expenditures in connection with new technology may adversely affect our ability to expand in other areas.

Licenses for the use of code division multiple access, or CDMA, technology have already been granted for the provision of fixed wireless services in a number of regions throughout Russia. CDMA is a second-generation digital cellular telephony technology that can be used for the provision of both wireless and fixed services. Although CDMA technology is currently classified in Russia as a fixed radio-telephone service, it may be used for wireless communications, and it may be offered for use via portable handsets. Currently, CDMA technology is offered by certain mobile operators in Russia using the NMT-450 standard. If CDMA operators were able to develop a widespread network throughout Russia, we would face increased competition.

***Failure to renew our licenses or receive renewed licenses with similar terms to our existing licenses could have a material adverse effect on our business and results of operations.***

Our licenses expire in various years from 2005 to 2016 and may be renewed in Russia, Ukraine and Uzbekistan upon application to the Federal Service for Supervision in the Area of Communications, the NCRC and the Agency of Communications and Informatization, respectively. From time to time, as required, we also apply for the re-issuance of licenses prior to their expiration.

Governmental officials have broad discretion in deciding whether to renew a license, and may not renew our licenses after expiration. If our licenses are renewed, they may be renewed with additional obligations, including payment obligations. Failure to renew our licenses or to receive renewed licenses with similar terms to our existing licenses could significantly diminish our service area, which could have a material adverse effect on our business and results of operations.

***We engage in transactions with related parties, which may present conflicts of interest, potentially resulting in the conclusion of transactions on terms not determined by market forces.***

We have purchased interests in various mobile telecommunications companies from Sistema and entered into arrangements with subsidiaries of Sistema for advertising (Maxima), interconnection services (MTT), insurance services (Rosno), interconnection and telephone numbering capacity (MGTS, Comstar and MTU-Inform), IT services and hardware purchases (Kvazar-Micro), banking services (MBRD), office leases (MGTS) and the purchase of a new billing system (STROM telecom). Furthermore, we have entered into a number of arrangements with T-Mobile and its affiliates, including agreements for the purchase of shares of UMC, and we have entered into a number of equipment lease agreements with Invest-Svyaz Holding, one of our shareholders and a wholly-owned subsidiary of Sistema. These transactions may present conflicts of interest, potentially resulting in the conclusion of transactions on terms not determined by market forces.

***If the Federal Antimonopoly Service was to conclude that we acquired or created a new company in contravention of antimonopoly legislation, it could impose administrative sanctions and require the divestiture of this company or other assets, which could have a material adverse effect on our business and results of operations.***

Our businesses have grown substantially through the acquisition and formation of companies, many of which required the prior approval of, or subsequent notification to, the Federal Antimonopoly



Service or its predecessor agencies. In part, relevant legislation in certain cases restricts the acquisition or formation of companies by groups of companies or individuals acting in concert without such prior approval or notification. While we believe that we have complied with the applicable legislation for our acquisitions and formation of new companies, this legislation is sometimes vague and subject to varying interpretations. If the Federal Antimonopoly Service was to conclude that an acquisition or formation of a new company was done in contravention of applicable legislation, it could impose administrative sanctions and require the divestiture of this company or other assets, which could have a material adverse effect on our business and results of operations.

In addition, if we or any of our subsidiaries were to be classified by the Federal Antimonopoly Service as a dominant market force or as having a dominant position in the market, the Federal Antimonopoly Service would have the power to impose certain restrictions on their businesses. These restrictions could result in competitive disadvantages, and materially adversely affect the business and results of operations of these entities. See "*Risks Relating to Our Industry—If we are found to have a dominant position in our markets, the government may regulate our tariffs and restrict our operations.*"

***In the event that the minority shareholders of our subsidiaries were to successfully challenge past interested party transactions or do not approve interested party or other transactions in the future, we could be limited in our operational flexibility and our results of operations could be materially adversely affected.***

We own less than 100% of the equity in some of our subsidiaries, with the remaining equity balance being held by minority shareholders. These subsidiaries have in the past carried out, and continue to carry out, numerous transactions with us and our other subsidiaries, which may be considered "interested party transactions" under Russian law, requiring approval by disinterested directors, disinterested independent directors or disinterested shareholders. See "Item 7. Major Shareholders and Related Party Transactions—B. Related Party Transactions." These transactions have not always been properly approved and, therefore, may be challenged by minority shareholders. In addition, Russian law requires a three-quarters majority vote of the holders of voting stock present at a shareholders meeting to approve certain transactions, including, for example, charter amendments, major transactions involving assets in excess of 50% of the assets of the company, repurchase by the company of shares and share issuances. In some cases, minority shareholders may not approve interested party transactions requiring their approval or other transactions requiring supermajority approval. In the event these minority shareholders were to successfully challenge past interested party transactions, or do not approve interested party or other transactions in the future, we could be limited in our operational flexibility and our results of operations could be materially adversely affected.

***All or part of our subscriber database, containing private information relating to our subscribers, was illegally copied and stolen in early 2003, and is currently publicly sold in Russia.***

In January 2003, we discovered that part of our database of subscribers, containing private subscriber information, was illegally copied and stolen. The database contained information such as the names, addresses, home phone numbers, passport details and other personal information of approximately five million of our subscribers. Following its theft, this database was available for sale in Russia. In addition, in May 2003, certain subscriber databases of several operators in the North-West region, including those of MTS, MegaFon, Delta Telecom and two other operators, were stolen and are currently being sold.

In December 2003, we completed our internal investigation relating to the theft of our subscriber databases and found that these incidents were due to weaknesses in our internal security in relation to physical access to such information. We have taken measures that we believe will prevent such incidents from occurring in the future, but such incidents may recur in the future.

In January 2003, lawsuits were filed by two of our subscribers seeking compensation for damages resulting from the leak of the subscribers' confidential information. While the subscribers subsequently withdrew their claims, if similar lawsuits are successful in the future, we might have to pay significant damages, including consequential damages, which could have a material adverse effect on our results of operations. Future breaches of security may also negatively impact our reputation and our brand image and lead to a loss of market share, which could materially adversely affect our business, prospects and results of operations.

#### **Risks Relating to Our Financial Condition**

***Servicing and refinancing of our indebtedness will require a significant amount of cash. Our ability to generate cash or obtain financing depends on many factors beyond our control.***

We have a substantial amount of outstanding indebtedness, primarily consisting of the obligations we entered into in connection with our notes and bank loans. At December 31, 2004, our consolidated total debt, including capital lease obligations, was approximately \$1,937.1 million, and we have signed several agreements for additional financing for an aggregate amount of approximately \$493.0 million since December 31, 2004. We have approximately \$370.9 million in notes and bank loans that are due by December 31, 2005.

Our ability to service, repay and refinance our indebtedness and to fund planned capital expenditures will depend on our ability to generate cash in the future. This, to a certain extent, is subject to general economic, financial, competitive, legislative, regulatory and other factors that are beyond our control. If we are unable to generate sufficient cash flow or otherwise obtain funds necessary to make required payments, we may default under the terms of our indebtedness, and the holders of our indebtedness would be able to accelerate the maturity of such indebtedness, which could cause defaults under our other indebtedness.

We may not be able to generate sufficient cash flow or access international capital markets or incur additional indebtedness to enable us to service or repay our indebtedness or to fund our other liquidity needs. We may be required to refinance all or a portion of our indebtedness on or before maturity, sell assets, reduce or delay capital expenditures or seek additional capital. We cannot assure you that any refinancing or additional financing would be available on commercially reasonable terms or at all, or whether our assets could be sold, or if sold, whether the proceeds therefrom would be sufficient to meet our debt service obligations. Our inability to generate sufficient cash flow to satisfy our debt service obligations, or to refinance debt on commercially reasonable terms, would materially adversely affect our business, financial condition, results of operations and prospects. See "Item 5. Operating and Financial Review and Prospects—Liquidity and Capital Resources."

***If we are unable to obtain adequate capital, we may have to limit our operations substantially, which could have a material adverse effect on our business, prospects and results of operations.***

We will need to make significant capital expenditures, particularly in connection with the development, construction and maintenance of, and the purchasing of software for, our GSM network. We spent approximately \$574.3 million in 2002, approximately \$958.8 million in 2003 and approximately \$1,358.9 million in 2004 for the fulfillment of our capital spending plans, and we may need to significantly increase our capital expenditures in the future to facilitate our regional growth and maintain our competitive network coverage. In addition, the acquisition of UMTS licenses and frequency allocations and the buildout of a UMTS network will require substantial additional capital expenditures. However, future financings and cash flow from our operations may not be sufficient to meet our planned needs in the event of various unanticipated potential developments, including the following:

- a lack of external financing sources;

- changes in the terms of existing financing arrangements;
- construction of the wireless networks at a faster rate or higher capital cost than anticipated;
- pursuit of new business opportunities or investing in existing businesses that require significant investment;
- acquisitions or development of any additional wireless licenses;
- slower than anticipated subscriber growth;
- slower than anticipated revenue growth;
- regulatory developments;
- changes in existing interconnect arrangements; or
- a deterioration in the Russian economy.

To meet our financing requirements, we may need to attract additional equity or debt financing. Russian companies are limited in their ability to issue shares in the form of ADRs or other depository receipts due to new Russian securities regulations that came into force in 2003 providing that no more than 40% of a Russian company's shares may be circulated abroad through sponsored depository receipt programs. As of May 31, 2005, depository receipts, including ADRs, accounted for approximately 37% of our outstanding shares. Therefore, our ability to raise additional equity financing through depository receipt programs is substantially limited. If we cannot obtain adequate funds to satisfy our capital requirements, we may need to limit our operations significantly, which could have a material adverse effect on our business, prospects and results of operations.

In addition, from time to time, we may merge our subsidiaries into us for operational reasons. Under Russian law, such merger would be considered a reorganization and we would be required to notify our creditors of this reorganization. Russian law also provides that, for a period of 30 days after notice, these creditors would have a right to accelerate our debts and demand reimbursement for applicable losses. In the event that we elect to undertake any such merger and all or part of our debt is accelerated, we may not have the ability to raise the funds necessary for repayment and our business and financial condition could be materially adversely affected. On November 9, 2004, our general meeting of shareholders approved a merger of seven of our wholly-owned subsidiaries into us. The term for notifying our creditors has not yet commenced. We do not, however, expect a substantial portion of our indebtedness to be accelerated.

***Devaluation of the ruble against the U.S. dollar could increase our costs and reduce our revenues.***

Until recently, the ruble has fluctuated dramatically against the U.S. dollar, in the great majority of instances falling in value. A significant portion of our costs, expenditures and liabilities, including capital expenditures and borrowings (including our U.S. dollar-denominated notes), are either denominated in, or closely linked to, the U.S. dollar, while substantially all of our revenues are denominated in rubles. As a result, the devaluation of the ruble against the U.S. dollar can adversely affect us by increasing our costs in ruble terms. In order to hedge against this risk, we link our tariffs in Russia, which are payable in rubles, to the U.S. dollar. The effectiveness of this hedge is limited, however, as we may not be able to increase prices in line with ruble devaluation against the U.S. dollar due to competitive pressures or regulatory restrictions, leading to a loss of revenue in U.S. dollar terms. We do not engage in any other hedging arrangements. Additionally, if the ruble declines against the U.S. dollar and price increases cannot keep pace, we could have difficulty repaying or refinancing our U.S. dollar-denominated indebtedness, including our notes. The devaluation of the ruble also results in losses in the value of ruble-denominated assets, such as ruble deposits. In order to hedge against this risk, we invest a significant portion of our cash in U.S. dollar-denominated deposits.

The decline in the value of the ruble against the U.S. dollar also reduces the U.S. dollar value of tax savings arising from the depreciation of our property, plant and equipment, since their basis for tax purposes is denominated in rubles at the time of the investment. Increased tax liability would increase total expenses.

***Inflation could increase our costs and adversely affect our results of operations.***

The Russian economy has been characterized by high rates of inflation. In 2004, the inflation rate of 11.7%, combined with the nominal appreciation of the ruble, resulted in the appreciation of the ruble against the U.S. dollar in real terms. As we tend to experience inflation-driven increases in certain of our costs, including salaries and rents, which are sensitive to rises in the general price level in Russia, our costs in U.S. dollar terms will rise. In this situation, due to competitive pressures, we may not be able to raise the prices we charge for our products and services sufficiently to preserve operating margins.

***Russian currency control regulations hinder our ability to conduct our business.***

The Central Bank of Russia has from time to time imposed various currency control regulations in attempts to support the ruble, and may take further actions in the future. Furthermore, the government and the Central Bank of Russia may impose additional requirements on cash inflows and outflows into and out of Russia or on the use of foreign currency in Russia, which could prevent us from carrying on necessary business transactions, or from successfully implementing our business strategy.

A new framework law on exchange controls took effect on June 18, 2004. This law empowers the government and the Central Bank of Russia to further regulate and restrict currency control matters, including operations involving foreign securities and foreign currency borrowings by Russian companies. The new law also abolishes the need for companies to obtain transaction-specific licenses from the Central Bank of Russia (except for opening bank accounts outside Russia), envisaging instead the implementation of generally applicable restrictions on currency operations. As the evolving regulatory regime is new and untested, it is unclear whether it will be more or less restrictive than the prior laws and regulations it has replaced.

***Vaguely drafted Russian transfer pricing rules and lack of reliable pricing information subject us to the risks of additional costs and penalties.***

Russian transfer pricing rules entered into force in 1999, giving Russian tax authorities the right to control prices for transactions between related entities and certain other types of transactions between independent parties, such as foreign trade transactions or transactions with significant price fluctuations. The Russian transfer pricing rules are vaguely drafted, leaving wide scope for interpretation by Russian tax authorities and arbitration courts, and they could be used in politically motivated investigations and prosecutions. We believe that the prices used by our group are market prices and, therefore, comply with the requirements of Russian tax law on transfer pricing. However, due to the uncertainties in interpretation of transfer pricing legislation, the tax authorities may challenge our prices and propose adjustments. If such price adjustments are upheld by the Russian arbitration courts and implemented, our future financial results could be adversely affected. In addition, we could face significant losses associated with the assessed amount of prior tax underpaid and related interest and penalties, which would have an adverse impact on our financial condition and results of operations. Although Ukraine has reformed its transfer pricing rules, similar concerns with interpretation and enforcement by the Ukrainian tax authorities exist.

***Restrictions on investments outside of Russia or in hard-currency-denominated instruments in Russia expose our cash holdings to devaluation.***

Currency regulations established by the Central Bank of Russia restrict investments by Russian companies outside Russia and in most hard-currency-denominated instruments in Russia, and there are

only a limited number of ruble-denominated instruments in which we may invest our excess cash. Any balances maintained in rubles will give rise to losses if the ruble devalues against the U.S. dollar.

Additionally, Russian companies must repatriate 100% of offshore foreign currency earnings to Russia and convert 10% of those earnings into rubles within seven days of receipt, although Russian legislation allows the Central Bank of Russia to decrease this conversion requirement or increase it up to 30%. For example, we earned around \$83.4 million, \$112.0 million and \$93.3 million in foreign currency in 2002, 2003 and 2004, respectively, primarily from our roaming agreements. This requirement further increases balances in our ruble-denominated accounts and, consequently, our exposure to devaluation risk.

***Continued or increased limitations on the conversion of rubles to foreign currency in Russia could increase our costs when making payments in foreign currency to suppliers and creditors and could cause us to default on our obligations to them.***

Many of our major capital expenditures are denominated and payable in various foreign currencies, including the U.S. dollar and euro. For example, as of December 31, 2004, we had \$164.7 million committed under contracts with foreign suppliers for the purchase of network infrastructure that were primarily denominated in U.S. dollars. Although Russian legislation currently permits the conversion of rubles into foreign currency, the market in Russia for the conversion of rubles into foreign currencies is limited. The scarcity of foreign currencies may tend to inflate their values relative to the ruble, and such a market may not continue to exist, which could increase our costs when making payments in foreign currencies to suppliers and creditors.

Additionally, any delay or other difficulty in converting rubles into a foreign currency to make a payment or delay or restriction in the transfer of foreign currency could limit our ability to meet our payment and debt obligations, which could result in the loss of suppliers, acceleration of debt obligations and cross-defaults and, consequently, have a material adverse effect on our business, financial condition and results of operations.

***Indentures relating to our notes and our controlling shareholder Sistema's notes contain, and our syndicated loan agreement contains, restrictive covenants, which limit our ability to incur debt and to engage in various activities.***

The indentures relating to our outstanding notes contain covenants limiting our ability to incur debt, create liens on our properties and enter into sale and lease-back transactions. The indentures also contain covenants limiting our ability to merge or consolidate with another person or convey our properties and assets to another person, as well as our ability to sell or transfer any of our or our subsidiaries' GSM licenses for the Moscow, St. Petersburg, Krasnodar and Ukraine license areas. Our syndicated loan facility contains similar and other covenants. Failure to comply with these covenants could cause a default and result in the debt becoming immediately due and payable, which would materially adversely affect our business, financial condition and results of operations.

In addition, Sistema, which controls 50.6% of our outstanding shares and consolidates our results in its financial statements, is subject to various covenants in the indentures related to its \$350.0 million in aggregate principal amount of notes due 2008 and \$350.0 million in aggregate principal amount of notes due 2011, which impose restrictions on Sistema and its restricted subsidiaries (including us) with respect to, inter alia, incurrence of indebtedness, creation of liens and disposal of assets. In these indentures, Sistema undertakes that it will not, and will not permit its restricted subsidiaries (including us) to, incur indebtedness unless a certain debt/EBITDA (as defined therein) ratio is met. In addition to us, Sistema has other businesses that require capital and, therefore, the consolidated Sistema group's capacity to incur indebtedness otherwise available to us could be diverted to its other businesses. Sistema may also enter into other agreements in the future that may further restrict it and its restricted subsidiaries (including us) from engaging in these and other activities. We expect Sistema to exercise its control over us in order for Sistema, as a consolidated group, to meet its covenants, which could materially limit our ability to conduct our operations, including the implementation of our business strategy.

***If a change in control occurs, our noteholders and other debt holders may require us to redeem notes or other debt, which could have a material adverse effect on our financial condition and results of operations.***

Under the terms of our outstanding notes, if a change in control occurs, our noteholders will have the right to require us to redeem notes not previously called for redemption. The price we will be required to pay upon such event will be 101% of the principal amount of the notes, plus accrued interest to the redemption date. A change in control will be deemed to have occurred in any of the following circumstances:

- Any person acquires beneficial ownership of 50% or more of the total voting power of all shares of our common stock; provided that the following transactions would not be deemed to result in a change in control:
  - any acquisition by Sistema, T-Mobile or their respective subsidiaries that results in the 50% threshold being exceeded; and
  - any acquisition by us, our subsidiary or our employee benefit plan.
- We merge or consolidate with or into, or convey, sell, lease or otherwise dispose of all or substantially all of our assets to, another entity or another entity merges into us and, immediately following such transaction, Sistema and T-Mobile together do not beneficially own at least 50% of the total voting power of all shares of common stock of such entity.
- We no longer beneficially own more than 50% of the issuer's share capital.

If a change in control occurs, and our noteholders and other debt holders exercise their right to require us to redeem all of their notes or debt, such event could have a material adverse effect on our financial condition and results of operations.

#### **Risks Relating to Our Industry**

***We face increasing competition that may result in reduced operating margins and loss of market share, as well as different pricing, service or marketing policies.***

The Russian wireless telecommunication services market is becoming increasingly competitive. The trend in Russian government licensing policies has been to increase competition among wireless telecommunication service providers. Russian regulatory authorities have moved from granting exclusive licenses for each technology standard per region to granting multiple licenses covering the same territory. Increased competition, including from the potential introduction of new mobile operators in the markets where we operate, may result in reduced operating margins and loss of market share, as well as different pricing, service or marketing policies.

***A merger between our two largest competitors would result in a competitor substantially larger than us with leading market shares in the Russian mobile communications market.***

In August 2003, Russian financial industrial conglomerate Alfa Group, which owns a 25.1% stake in Vimpelcom, announced its purchase of CT-Mobile, which owns a 25.1% stake in MegaFon. This acquisition gives Alfa Group a 25.1% blocking stake in MegaFon and the press reported that Alfa Group might seek to merge Vimpelcom and MegaFon, Russia's second and third largest wireless communications providers and our two largest competitors. Though it is unclear whether such merger might occur, in the event that it does, it would result in a competitor substantially larger than us with leading market shares in the Russian wireless communications market.

***The regulatory environment for telecommunications in Russia and Ukraine is uncertain and subject to political influence or manipulation, which may result in negative and arbitrary regulatory and other decisions against us on the basis of other than legal considerations and in preferential treatment for our competitors.***

We operate in an uncertain regulatory environment. The legal framework with respect to the provision of telecommunication services in Russia and Ukraine and in other areas in which we may operate in the future is not well developed, and a number of conflicting laws, decrees and regulations apply to the telecommunications sector.

Moreover, regulation is conducted largely through the issuance of licenses and instructions, and governmental officials have a high degree of discretion. In this environment, political influence or manipulation could be used to affect regulatory, tax and other decisions against us on the basis of other than legal considerations. For example, Russian government authorities investigated Vimpelcom in late 2003 on grounds that it was illegally operating in Moscow pursuant to a license issued to its wholly-owned subsidiary rather than to Vimpelcom itself. In addition, some of our competitors may receive preferential treatment from the government, potentially giving them a substantial advantage over us. For example, according to press reports, MegaFon and Kyivstar, our competitors in Russia and Ukraine, respectively, received preferential treatment in regulatory matters in the past.

***Because of limitations on the rights of license holders and the need to have a license reissued in the event of a merger, our ability to integrate our networks may be restricted, thus preventing us from offering integrated network services.***

As our regional development program proceeds, we intend to integrate our various networks to create a single, unified GSM network. The Federal Law on Communications and other telecommunications regulations prohibit the transfer or assignment of licenses and require that telecommunications services must be provided by the licensee only. Further, applicable regulations require that agreements for the provision of telecommunications services must be concluded and performed only by the licensee. This requirement has been an important factor in our recent acquisitions. As we are unable to buy licenses, we must instead purchase the company holding the license. We must also continue to operate through such company in its license area by entering into agency, lease, services and similar agreements.

We have entered into a series of agreements with a number of our subsidiaries for the provision of network construction services, the lease of wireless switching centers and related services. The government may change its position and view these agreements as violating the general prohibition on the transfer or assignment of licenses. For example, in 2003, the government challenged Vimpelcom on the grounds that it was illegally operating in Moscow pursuant to a license issued to its 100% owned subsidiary rather than to Vimpelcom itself.

Additionally, Russian law requires that, in the event of a merger, a license held by either of the merging entities must be reissued to the successor entity, rather than simply transferred. We intend to continue to merge with our wholly-owned subsidiaries as part of our efforts to integrate our networks; however, a failure to receive a new license as part of a merger would result in the loss of our ability to operate in that license area.

Restrictions on our ability to enter into contracts with our subsidiaries, or the failure to receive a new license in the event of a merger, would restrict our ability to create a single, unified GSM network, reducing our ability to attract and retain subscribers and compete with a federal, nation-wide licensee in the event that such a license was granted.

***If we are found to have a dominant position in our markets, the government may regulate our tariffs and restrict our operations.***

Under Russian legislation, the Federal Antimonopoly Service may categorize a company as a dominant force in a market. Current Russian legislation does not clearly define "market" in terms of the types of services or the geographic area. As of December 31, 2004, MTS OJSC and its subsidiaries CJSC Kuban-GSM, Tomsk Cellular Communications LLC, CJSC Siberian Cellular System-900 and CJSC UDN-900 are categorized as companies with a market share exceeding 35%. This classification, in turn, gives the Federal Antimonopoly Service the power to impose certain restrictions on the businesses of those entities.

Additionally, UMC, which has over a 50% market share of the Ukrainian wireless communications market, can be categorized as a company with a dominant position in the market and become subject to specific government-imposed restrictions. While UMC is currently not categorized as a company with a dominant position in the market, it reduced certain of its tariffs at the recommendation of the AMC in April 2004. See "Item 4. Information on Our Company—B. Business Overview—Regulation in Ukraine—Competition" for additional information.

If we or any of our subsidiaries were classified as a dominant market force or as having a dominant position in the market, the imposition of government-determined tariffs could result in competitive disadvantages, and our business and results of operations could be materially adversely affected. Our refusal to adjust our tariffs according to such government-determined rates could result in the withholding of all our revenues by Russian authorities. Additionally, restrictions on expansion or government-mandated withdrawal from regions or markets could reduce our subscriber base and prevent us from implementing our business strategy. Moreover, we could be required to make additional license applications at an additional unexpected cost.

***The public switched telephone networks have reached capacity limits and need modernization, which may inconvenience our subscribers and may require us to make substantial investments in public switched telephone networks.***

Due to the recent growth in fixed and wireless telephone use in Moscow, the city's "095" code has reached numbering capacity limits and an additional code or codes are expected to be introduced in the future. Calls between a new code and another code will require callers to dial through "8," the long distance dialing prefix, which is also used by our "federal" number subscribers. The overtaking of these long distance lines may inconvenience our federal number subscribers by causing incoming and outgoing calls to have lower completion rates. Resolving these issues will require additional investment. In addition, continued growth in local, long-distance and international traffic, including that generated by our subscribers, may require substantial investment in public switched telephone networks.

Although the operators of public switched telephone networks are normally responsible for these investments, their weak financial condition may prevent them from making these investments. Since we are financially strong relative to these public network operators, we may be compelled to make such investments on their behalf, placing an additional burden on our financial and human resources. Additionally, assuming we make such investments, we may not own the assets resulting from such investment. While we cannot estimate the financial and operating burdens associated with such investments, they may be substantial.

Additionally, to meet subscriber demand and provide for an adequate inventory of numbering capacity, we have entered into contracts with local fixed-line providers for allocation of numbering capacity to us. These contracts are now under review by the Ministry of Information Technologies and Communication and are subject to change in order to comply with new legislative requirements. The Ministry of Information Technologies and Communications may also require cellular communication service providers to allow their customers to retain their mobile number when switching from one



provider to another. These changes in our contracts and in the regulations may cause us to incur additional expenses and a loss of numbering capacity.

In Ukraine, new numbering capacity must first be established on the networks of Ukrainian public fixed-line operators before the numbers are made available for use by mobile operators. Thus, depending on the rate in which new numbers are established on the fixed-line networks, UMC may be constrained in its ability to allocate new phone numbers to potential customers which could hinder UMC's ability to attract new subscribers and cause its market share to decline.

***Alleged medical risks of cellular technology may subject us to negative publicity or litigation, decrease our access to base station sites, diminish subscriber usage and hinder access to additional financing.***

Electromagnetic emissions from transmitter masts and mobile handsets may harm the health of individuals exposed for long periods of time to these emissions. The actual or perceived health risks of transmitter masts and mobile handsets could materially adversely affect us by reducing subscriber growth, reducing usage per subscriber, increasing the number of product liability lawsuits, increasing the difficulty in obtaining or maintaining sites for base stations and/or reducing the financing available to the wireless communications industry.

***Computer viruses may harm or disrupt our network.***

As telecommunications and IT networks increase in size and complexity, they are becoming increasingly susceptible to computer viruses. These viruses can potentially spread throughout a network system, slowing the network and disrupting service. In the event that any of our telecommunications or IT networks are the target of a virus, we may be unable to maintain the integrity of such networks and software operations, which could have a material adverse effect on our business and results of operations.

## **Risks Relating to the Russian Federation and Ukraine**

### **Economic Risks**

***Economic instability in Russia and Ukraine could adversely affect our business.***

Since the dissolution of the Soviet Union, the Russian and Ukrainian economies have experienced at various times:

- significant declines in gross domestic product;
- hyperinflation;
- an unstable currency;
- high government debt relative to gross domestic product;
- a weak banking system providing limited liquidity to domestic enterprises;
- high levels of loss-making enterprises that continued to operate due to the lack of effective bankruptcy proceedings;
- significant use of barter transactions and illiquid promissory notes to settle commercial transactions;
- widespread tax evasion;
- growth of a black and grey market economy;
- pervasive capital flight;
- high levels of corruption and the penetration of organized crime into the economy;

- significant increases in unemployment and underemployment; and
- the impoverishment of a large portion of the population.

The Russian and Ukrainian economies have been subject to abrupt downturns. In particular, on August 17, 1998, in the face of a rapidly deteriorating economic situation, the Russian government defaulted on its ruble-denominated securities, the Central Bank of Russia stopped its support of the ruble and a temporary moratorium was imposed on certain hard currency payments. These actions resulted in an immediate and severe devaluation of the ruble and a sharp increase in the rate of inflation; a dramatic decline in the prices of Russian debt and equity securities; and an inability of Russian issuers to raise funds in the international capital markets. Certain other CIS countries, including Ukraine and Belarus, were similarly affected by these events.

These problems were aggravated by the near collapse of the Russian banking sector after the events of August 17, 1998, as evidenced by the termination of the banking licenses of a number of major Russian banks. This further impaired the ability of the banking sector to act as a consistent source of liquidity to Russian companies and resulted in the losses of bank deposits in some cases.

Recently, the Russian and Ukrainian economies have experienced positive trends, such as the increase in the gross domestic product, relatively stable national currencies, strong domestic demand, rising real wages and a reduced rate of inflation; however, these trends may not continue or may be abruptly reversed.

***The Russian banking system remains underdeveloped, and another banking crisis could place severe liquidity constraints on our business.***

Russia's banking and other financial systems are not well developed or regulated, and Russian legislation relating to banks and bank accounts is subject to varying interpretations and inconsistent applications. The August 1998 financial crisis resulted in the bankruptcy and liquidation of many Russian banks and almost entirely eliminated the developing market for commercial bank loans at that time. Although the Central Bank of Russia has the mandate and authority to suspend banking licenses of insolvent banks, many insolvent banks still operate. Most Russian banks also do not meet international banking standards, and the transparency of the Russian banking sector still lags far behind internationally accepted norms. Aided by inadequate supervision by the regulators, many banks do not follow existing Central Bank regulations with respect to lending criteria, credit quality, loan loss reserves or diversification of exposure. Further, bank deposits generally are not insured in Russia.

Recently, there has been a rapid increase in lending by Russian banks, which many believe has been accompanied by a deterioration in the credit quality of the borrowers. In addition, a robust domestic corporate debt market is leading to Russian banks increasingly holding large amounts of Russian corporate ruble bonds in their portfolios, which is further deteriorating the risk profile of Russian bank assets. The serious deficiencies in the Russian banking sector, combined with the deterioration in the credit portfolios of Russian banks, may result in the banking sector being more susceptible to market downturns or economic slowdowns, including due to Russian corporate defaults that may occur during any such market downturn or economic slowdown. In addition, the Central Bank of Russia in 2004 revoked the licenses of certain Russian banks, which resulted in market rumors about additional bank closures and many depositors withdrawing their savings. If a banking crisis were to occur, Russian companies would be subject to severe liquidity constraints due to the limited supply of domestic savings and the withdrawal of foreign funding sources that would occur during such a crisis.

There is currently a limited number of creditworthy Russian banks, most of which are located in Moscow. We have tried to reduce our risk by receiving and holding funds in a number of Russian banks, including subsidiaries of foreign banks. Nonetheless, we hold the bulk of our excess ruble and foreign currency cash in Russian banks, including subsidiaries of foreign banks, in part because we are required to do so by Central Bank regulations and because the ruble is not transferable or convertible.

outside of Russia. There are few, if any, safe ruble-denominated instruments in which we may invest our excess ruble cash. Another banking crisis or the bankruptcy or insolvency of the banks from which we receive or with which we hold our funds could result in the loss of our deposits or affect our ability to complete banking transactions in Russia, which could have a material adverse effect on our business, financial conditions and results of operations.

***The physical infrastructure in Russia and Ukraine is in very poor condition, which could disrupt normal business activity.***

The physical infrastructure in Russia and Ukraine largely dates back to Soviet times and has not been adequately funded and maintained over the past decade. Particularly affected are the rail and road networks; power generation and transmission; communication systems; and building stock. For instance, in May 2005, a fire and explosion in one of the Moscow power substations built in 1963 caused a major outage in a large section of Moscow and some surrounding regions. The blackout also hit the ground electric transport, led to road traffic accidents and massive traffic congestion, disrupted electricity and water supply in office and residential buildings and affected mobile communications. The trading on exchanges and the operation of many stores and markets were also halted. Road conditions throughout Russia and Ukraine are poor, with many roads not meeting minimum quality requirements. The Russian and Ukrainian governments are actively considering plans to reorganize the nations' rail, electricity and telephone systems. Any such reorganization may result in increased charges and tariffs while failing to generate the anticipated capital investment needed to repair, maintain and improve these systems.

The deterioration of physical infrastructure in Russia and Ukraine harms the national economies, disrupts the transportation of goods and supplies, adds costs to doing business in these countries and can interrupt business operations. These difficulties can impact us directly; for example, we have needed to keep portable electrical generators available to help us maintain base station operations in the event of power failures. Further deterioration in the physical infrastructure could have a material adverse effect on our business and the value of our securities.

***Fluctuations in the global economy may materially adversely affect the Russian and Ukrainian economies and our business.***

The Russian and Ukrainian economies are vulnerable to market downturns and economic slowdowns elsewhere in the world. As has happened in the past, financial problems or an increase in the perceived risks associated with investing in emerging economies could dampen foreign investment in Russia and Ukraine and Russian and Ukrainian businesses could face severe liquidity constraints, further adversely affecting their economies. Additionally, because Russia produces and exports large amounts of oil, the Russian economy is especially vulnerable to the price of oil on the world market and a decline in the price of oil could slow or disrupt the Russian economy. Recent military conflicts and international terrorist activity have also significantly impacted oil and gas prices, and pose additional risks to the Russian economy. Russia and Ukraine are also major producers and exporters of metal products and their economies are vulnerable to world commodity prices and the imposition of tariffs and/or antidumping measures by the United States, the European Union or by other principal export markets.

#### **Political and Social Risks**

***Political and governmental instability could materially adversely affect the value of our securities.***

Since 1991, Russia has sought to transform itself from a one-party state with a centrally-planned economy to a democracy with a market economy. As a result of the sweeping nature of the reforms, and the failure of some of them, the Russian political system remains vulnerable to popular dissatisfaction, including dissatisfaction with the results of privatizations in the 1990s, as well as to

demands for autonomy from particular regional and ethnic groups. Moreover, the composition of the Russian government, the prime minister and the other heads of federal ministries has at times been highly unstable. For example, six different prime ministers headed governments between March 1998 and May 2000. On December 31, 1999, President Yeltsin unexpectedly resigned. Vladimir Putin was subsequently elected president on March 26, 2000 and re-elected for a second term on March 14, 2004. Throughout his first term in office, President Putin has maintained governmental stability and even accelerated the reform process. In February 2004, President Putin dismissed his entire cabinet, including the prime minister. This was followed on March 12, 2004, by President Putin's announcement of a far-reaching restructuring of the Russian government, with the stated aim of making the government more transparent and efficient. The changes included, for example, reducing the number of ministries from 30 to 14 and dividing the government into three levels: ministries, services and agencies.

In addition to the restructuring of the Russian Federal government, the Russian parliament adopted legislation proposed by President Putin whereby the executives of sub-federal political units will no longer be directly elected by the population and will instead be nominated by the President of the Russian Federation and confirmed by the legislature of the sub-federal political unit. Further, President Putin has proposed to eliminate individual races in State Duma elections, so that voters would only cast ballots for political parties. These new structures are largely not yet finalized and implemented.

Future changes in government, major policy shifts or lack of consensus between various branches of the government and powerful economic groups could also disrupt or reverse economic and regulatory reforms.

Similarly to Russia, Ukraine has experienced political instability since its independence in 1991, having seen nine changes in prime minister since 1991. The various state authorities, and the relations between them, as well as the Ukrainian government's policies and the political leaders who formulate and implement them, are subject to rapid change. For example, following the presidential elections in November 2004, mass demonstrations and strikes took place throughout Ukraine to protest the election process and results. While tensions in Ukraine appear to have subsided following the invalidation of the November election results and the new presidential election held on December 26, 2004, the long-term effects of these events and policy direction of the new government are not yet known.

Any disruption or reversal of the reform policies, recurrence of political or governmental instability or occurrence of conflicts with powerful economic groups could have a material adverse effect on our business and the value of investments in Russia and Ukraine, and the value of our securities could decline.

***Conflict between central and regional authorities and other conflicts could create an uncertain operating environment hindering our long-term planning ability and could materially adversely affect the value of investments in Russia, including the value of our securities.***

The Russian Federation is a federation of 89 sub-federal political units, consisting of republics, territories, regions, cities of federal importance and autonomous regions and districts. The delineation of authority and jurisdiction among the members of the Russian Federation and the federal government is, in many instances, unclear and remains contested. Lack of consensus between the federal government and local or regional authorities often results in the enactment of conflicting legislation at various levels and may lead to further political instability. In particular, conflicting laws have been enacted in the areas of privatization, land legislation and licensing. Some of these laws and governmental and administrative decisions implementing them, as well as certain transactions consummated pursuant to them, have in the past been challenged in the courts, and such challenges may occur in the future. This lack of consensus hinders our long-term planning efforts and creates uncertainties in our operating environment, both of which may prevent us from effectively and efficiently implementing our business strategy.

Additionally, ethnic, religious, historical and other divisions have, on occasion, given rise to tensions and, in certain cases, military conflict, such as the continuing conflict in Chechnya, which has brought normal economic activity within Chechnya to a halt and disrupted the economies of neighboring regions. Various armed groups in Chechnya have regularly engaged in guerrilla attacks in that area, and recently, other parts of Russia have experienced violence related to the Chechen conflict. Violence and attacks relating to this conflict have also spread to other parts of Russia, and several terrorist attacks have been carried out by Chechen terrorists throughout Russia, including in Moscow. The further intensification of violence, including terrorist attacks and suicide bombings, or its spread to other parts of Russia, could have significant political consequences, including the imposition of a state of emergency in some or all of Russia. Moreover, any terrorist attacks and the resulting heightened security measures are likely to cause disruptions to domestic commerce and exports from Russia, and could materially adversely affect our business and the value of investments in Russia, including the value of our securities.

In Ukraine, tensions between certain regional authorities and the central government were recently ignited following the November 2004 presidential elections. Amid the mass demonstrations and strikes that took place throughout Ukraine to protest the election process and results, the regional authorities in three regions in eastern Ukraine threatened to conduct referendums on creating a separate, autonomous region within Ukraine. Though the regional authorities backed down from these threats, and tensions in Ukraine appear to have subsided following the invalidation of the November election results and the new presidential election held on December 26, 2004, the long-term effects of these events and their effect on relations among Ukrainians is not yet known.

***Crime, corruption and negative publicity could disrupt our ability to conduct our business and could materially adversely affect our business, financial condition and results of operations or prospects.***

The political and economic changes in Russia and Ukraine in recent years have resulted in significant dislocations of authority. The local and international press have reported that significant criminal activity, including organized crime, has arisen, particularly in large metropolitan centers. Property crime in large cities has increased substantially. In addition, the local press and international press have reported high levels of official corruption in the locations where we conduct our business, including the bribing of officials by competitors and others for the purpose of initiating investigations by government agencies. Press reports have also described instances in which government officials engaged in selective investigations and prosecutions to further the commercial interests of certain government officials or certain companies or individuals. Additionally, published reports indicate that a significant number of Russian and Ukrainian media regularly publish disparaging articles in return for payment. The depredations of organized or other crime, demands of corrupt officials, claims that we have been involved in official corruption or engaged in improper transactions or slanted articles, press speculation and negative publicity could disrupt our ability to conduct our business and could materially adversely affect our business, financial condition and results of operations or prospects.

***Social instability could increase support for renewed centralized authority, nationalism or violence and thus materially adversely affect our operations.***

The failure of the government and many private enterprises to pay full salaries on a regular basis and the failure of salaries and benefits generally to keep pace with the rapidly increasing cost of living have led in the past, and could lead in the future, to labor and social unrest. For example, in 1998, miners in several regions of Russia, demanding payment of overdue wages, resorted to strikes which included blocking major railroads. More recently, mass protests and strikes erupted across Ukraine following the country's presidential election in November 2004. Such labor and social unrest may have political, social and economic consequences, such as increased support for a renewal of centralized authority; increased nationalism, with restrictions on foreign involvement in the economies of Russia

and Ukraine; and increased violence. An occurrence of any of the foregoing events could restrict our operations and lead to the loss of revenue, materially adversely affecting our operations.

***Major changes in Ukraine-Russia relations may adversely affect our business.***

The relationship between Ukraine and Russia has been historically strained due, among other things, to Ukraine's failure to pay arrears relating to the supply of energy resources, Russia's introduction of a 20% VAT on Ukrainian imports and border disputes. In addition, the impact of the recent political crisis in Ukraine and the results of the December 26, 2004 presidential election on Ukraine-Russia relations is not yet clear.

In recent years, bilateral relations between Ukraine and Russia have improved, due in part to the conclusion in May 1997 of the Friendship and Cooperation Treaty, the conclusion in December 2000 of two inter-governmental agreements on the transit and supply of Russian natural gas, the conclusion in October 2002 of a framework agreement to ensure natural gas transit for the next 30 years and provide for the construction, modernization and operation of gas pipelines, and by Ukraine's ratification in September 2003 of an agreement with Russia, Kazakhstan and Belarus to create a "free trade" economic zone.

However, any major changes in Ukraine-Russia relations, in particular any such changes adversely affecting energy supplies from Russia to Ukraine and/or Ukraine's export of services and goods to Russia, could materially adversely impact the Ukrainian economy and our Ukrainian operations.

**Legal Risks**

***Weaknesses relating to the legal system and legislation create an uncertain environment for investment and business activity in Russia and Ukraine, which could have a material adverse effect on an investment in our securities.***

Each of Russia and Ukraine is still developing the legal framework required to support a market economy. The following risk factors relating to the Russian and Ukrainian legal systems create uncertainty with respect to the legal and business decisions that we make, many of which uncertainties do not exist in countries with more developed market economies:

- inconsistencies between and among laws, the Constitution, Presidential decrees and governmental, ministerial and local orders, decisions, resolutions and other acts;
- conflicting local, regional and federal rules and regulations;
- the lack of judicial and administrative guidance on interpreting legislation;
- the relative inexperience of judges and courts in interpreting legislation;
- corruption within the judiciary;
- a high degree of discretion on the part of governmental authorities, which could result in arbitrary actions such as suspension or termination of our licenses; and
- poorly developed bankruptcy procedures that are subject to abuse.

Additionally, several fundamental laws have only recently become effective. The recent nature of much of Russian and Ukrainian legislation, the lack of consensus about the scope, content and pace of economic and political reform and the rapid evolution of the Russian and Ukrainian legal systems in ways that may not always coincide with market developments place the enforceability and underlying constitutionality of laws in doubt and results in ambiguities, inconsistencies and anomalies. In addition, Russian and Ukrainian legislation often contemplates implementing regulations that have not yet been promulgated, leaving substantial gaps in the regulatory infrastructure. All of these weaknesses could affect our ability to enforce our rights under our licenses and under our contracts, or to defend

ourselves against claims by others. Furthermore, we cannot assure you that regulators, judicial authorities or third parties will not challenge our internal procedures and by-laws or our compliance with applicable laws, decrees and regulations.

***The judiciary's lack of independence and inexperience, the difficulty of enforcing court decisions and governmental discretion in enforcing claims could prevent us or you from obtaining effective redress in a court proceeding, materially adversely affecting an investment in our securities.***

The independence of the judicial system and its immunity from economic, political and nationalistic influences in each of Russia and Ukraine remain largely untested. The court system in each of Russia and Ukraine is understaffed and underfunded. Judges and courts are generally inexperienced in the area of business and corporate law. Judicial precedents generally have no binding effect on subsequent decisions. Not all Russian and Ukrainian legislation and court decisions are readily available to the public or organized in a manner that facilitates understanding. The Russian and Ukrainian judicial systems can be slow or unjustifiably swift. Enforcement of court orders can in practice be very difficult in Russia and Ukraine. All of these factors make judicial decisions in Russia and Ukraine difficult to predict and effective redress uncertain. Additionally, court claims are often used in furtherance of political aims or infighting. We may be subject to such claims and may not be able to receive a fair hearing. Additionally, court orders are not always enforced or followed by law enforcement agencies, and the government may attempt to invalidate court decisions by backdating or retroactively applying relevant legislative changes.

These uncertainties also extend to property rights. During Russia and Ukraine's transformation from centrally planned economies to market economies, legislation has been enacted in both countries to protect private property against expropriation and nationalization. However, it is possible that due to the lack of experience in enforcing these provisions and due to potential political changes, these protections would not be enforced in the event of an attempted expropriation or nationalization. Expropriation or nationalization of any of our entities, their assets or portions thereof, including UMC, potentially without adequate compensation, would have a material adverse effect on our business.

***Selective or arbitrary government action may have a material adverse effect on our business, financial condition and results of operations or prospects.***

We operate in an uncertain regulatory environment. Governmental authorities in Russia and Ukraine have a high degree of discretion and, at times, act selectively or arbitrarily, without hearing or prior notice, and sometimes in a manner that is inconsistent with legislation or influenced by political or commercial considerations. Selective or arbitrary governmental actions have reportedly included the denial or withdrawal of licenses, sudden and unexpected tax audits, criminal prosecutions and civil actions. Federal and local government entities have also used ordinary defects in matters surrounding share issuances and registration as pretexts for court claims and other demands to invalidate such issuances and registrations or to void transactions, often for political purposes. Moreover, the government also has the power in certain circumstances, by regulation or government act, to interfere with the performance of, nullify or terminate contracts. Standard & Poor's has expressed concerns that "Russian companies and their investors can be subjected to government pressure through selective implementation of regulations and legislation that is either politically motivated or triggered by competing business groups." In this environment, our competitors may receive preferential treatment from the government, potentially giving them a competitive advantage over us.

In addition, in 2003 and 2004, the Ministry for Taxes and Levies aggressively brought tax evasion claims on certain Russian companies' use of tax-optimization schemes, and press reports have speculated that these enforcement actions have been selective and politically motivated. Selective or arbitrary government action, if directed at us, could have a material adverse effect on our business, financial condition and results of operations or prospects.

***Developing corporate and securities laws and regulations in Russia may limit our ability to attract future investment.***

The regulation and supervision of the securities market, financial intermediaries and issuers are considerably less developed in Russia than in the United States and Western Europe. Securities laws, including those relating to corporate governance, disclosure and reporting requirements, have only recently been adopted, whereas laws relating to anti-fraud safeguards, insider trading restrictions and fiduciary duties are rudimentary. In addition, the Russian securities market is regulated by several different authorities, which are often in competition with each other. These include

- the Federal Service for the Financial Markets;
- the Ministry of Finance;
- the Federal Antimonopoly Service;
- the Central Bank of Russia; and
- various professional self-regulatory organizations.

The regulations of these various authorities are not always coordinated and may be contradictory.

In addition, Russian corporate and securities rules and regulations can change rapidly, which may materially adversely affect our ability to conduct securities-related transactions. While some important areas are subject to virtually no oversight, the regulatory requirements imposed on Russian issuers in other areas result in delays in conducting securities offerings and in accessing the capital markets. It is often unclear whether or how regulations, decisions and letters issued by the various regulatory authorities apply to our company. As a result, we may be subject to fines or other enforcement measures despite our best efforts at compliance.

***Shareholder liability under Russian legislation could cause us to become liable for the obligations of our subsidiaries.***

The Civil Code of the Russian Federation dated January 26, 1996, or the Civil Code, and the Federal Law on Joint Stock Companies of December 26, 1995, or the Federal Law on Joint Stock Companies, generally provide that shareholders in a Russian joint stock company are not liable for the obligations of the joint stock company and bear only the risk of loss of their investment. This may not be the case, however, when one person is capable of determining decisions made by another person or entity. The person or entity capable of determining such decisions is deemed an "effective parent." The person whose decisions are capable of being so determined is deemed an "effective subsidiary." The effective parent bears joint and several responsibility for transactions concluded by the effective subsidiary in carrying out these decisions if:

- this decision-making capability is provided for in the charter of the effective subsidiary or in a contract between the companies; and
- the effective parent gives obligatory directions to the effective subsidiary.

In addition, an effective parent is secondarily liable for an effective subsidiary's debts if an effective subsidiary becomes insolvent or bankrupt resulting from the action or inaction of an effective parent. This is the case no matter how the effective parent's ability to determine decisions of the effective subsidiary arises. For example, this liability could arise through ownership of voting securities or by contract. In these instances, other shareholders of the effective subsidiary may claim compensation for the effective subsidiary's losses from the effective parent, which caused the effective subsidiary to take action or fail to take action knowing that such action or failure to take action would result in losses. Accordingly, we could be liable in some cases for the debts of our consolidated



subsidiaries. This liability could have a material adverse effect on our business, results of operations and financial condition.

***Shareholder rights provisions under Russian law may impose additional costs on us, which could materially adversely affect our financial condition and results of operations.***

Russian law provides that shareholders that vote against or abstain from voting on certain matters have the right to sell their shares to us at market value in accordance with Russian law. The decisions that trigger this right to sell shares include:

- decisions with respect to a reorganization;
- the approval by shareholders of a "major transaction," which, in general terms, is a transaction involving property worth between 25% and 50% of the gross book value of our assets calculated according to Russian accounting standards, regardless of whether the transaction is actually consummated; and
- the amendment of our charter in a manner that limits shareholder rights.

Our obligation to purchase shares in these circumstances, which is limited to 10% of MTS OJSC's net assets calculated in accordance with Russian accounting standards at the time the matter at issue is voted upon, could have a material adverse effect on our results of operations and financial condition.

***Limitations on foreign investment could impair the value of your investment in our securities and could hinder our access to additional capital.***

Russian and Ukrainian legislation governing foreign investment activities does not prohibit or restrict foreign investment in the telecommunications industry. However, a lack of consensus exists over the manner and scope of government control over the telecommunications industry. While draft legislation protecting the rights of foreign investors specifically in the telecommunications industry has been considered at various times, the Law on Foreign Investment in the Russian Federation does not provide any specific protections in this regard, nor are there specific protections in Ukraine. Because the telecommunications industry is widely viewed as strategically important to Russia and Ukraine, governmental control over the telecommunications industry may increase, and foreign investment in or control over the industry may be limited. Any such increase in governmental control or limitation on foreign investment could impair the value of your investment in our securities and could hinder our access to additional capital.

***The implementation of the new Federal Law on Communications and the new Ukrainian Law on Telecommunications will impose an additional financial burden on us, which may materially adversely affect our financial condition and results of operations.***

The new Federal Law on Communications came into force on January 1, 2004. Among other things, this law provides for the establishment of a "universal services reserve fund" for the purpose of supporting communications companies operating in less developed regions of Russia. This reserve fund will be funded by a levy imposed on all communication services providers, including us. According to a government decree enacted on April 21, 2005, such providers must make quarterly payments in the amount of 1.2% of the difference between their total revenues and revenues generated by interconnection services. However, the procedures for its collection and subsequent distribution have not yet been established. This additional levy, the amount of which may be changed by the Russian government at its own discretion, will increase our costs and may materially adversely affect our financial condition and results of operations.

In addition, the new Ukrainian Law on Telecommunications also came into force on January 1, 2004. However, regulations implementing the new law have not yet been promulgated and certain regulatory bodies established by the new law have not yet commenced their regulatory functions. For

example, the regulatory body tasked with regulating the telecommunications industry and issuing telecommunications licenses in Ukraine, the NCRC was formed in January 2005 but has not begun to perform its regulatory functions and no other regulatory authority has been designated or is permitted to perform these functions under the law. In addition, the new Ukrainian Law on Telecommunications, among other things, may require companies with a dominant position in the telecommunications market to develop public telecommunications services if directed to do so by the regulatory authorities. See "Item 4. Information on Our Company—B. Business Overview—Regulation in Ukraine—Competition." As UMC's estimated market share in mobile telecommunication services in Ukraine is over 50%, implementation of the new law may materially adversely affect our financial condition and results of operations.

***Changes in the Russian tax system could materially adversely affect an investment in our securities.***

Generally, taxes payable by Russian companies are substantial and numerous. These taxes include, among others:

- income taxes;
- value-added tax, or VAT;
- excise taxes and import duties;
- unified social tax; and
- property tax.

The tax environment in Russia has historically been complicated by the fact that various authorities have often issued contradictory pieces of tax legislation. For example, tax laws are unclear with respect to the deductibility of certain expenses and at times we have taken a position that may be considered aggressive by tax authorities, but that we consider to be in compliance with current law. This uncertainty potentially exposes us to significant fines and penalties and enforcement measures despite our best efforts at compliance, and could result in a greater than expected tax burden and the suspension or termination of our telecommunications licenses.

Because of the political changes which have occurred in Russia over the past several years, there have recently been significant changes to the Russian taxation system. Global tax reforms commenced in 1999 with the introduction of Part One of the Tax Code of the Russian Federation, or the Tax Code, which sets general taxation guidelines. Since then, Russia has been in the process of replacing legislation regulating the application of major taxes such as corporate income tax, VAT and property tax with new chapters of the Tax Code.

In practice, the Russian tax authorities often interpret the tax laws in a way that rarely favors taxpayers, who often have to resort to court proceedings to defend their position against the tax authorities. Differing interpretations of tax regulations exist both among and within government ministries and organizations at the federal, regional and local levels, creating uncertainties and inconsistent enforcement. Tax declarations, together with related documentation such as customs declarations, are subject to review and investigation by a number of authorities, each of which may impose fines, penalties and interest charges. Generally, taxpayers are subject to inspection for a period of three calendar years of their activities which immediately preceded the year in which the audit is carried out. As previous audits do not exclude subsequent claims relating to the audited period, the statute of limitations is not entirely effective. In addition, in some instances, new tax regulations have been given retroactive effect.

Moreover, financial statements of Russian companies are not consolidated for tax purposes. Therefore, each of our Russian entities pays its own Russian taxes and may not offset its profit or loss against the loss or profit of another entity in our group. In addition, payments of intercompany

dividends are subject to a withholding tax of 9% to 15%, though this tax does not apply to dividends paid out further up the ownership chain once they have already been taxed at the lower level.

The foregoing conditions create tax risks in Russia that are more significant than typically found in countries with more developed tax systems, imposing additional burdens and costs on our operations, including management resources. In addition to our substantial tax burden, these risks and uncertainties complicate our tax planning and related business decisions, potentially exposing us to significant fines and penalties and enforcement measures despite our best efforts at compliance, and could materially adversely affect our business and the value of our securities.

***The implications of the tax system in Ukraine are uncertain and various tax laws are subject to different interpretations.***

Ukraine currently has a number of laws related to various taxes imposed by both central and regional governmental authorities. Applicable taxes include value-added tax, corporate income tax (profits tax), customs duties, payroll (social) taxes and other taxes. These tax laws have not been in force for significant periods of time compared to more developed market economies and are constantly changed and amended. Accordingly, few precedents regarding tax issues are available.

Although the Ukrainian Constitution prohibits retroactive enforcement of any newly enacted tax laws and the Law on Taxation System specifically requires legislation to adopt new tax laws at least six months prior to them becoming effective, such rules have largely been ignored. In addition, tax laws are often vaguely drafted, making it difficult for us to determine what actions are required for compliance. Differing opinions regarding the legal interpretation of tax laws often exist both among and within governmental ministries and organizations, including the tax administration, creating uncertainties and areas of conflict for taxpayers and investors. In practice, the Ukrainian tax authorities tend to interpret the tax laws in an arbitrary way that rarely favors taxpayers.

Tax declarations/returns, together with other legal compliance areas (for example, customs and currency control matters), may be subject to review and investigation by various administrative divisions of the tax authorities, which are authorized by law to impose severe fines, penalties and interest charges. These circumstances create tax risks in Ukraine substantially more significant than typically found in countries with more developed tax systems. Generally, tax declarations/returns in Ukraine remain open and subject to inspection for a three-year period. However, this term may not be observed or may be extended under certain circumstances, including in the context of a criminal investigation. While we believe that we are currently in compliance with the tax laws affecting our operations in Ukraine, it is possible that relevant authorities may take differing positions with regard to interpretative issues, which may result in a material adverse effect on our results of operations and financial condition.

***We face similar risks in other countries of the CIS.***

In addition to Russia and Ukraine, we currently have operations in other CIS countries, including Belarus and Uzbekistan. We may acquire additional operations in other countries of the CIS. In many respects, the risks inherent in transacting business in these countries are similar to those in Russia and Ukraine, especially those risks set out above in "—Risks Relating to the Russian Federation and Ukraine."

***Because the depositary may be considered the beneficial holder of the shares underlying the ADSs, these shares may be arrested or seized in legal proceedings in Russia against the depositary.***

Because Russian law may not recognize ADS holders as beneficial owners of the underlying shares, it is possible that you could lose all your rights to those shares if the depositary's assets in Russia are seized or arrested. In that case, you would lose all the money you have invested.

Russian law might treat the depositary as the beneficial owner of the shares underlying the ADSs. This would be different from the way other jurisdictions, such as the states of the United States, treat ADSs. In those jurisdictions, although shares may be held in the depositary's name or to its order and it is therefore a "legal" owner of the shares, the ADS holders are the "beneficial," or real owners. In those jurisdictions, no action against the depositary, the legal owner, would ever result in the beneficial owners losing their shares. Because Russian law may not make the same distinction between legal and beneficial ownership, it may only recognize the rights of the depositary in whose name the shares are held, not the rights of ADS holders, to the underlying shares.

Thus, in proceedings brought against a depositary, whether or not related to shares underlying ADSs, Russian courts may treat those underlying shares as the assets of the depositary, open to seizure or arrest. We do not know yet whether the shares underlying ADSs may be seized or arrested in Russian legal proceedings against a depositary. In the past a lawsuit has been filed against a depositary bank other than our depositary seeking the seizure of various Russian companies' shares represented by ADSs issued by that depositary. In the event that this type of suit were to be successful in the future, and the shares were to be seized or arrested, the ADS holders involved would lose their rights to the underlying shares.

***Your voting rights with respect to the shares represented by our ADSs are limited by the terms of the deposit agreement for our ADSs and relevant requirements of Russian law.***

You will be able to exercise voting rights with respect to the shares represented by ADSs only in accordance with the provisions of the deposit agreement relating to the ADSs and relevant requirements of Russian law. However, there are practical limitations upon your ability to exercise your voting rights due to the additional procedural steps involved in communicating with you. For example, our charter requires us to notify shareholders at least 30 days in advance of any meeting. Our shareholders will receive notice directly from us and will be able to exercise their voting rights by either attending the meeting in person or voting by power of attorney.

As an ADS holder, you, by comparison, will not receive notice directly from us. Rather, in accordance with the deposit agreement, we will provide the notice to the depositary. The depositary has undertaken in turn, as soon as practicable thereafter, to mail to you the notice of such meeting, voting instruction forms and a statement as to the manner in which instructions may be given by holders. To exercise your voting rights, you must then instruct the depositary how to vote its shares. Because of this extra procedural step involving the depositary, the process for exercising voting rights may take longer for you than for holders of shares. ADSs for which the depositary does not receive timely voting instructions will not be voted at any meeting.

In addition, although securities regulations expressly permit the depositary to split the votes with respect to the shares underlying the ADSs in accordance with instructions from ADS holders, this regulation remains untested, and the depositary may choose to refrain from voting at all unless it receives instructions from all ADS holders to vote the shares in the same manner. You may thus have significant difficulty in exercising voting rights with respect to the shares underlying the ADSs.

***You may be unable to repatriate your earnings from our ADSs.***

Russian currency control legislation pertaining to payment of dividends provides that ruble dividends on common stock may be paid to the depository or its nominee and converted into U.S. dollars by the depository for distribution to owners of ADSs without restriction. Also, ADSs may be sold by non-residents of Russia for U.S. dollars outside Russia without regard to Russian currency control laws as long as the buyer is not a Russian resident.

Under the terms of the deposit agreement, there is no restriction on the sale of our ADSs to Russian residents. However, Russian currency control legislation effectively limits the ability of a non-resident of Russia to sell our ADSs to a Russian resident. Without a special license or a general banking license granted by the Central Bank, either of which is in practice difficult to obtain:

- Russian legal entities must purchase securities for rubles and may not purchase foreign currency-denominated securities, such as our ADSs; and
- Russian individuals may only purchase up to \$75,000 worth of such securities in one calendar year.

Moreover, sales of ADSs (as opposed to sales of underlying shares) to Russian residents may violate Russian securities laws. Accordingly, an ADS holder seeking to sell its holding to a Russian resident may in practice need first to withdraw the shares underlying its ADSs and establish a special ruble account to receive the proceeds from the sale of the shares. The repatriation of sale proceeds may be subject to significant costs and delays.

The ability of the depository and other persons to convert rubles into U.S. dollars or another foreign currency is also subject to the availability of U.S. dollars or other foreign currency in Russia's currency markets. Although there is an existing market within Russia for the conversion of rubles into U.S. dollars and other foreign currencies, including the interbank currency exchange and over-the-counter and currency futures markets, the further development of this market is uncertain. At present, there is no market for the conversion of rubles into foreign currencies outside of Russia and no viable market in which to hedge ruble-currency and ruble-denominated investments.

***Future sales of common stock or ADSs may affect the market price of our common stock and ADSs.***

Sales, or the possibility of sales, of substantial numbers of shares of our common stock or ADSs in the public market, including the Russian stock market, could have an adverse effect on the market trading prices of the ADSs. Our subsequent equity offerings may reduce the percentage ownership of our shareholders. Newly issued preferred stock may have rights, preferences or privileges senior to those of common stock.

***You may not be able to benefit from the United States-Russia double tax treaty.***

In accordance with Russian legislation, dividends paid to a nonresident holder generally will be subject to Russian withholding tax at a 15% rate for legal entities, and at the rate of 30% for individuals. This tax may be reduced to 5% or 10% under the United States-Russia income tax treaty for U.S. holders: a 5% rate applies for U.S. holders who are legal entities owning 10% or more of the company's outstanding shares, and a 10% rate applies to dividends paid to U.S. holders, including individuals and legal entities, owning less than 10% of the company's outstanding shares. However, the Russian tax rules applicable to U.S. holders are characterized by significant uncertainties and limited interpretive guidance. Thus, while a U.S. holder may technically be entitled to benefit from the provisions of the United States-Russia income tax treaty, in practice such relief may be difficult or impossible to obtain. See "Item 10. Additional Information—E. Taxation—Russian Income and Withholding Tax Considerations" for additional information.

***Capital gain from sale of ADSs may be subject to Russian income tax.***

Under Russian tax legislation, gains arising from the disposition of Russian shares and securities, such as our common stock, as well as financial instruments derived from such shares, such as our ADSs, may be subject to Russian income or withholding taxes. However, no procedural mechanism currently exists to withhold any capital gains or for subsequent remittance of such amounts to the Russian tax authorities with respect to sales made between non-residents or sales of ADSs on the New York Stock Exchange.

***Foreign judgments may not be enforceable against us.***

Our presence outside the United States may limit your legal recourse against us. We are incorporated under the laws of the Russian Federation. Substantially all of our directors and executive officers named in this document reside outside the United States. All or a substantial portion of our assets and the assets of our officers and directors are located outside the United States. As a result, you may not be able to effect service of process within the United States on us or on our officers and directors. Similarly, you may not be able to obtain or enforce U.S. court judgments against us, our officers and directors, including actions based on the civil liability provisions of the federal securities laws of the United States.

There is no treaty between the United States and the Russian Federation providing for reciprocal recognition and enforcement of foreign court judgments in civil and commercial matters. These limitations may deprive you of effective legal recourse for claims related to your investment in the ADSs. The deposit agreement provides for actions brought by any party thereto against us to be settled by arbitration in accordance with the Commercial Arbitration Rules of the American Arbitration Association, provided that any action under the U.S. federal securities laws or the rules or regulations promulgated thereunder may, but need not, be submitted to arbitration. The Russian Federation is a party to the United Nations (New York) Convention on the Recognition and Enforcement of Foreign Arbitral Awards, but it may be difficult to enforce arbitral awards in the Russian Federation due to a number of factors, including the inexperience of Russian courts in international commercial transactions, official and unofficial political resistance to enforcement of awards against Russian companies in favor of foreign investors and Russian courts' inability to enforce such orders and corruption.

**Other Risks**

***We have not independently verified information regarding our competitors, nor have we independently verified official data from Russian government agencies.***

We have derived substantially all of the information contained in this document concerning our competitors from publicly available information, including press releases and filings under the U.S. securities laws, and we have relied on the accuracy of this information without independent verification.

In addition, some of the information contained in this document has been derived from official data of Russian government agencies. The official data published by Russian federal, regional and local governments may be substantially less complete or researched than those of Western countries. Official statistics may also be produced on different bases than those used in Western countries. Any discussion of matters relating to Russia in this document must, therefore, be subject to uncertainty due to concerns about the completeness or reliability of available official and public information.

The veracity of some official data released by the Russian government may be questionable. In the summer of 1998, the Director of the Russian State Committee on Statistics and a number of his subordinates were arrested and charged in connection with their misuse of economic data.