



JOINT-STOCK FINANCIAL CORPORATION
SISTEMA

U.S.\$500,000,000 6.95% Loan Participation Notes due 2019

issued by, but with limited recourse to,

SISTEMA INTERNATIONAL FUNDING S.A.

for the sole purpose of making a loan to

Sistema Joint Stock Financial Corporation

Issue Price: 100%

SISTEMA INTERNATIONAL FUNDING S.A, a *société anonyme* (a public limited liability company) incorporated in Luxembourg whose registered office is at 2, Boulevard Konrad Adenauer, L-1115 Luxembourg, Grand Duchy of Luxembourg, registered with the Register of commerce and companies in Luxembourg under number B 168486 (the “**Issuer**”), is issuing an aggregate principal amount of U.S.\$500,000,000 6.95% Loan Participation Notes due 2019 (the “**Notes**”) for the sole purpose of making a loan (the “**Loan**”) to Sistema Joint Stock Financial Corporation (“**Sistema JSFC**” or the “**Borrower**”) pursuant to a loan agreement dated 16 May 2012 between the Issuer, as lender, and the Borrower (the “**Loan Agreement**”). The Loan will bear interest of 6.95% per annum.

Subject to the provisions of the Trust Deed (as defined herein), the Issuer will charge as security for its payment obligations in respect of the Notes and under the Trust Deed (i) its rights to all payments of principal, interest and additional amounts (if any) payable by the Borrower under the Loan Agreement; (ii) its rights to receive all sums which may be or become payable by the Borrower under any claim, award or judgment relating to the Loan Agreement; and (iii) all the rights, title and interest in and to amounts deposited from time to time in an account of the Issuer pursuant to the Loan Agreement, in each case except for any Reserved Rights (as defined in the Trust Deed) to Deutsche Trustee Company Limited (the “**Trustee**”), as trustee for the benefit of the holders of the Notes (the “**Noteholders**”) upon the closing of the offering of the Notes. Furthermore, under the terms of the Trust Deed, the Issuer will assign all of its rights under the Loan Agreement, except for any Reserved Rights (as defined in the Trust Deed) and rights subject to the charge as described above, to the Trustee for the benefit of the Noteholders upon the closing of the offering of the Notes.

The Notes are secured limited recourse obligations of the Issuer. In each case where amounts of principal, interest and additional amounts (if any) are stated to be payable in respect of the Notes, the obligation of the Issuer to make such payment will constitute an obligation only to account to the Noteholders, on each date upon which such amounts of principal, interest and additional amounts (if any) are due in respect of the Notes, for an amount equivalent to all principal, interest and additional amounts (if any) actually received and retained (net of tax) by or for the account of the Issuer pursuant to the Loan Agreement, excluding amounts paid in respect of the Reserved Rights. The Issuer will have no other financial obligation under the Notes. **The Noteholders will be deemed to have accepted and agreed that they will be relying solely and exclusively on Sistema’s credit and financial standing in respect of the financial servicing of the Notes.**

Interest on the Notes will be payable at an annual rate equal to 6.95%. Subject to receipt of the funds necessary therefor from the Borrower, the Issuer will make interest payments on the Notes in arrear on 17 May and 17 November in each year, commencing on 17 November 2012, as described under clause 5 (Interest) of the “Terms and Conditions of the Notes” (the “**Conditions**”) Unless previously redeemed or cancelled, the Notes will be redeemed at their principal amount on 17 May 2019.

Except as set forth herein under “Taxation,” payments in respect of the Notes (and the Loan) will be made without any deduction or withholding on account of taxes. As set forth more fully in the Loan Agreement, Sistema JSFC may prepay the Loan at its principal amount, in whole but not in part, together with accrued interest, if (i) Sistema JSFC or the Issuer must deduct or withhold certain taxes from payments they make in respect of the Loan or the Notes, respectively; or (ii) it becomes illegal for the Notes or the Loan to remain outstanding. Upon such occurrence, the Issuer will, subject to the receipt of the relevant funds from Sistema JSFC, prepay the principal amount of all Notes outstanding, together with accrued interest.

Except as otherwise expressly provided in this prospectus (the “**Prospectus**”) and in the Trust Deed, no proprietary or other direct interest in the Issuer’s rights under or in respect of the Loan Agreement, or in any rights that the Issuer may receive by way of assignment in respect of the Loan, exists for the benefit of the Noteholders. Subject to the terms of the Trust Deed and the Conditions, no Noteholder will be entitled to enforce any provisions of the Loan Agreement or have direct recourse to the Borrower.

AN INVESTMENT IN THE NOTES INVOLVES A HIGH DEGREE OF RISK. SEE “RISK FACTORS” ON PAGE 13.

THE NOTES AND THE LOAN HAVE NOT BEEN, AND WILL NOT BE, REGISTERED UNDER THE U.S. SECURITIES ACT OF 1933 (THE “**SECURITIES ACT**”), OR WITH ANY SECURITIES REGULATORY AUTHORITY OF ANY STATE OR OTHER JURISDICTION OF THE UNITED STATES AND THE ISSUER IS NOT, AND WILL NOT BE, REGISTERED UNDER THE U.S. INVESTMENT COMPANY ACT OF 1940 (THE “**INVESTMENT COMPANY ACT**”). THE NOTES MAY NOT BE OFFERED OR SOLD WITHIN THE UNITED STATES OR TO, OR FOR THE ACCOUNT OR BENEFIT OF, U.S. PERSONS (AS DEFINED IN REGULATION S UNDER THE SECURITIES ACT (“**REGULATION S**”)) EXCEPT PURSUANT TO AN EXEMPTION FROM, OR IN A TRANSACTION NOT SUBJECT TO, THE REGISTRATION REQUIREMENTS OF THE SECURITIES ACT. THE NOTES ARE BEING OFFERED AND SOLD OUTSIDE THE UNITED STATES TO NON-U.S. PERSONS IN RELIANCE ON REGULATION S (THE “**REGULATION S NOTES**”) AND WITHIN THE UNITED STATES TO QUALIFIED INSTITUTIONAL BUYERS (“**QIBS**”), AS DEFINED IN RULE 144A UNDER THE SECURITIES ACT (“**RULE 144A**”), THAT ARE ALSO QUALIFIED PURCHASERS (“**QPS**”), AS DEFINED IN SECTION 2(a)(51) OF THE INVESTMENT COMPANY ACT, IN RELIANCE ON THE EXEMPTION FROM REGISTRATION UNDER THE SECURITIES ACT PROVIDED BY RULE 144A (THE “**RULE 144A NOTES**”). PROSPECTIVE INVESTORS ARE HEREBY NOTIFIED THAT SELLERS OF THE RULE 144A NOTES MAY BE RELYING ON THE EXEMPTION FROM THE PROVISIONS OF SECTION 5 OF THE SECURITIES ACT PROVIDED BY RULE 144A. FOR A DESCRIPTION OF THESE AND CERTAIN FURTHER RESTRICTIONS ON OFFERS, SALES AND TRANSFERS OF THE NOTES AND THE DISTRIBUTION OF THIS PROSPECTUS, SEE “SUBSCRIPTION AND SALE” AND “TRANSFER RESTRICTIONS.”

Information contained in this Prospectus is not an offer, or an invitation to make offers, sell, purchase, exchange or transfer any securities in the Russian Federation, and does not constitute an advertisement or offering of any securities in the Russian Federation. The securities referred to in this Prospectus have not been and will not be registered in the Russian Federation or admitted to public placement and/or public circulation in the Russian Federation and are not intended for “placement” or public “circulation” in the Russian Federation except as permitted by Russian law.

The Prospectus has been approved by the Central Bank of Ireland (the “**Central Bank**”) as competent authority under Directive 2003/71/EC (the “**Prospectus Directive**”). The Central Bank only approves this Prospectus as meeting the requirements imposed under Irish and European Union law pursuant to the Prospectus Directive. Application has been made to the Irish Stock Exchange for the Notes to be admitted to the official list and trading on its regulated market (the “**Market**”). The Market is a regulated market for the purposes of Directive 2004/39/EC of the European Parliament and of the Council on markets in financial instruments. There is no assurance that a trading market in the Notes will develop or be maintained.

The Notes are rated “BB-” by Fitch Ratings CIS Ltd. (“**Fitch**”) and “BB” by Standard & Poor’s Credit Market Services Europe Limited. (“**S&P**”). A rating is not a recommendation to buy, sell or hold securities and may be subject to suspension, reduction or withdrawal at any time by the assigning rating agency. Fitch and S&P are established in the European Union and registered under Regulation (EC) No 1060/2009, as amended (the “**CRA Regulation**”). As such, Fitch and S&P are included in the list of credit rating agencies published by the European Securities and Markets Authority on its website in accordance with the CRA Regulation.

The Notes will be in registered form and will be offered and sold in the minimum denomination of U.S.\$200,000 or higher integral multiples of U.S.\$1,000 in excess thereof. The Regulation S Notes will initially be represented by a global certificate (the “**Regulation S Global Certificate**”), without interest coupons, registered in the name of a nominee of, and deposited with a common depository for, Euroclear Bank SA/NV (“**Euroclear**”) and Clearstream Banking, *société anonyme* (“**Clearstream, Luxembourg**”) on the Issue Date (as defined in the Overview of the Offering). The Rule 144A Notes will initially be represented by a global certificate (the “**Rule 144A Global Certificate**”) and, together with the Regulation S Global Certificate, the “**Global Certificates**”), without interest coupons, registered in the name of Cede & Co. as nominee for The Depository Trust Company (“**DTC**”) on the Issue Date. The Global Certificates will only be exchangeable for definitive certificates (“**Definitive Certificates**”) in certain limited circumstances as described herein. See “*Summary of the Provisions relating to the Notes in Global Form.*”

Joint Lead Managers

Deutsche Bank

Morgan Stanley

VTB Capital

Prospectus Dated 16 May 2012

This Prospectus comprises a prospectus for the purposes of Article 5.4 of the Prospectus Directive and for the purpose of giving information with respect to the Issuer, Sistema JSFC and its subsidiaries and affiliates taken as a whole (“**Sistema**”) the Loan and the Notes, which, according to the particular nature of the Issuer, Sistema JSFC, the Loan and the Notes, is necessary to enable investors to make an informed assessment of the assets and liabilities, financial position, profits and losses and prospects of the Issuer and Sistema.

The language of the Prospectus is English. Certain legislative references and technical terms have been cited in their original language in order that the correct technical meaning may be ascribed to them under applicable law.

Sistema JSFC and the Issuer (the “**Responsible Persons**”) accept responsibility for the information contained in this Prospectus. To the best of the knowledge of the Responsible Persons (which have taken all reasonable care to ensure that such is the case), the information contained in this Prospectus is in accordance with the facts and contains no omission likely to affect the import of such information. In addition, Sistema JSFC having made all reasonable enquiries, confirms that (i) this Prospectus contains all information with respect to Sistema JSFC, Sistema, the Loan and the Notes that is material in the context of the issue and offering of the Notes; (ii) to the best knowledge of Sistema JSFC, the statements contained in this Prospectus relating to Sistema are in every material particular true and accurate and not misleading; (iii) the opinions, expectations and intentions expressed in this Prospectus with regard to Sistema are honestly held, have been reached after considering all relevant circumstances and are based on reasonable assumptions; (iv) there are no other facts in relation to Sistema JSFC, Sistema, the Loan or the Notes the omission of which would, in the context of the issue and offering of the Notes, make any statement in this Prospectus misleading in any material respect; and (v) all reasonable enquiries have been made by Sistema JSFC to ascertain such facts and to verify the accuracy of all such information and statements.

This Prospectus does not constitute an offer of, or an invitation by or on behalf of, any of the Issuer, Sistema JSFC or any Joint Lead Manager (as defined in “*Subscription and Sale*”) to subscribe for or purchase any Notes in any jurisdiction where it is unlawful to make such an offer or invitation, and this Prospectus may not be used for, or in connection with, any offer of, or invitation by or on behalf of, any of the Issuer, Sistema JSFC or any Joint Lead Manager to subscribe for or purchase any Notes in any jurisdiction or under any circumstances in which such offer or invitation is not authorised or is unlawful. The distribution of this Prospectus and the offer or sale of the Notes in certain jurisdictions may be restricted by law. The Issuer, Sistema JSFC and the Joint Lead Managers each require any person into whose possession this Prospectus comes to inform themselves about and to observe any such restrictions.

In making an investment decision, prospective investors must rely on their own examination of the Issuer, Sistema JSFC, Sistema, the Loan and the Notes and the terms of this Prospectus, including the risks involved. No person is authorised to provide any information or to make any representation not set forth in this Prospectus. Any information or representation not so set forth must not be relied upon as having been authorised by or on behalf of any of the Issuer, Sistema JSFC, the Trustee or any Joint Lead Manager. The delivery of this Prospectus at any time does not imply that the information set forth in it is correct as at any time after its date.

Neither the delivery of this Prospectus nor the offering, sale or delivery of any Note shall in any circumstances create any implication that there has been no adverse change, or any event reasonably likely to involve any adverse change, in the condition (financial or otherwise) of the Issuer or Sistema JSFC after the date of this Prospectus. None of the Issuer, Sistema JSFC, the Trustee, the Agents (as defined in the Trust Deed) or any Joint Lead Manager or any of their respective representatives makes any representation to any offeree or purchaser of the Notes offered hereby regarding the legality of an investment by such offeree or purchaser under applicable legal, investment or similar laws. Each investor should consult with their own advisers as to the legal, tax, business, financial and related aspects of the purchase of the Notes.

Prospective investors must comply with all laws that apply to them in any place in which they buy, offer or sell any Notes or possess this Prospectus. Any consents or approvals that are needed in order to purchase any Notes must be obtained. The Issuer, Sistema JSFC, the Trustee, the Agents and the Joint Lead Managers are not responsible for compliance with these legal requirements. The appropriate characterisation of the Notes under various legal investment restrictions, and thus the ability of investors subject to these restrictions to purchase the Notes, is subject to significant interpretative uncertainties. No representation or warranty is made as to whether or the extent to which the Notes constitute a legal investment for investors whose investment authority is subject to legal restrictions. Such investors should consult their legal advisers regarding such matters.

This Prospectus has been filed with and approved by the Central Bank as required by the Prospectus (Directive 2003/71/EC) Regulations 2005 (“**Prospectus Regulations**”).

Any investment in the Notes does not have the status of a bank deposit and is not within the scope of the deposit protection scheme operated by the Central Bank. The Issuer is not and will not be regulated by the Central Bank as a result of issuing the Notes.

In connection with the issue of the Notes, Morgan Stanley & Co. International plc (or person(s) acting on its behalf) may over-allot the Notes or effect transactions with a view to supporting the market price of the Notes at a level higher than that which might otherwise prevail. However, there is no assurance that Morgan Stanley & Co. International plc (or person(s) acting on its behalf) will undertake stabilisation action. Any stabilisation action may begin on or after the date on which adequate public disclosure of the terms of the offer of the Notes is made and, if begun, may be ended at any time, but it must end no later than the earlier of 30 days after the issue date of the Notes and 60 days after the date of the allotment of the Notes. Any stabilisation action or over-allotment must be conducted by Morgan Stanley & Co. International plc (or person(s) acting on its behalf) in accordance with all applicable laws and rules.

NO REPRESENTATION OR WARRANTY, EXPRESS OR IMPLIED, IS MADE BY THE JOINT LEAD MANAGERS AS TO THE ACCURACY OR COMPLETENESS OF THE INFORMATION SET FORTH IN THIS PROSPECTUS, AND NOTHING CONTAINED IN THIS PROSPECTUS IS, OR SHALL BE RELIED UPON AS, A PROMISE OR REPRESENTATION, WHETHER AS TO THE PAST OR THE FUTURE. NONE OF THE JOINT LEAD MANAGERS ASSUMES ANY RESPONSIBILITY FOR THE ACCURACY OR COMPLETENESS OF THE INFORMATION SET FORTH IN THIS PROSPECTUS. EACH PERSON CONTEMPLATING MAKING AN INVESTMENT IN THE NOTES MUST MAKE ITS OWN INVESTIGATION AND ANALYSIS OF THE CREDITWORTHINESS OF THE ISSUER AND SISTEMA AND ITS OWN DETERMINATION OF THE SUITABILITY OF ANY SUCH INVESTMENT, WITH PARTICULAR REFERENCE TO ITS OWN INVESTMENT OBJECTIVES AND EXPERIENCE, AND ANY OTHER FACTORS WHICH MAY BE RELEVANT TO IT IN CONNECTION WITH SUCH INVESTMENT.

THE NOTES AND THE LOAN HAVE NOT BEEN APPROVED OR DISAPPROVED BY THE U.S. SECURITIES AND EXCHANGE COMMISSION (THE “COMMISSION”), ANY STATE SECURITIES COMMISSION IN THE UNITED STATES OR ANY OTHER U.S. REGULATORY AUTHORITY, NOR HAVE ANY OF THE FOREGOING AUTHORITIES PASSED UPON OR ENDORSED THE MERITS OF THE NOTES OR THE ACCURACY OR THE ADEQUACY OF THIS PROSPECTUS. ANY REPRESENTATION TO THE CONTRARY IS A CRIMINAL OFFENCE IN THE UNITED STATES.

NOTICE TO NEW HAMPSHIRE RESIDENTS

NEITHER THE FACT THAT A REGISTRATION STATEMENT OR AN APPLICATION FOR A LICENCE HAS BEEN FILED UNDER CHAPTER 421-B OF THE NEW HAMPSHIRE REVISED STATUTES (“RSA 421-B”) WITH THE STATE OF NEW HAMPSHIRE NOR THE FACT THAT A SECURITY IS EFFECTIVELY REGISTERED OR A PERSON IS LICENCED IN THE STATE OF NEW HAMPSHIRE CONSTITUTES A FINDING BY THE SECRETARY OF STATE OF NEW HAMPSHIRE THAT ANY DOCUMENT FILED UNDER RSA 421-B IS TRUE, COMPLETE AND NOT MISLEADING. NEITHER ANY SUCH FACT NOR THE FACT THAT AN EXEMPTION OR EXCEPTION IS AVAILABLE FOR A SECURITY OR A TRANSACTION MEANS THAT THE SECRETARY OF STATE HAS PASSED IN ANY WAY UPON THE MERITS OR QUALIFICATIONS OF, OR RECOMMENDED OR GIVEN APPROVAL TO, ANY PERSON, SECURITY OR TRANSACTION. IT IS UNLAWFUL TO MAKE, OR CAUSE TO BE MADE, TO ANY PROSPECTIVE PURCHASER, CUSTOMER OR CLIENT ANY REPRESENTATION INCONSISTENT WITH THE PROVISIONS OF THIS PARAGRAPH.

ADDITIONAL INFORMATION

Neither Sistema JSFC nor the Issuer are required to file periodic reports under Section 13 or 15 of the U.S. Securities Exchange Act of 1934 (the “**Exchange Act**”). For so long as either Sistema JSFC or the Issuer are not a reporting company under Section 13 or 15(d) of the Exchange Act, or are exempt from reporting pursuant to Rule 12g3-2(b) thereunder, Sistema JSFC or the Issuer will, upon request, furnish to each Noteholder or beneficial owner of Notes that are “restricted securities” (within the meaning of Rule 144(a)(3) under the Securities Act and to each prospective purchaser thereof designated by such Noteholder or beneficial owner upon request of such Noteholder, beneficial owner or prospective purchaser, in connection with a transfer or proposed transfer of any such Rule 144A Notes under the Securities Act the information required to be delivered pursuant to Rule 144A(d)(4) under the Securities Act.

The FATCA rules were enacted in 2010 to prevent U.S. tax evasion by requiring foreign banks and investment funds to provide information to the U.S. Internal Revenue Service (the “**IRS**”) about U.S. customers and investors. This is achieved through a comprehensive information reporting regime that requires foreign financial institutions (such as Sistema and the Issuer) to conduct diligence on their account holders and investors to determine whether their accounts are “U.S. accounts,” and either provide detailed information about these U.S. accounts to the IRS or suffer a 30% withholding tax on certain payments. The U.S. Treasury Department has not yet released final regulations clarifying the statutory language of FATCA, so the scope and application of FATCA is uncertain at this time. It is possible that FATCA could operate to impose U.S. withholding tax on (i) beginning in 2014, payments to Sistema and the Issuer in respect of U.S. securities, including interest and dividends, (ii) beginning in 2015, payments to Sistema and the Issuer of gross proceeds from the disposition of such securities, and (iii) beginning no earlier than 2017, certain “pass-thru payments” to Sistema and the Issuer, as well as certain “pass-thru” payments from the Issuer to certain Noteholders. It is also possible that Sistema and the Issuer could incur material costs in implementing information-gathering systems to comply with FATCA. Given the lack of final regulations or other binding guidance, it is impossible for Sistema to evaluate the potential effect of FATCA at this time.

PRESENTATION OF FINANCIAL AND OTHER INFORMATION

Financial Information

The financial information set forth herein has, unless otherwise indicated, been derived from our audited consolidated financial statements as at 31 December 2011 and 2010 and for the years ended 31 December 2011, 2010 and 2009, prepared in accordance with U.S. GAAP (the “**U.S. GAAP Financial Statements**”) and included elsewhere in this document. The U.S. GAAP Financial Statements, set forth on pages F-1 through F-57 of this Prospectus, were prepared in accordance with U.S. GAAP set forth in the opinions and pronouncements of the Accounting Principles Board of the American Institute of Certified Public Accountants and statements and pronouncements of the Financial Accounting Standards Board. The U.S. dollar is the reporting currency for the U.S. GAAP Financial Statements.

The U.S. GAAP Financial Statements included in this Prospectus have been audited by ZAO Deloitte & Touche CIS (“**Deloitte & Touche**”), independent auditors, as stated in their report appearing herein, which report expresses an unqualified opinion on the financial statements. The address of Deloitte & Touche is 5 Lesnaya Street, Moscow, 125047, the Russian Federation. Deloitte & Touche is a member of the Audit Chamber of the Russian Federation.

Market Data

Market data used in this Prospectus have been extracted from the relevant sources we believe to be reliable including, without limitation, in the section headed “*Business.*” Such information, data and statistics may be approximations or estimates or use rounded numbers. Each of the Issuer and Sistema JSFC has relied on the accuracy of this information without independent verification and only accepts responsibility for accurately reproducing such information. So far as the Issuer and Sistema JSFC are able to ascertain from this publicly available information, no facts have been omitted which would render the reproduced information misleading or inaccurate.

In addition, some of the information contained in this Prospectus has been derived from the official data of Russian government agencies. The official data published by Russian federal, regional and local governments is 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 the Russian Federation in this Prospectus is, therefore, 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. The Issuer and Sistema JSFC only accept responsibility for accurately reproducing such information. So far as the Issuer and Sistema JSFC are able to ascertain from this publicly available information, no facts have been omitted which would render the reproduced information misleading or inaccurate.

Certain definitions

In this Prospectus, references to “Sistema,” “we,” “us,” “ourselves,” “our” mean Sistema JSFC and its consolidated subsidiaries, unless the context requires otherwise. References to Sistema JSFC are to Sistema JSFC only. References to MTS are to Mobile TeleSystems Open Joint Stock Company (“**MTS OJSC**”) and its consolidated subsidiaries, unless the context requires otherwise. References to MTS OJSC are to MTS OJSC only. References to Bashneft are to Joint Stock Oil Company Bashneft (“**JSOC Bashneft**”) and its consolidated subsidiaries, unless the context requires otherwise. References to JSOC Bashneft are to JSOC Bashneft only. References to Bashkirenergo are to Open Joint Stock Company Bashkirenergo (“**OJSC Bashkirenergo**”) and its consolidated subsidiaries, unless the context requires otherwise. References to OJSC Bashkirenergo are to OJSC Bashkirenergo only.

CURRENCIES AND EXCHANGE RATES

In this Prospectus, references to (i) “U.S. dollars,” “dollars,” “\$,” “USD,” or “U.S.\$” are to the lawful currency of the United States of America, its territories and possessions, any state of the United States of America and the District of Columbia (the “**United States**” or “**U.S.**”); (ii) “roubles” or “RUB” are to the lawful currency of the Russian Federation; and (iii) “€,” “euro” or “EUR” are to the lawful currency of the member states of the European Union that adopted a single currency in accordance with the Treaty establishing the European Community (signed in Rome on 25 March 1957), as amended by the Treaty on European Union (signed in Maastricht on 7 February 1992), the Treaty of Amsterdam (signed in Amsterdam on 2 October 1997) and the Treaty of Nice (signed in Nice on 26 February 2001).

The following tables set forth, for the periods indicated, certain information regarding the exchange rate between the rouble and the U.S. dollar, based on the official exchange rate quoted by the Central Bank of the Russian Federation (the “**CBR**”). These rates may differ from the actual rates used in the preparation of the U.S. GAAP Financial Statements and other financial information appearing in this Prospectus.

<u>Year</u>	Roubles per U.S. dollar			
	High	Low	Period average ⁽¹⁾	Period End
2007	26.58	24.26	25.58	24.55
2008	29.38	23.13	24.86	29.38
2009	36.43	28.67	31.72	30.24
2010	31.78	28.93	30.37	30.48
2011	32.68	27.26	29.35	32.20
 <u>Month</u>				
January 2012	32.20	30.36	31.52	30.36
February 2012	30.41	28.95	29.88	28.95
March 2012	29.67	28.95	29.37	29.33
April 2012	29.80	29.28	29.47	29.36
May 2012 (through 16 May)	30.33	29.36	29.85	30.33

(1) The average rates are calculated as the average of the daily exchange rates on each business day (which rate is announced by the CBR for each such business day) and on each non-business day (which rate is equal to the exchange rate on the previous business day).

The exchange rate between the rouble and the U.S. dollar quoted by the CBR on 31 December 2011 was 32.20 roubles per U.S. dollar.

The exchange rate between the rouble and the U.S. dollar on 16 May 2012 was 30.33 roubles per U.S.\$1.00. No representation is made that the rouble or U.S. dollar amounts in this Prospectus could have been converted into U.S. dollars or roubles, as the case may be, at any particular rate or at all.

Certain amounts that appear in this Prospectus have been subject to rounding adjustments; accordingly, figures shown as totals in certain tables may not be an arithmetic aggregation of the figures that precede them.

OIL RESERVES DATA

This Prospectus contains information concerning Bashneft's crude oil reserves that, except as otherwise indicated, has been primarily derived or extracted from the report (the "**Reserves Report**") of Miller and Lents, Ltd., a firm of independent petroleum engineers ("**Miller and Lents**"), dated as at 31 December 2011. **The information concerning such crude oil reserves that is contained in this Prospectus that has been so primarily derived or extracted is qualified in its entirety by reference to the more detailed information contained in the Reserves Report, copies of which may be inspected at the offices of the Issuer, the Trustee and the Principal Paying Agent.** See "*General Information.*" This Prospectus presents information concerning reserves on the basis of the definitions contained in the U.S. Securities Exchange Commission ("**SEC**") Regulation S-X, Rule 4-10(a) ("**SEC Standards**") (certain of those definitions attached hereto as Annex A) ("**SEC Reserves Definitions**").

The Reserves Report does not contain the evaluation of the Trebs and Titov oil fields. Data relating to the Trebs and Titov oil fields are presented based on Russian standards, which are not comparable with SEC Standards.

Petroleum engineering is a subjective process of estimating underground accumulations of oil and gas that cannot be measured in an exact manner. These estimates necessarily depend upon a number of variable factors and assumptions, many of which are beyond our control. Due to the inherent uncertainties and the necessarily limited nature of reservoir data and the inherently imprecise nature of reserves estimates the reserves amounts disclosed in this Prospectus may change as additional information becomes available. Prospective investors should not place undue reliance on the ability of the Reserves Reports to predict actual reserves or on comparisons of similar reports concerning companies established in other economic systems.

In estimating Bashneft's reserves as at 31 December 2011 under the SEC Standards, we have included within proved reserves significant quantities of crude oil and gas that Bashneft expects to produce after the expiration dates of certain of Bashneft's current production licences in the Russian Federation. Bashneft believes that its Russian licences will be extended to permit production subsequent to their current expiration dates. To date Bashneft has never had any licence renewal application denied or rejected. See "*Risk Factors—General Risks—The licences and permits that we require for our business may be invalidated, suspended or may not be issued or renewed, or may contain onerous terms and conditions that restrict our ability to conduct our operations or could result in substantial compliance costs or administrative penalties*" for more information on licences in the Russian Federation.

The Reserves Report was prepared on the basis that Bashneft owns 100% of the reserves discussed therein and was not prepared on the basis of Sistema JSFC's ownership stake in the reserves, which is less than 100%, given that Sistema JSFC beneficially owns a 69% stake in Bashneft.

Miller and Lents is an independent oil and gas consulting firm. No director, officer or key employee of Miller and Lents has any financial ownership in Bashneft or any affiliate of Bashneft. The business address of Miller and Lents is Two Houston Center, 909 Fannin Street, Suite 1300, Houston, Texas 77010.

Presentation of Reserves and Production Data

All numerical data regarding figures for production of crude oil presented in this Prospectus are presented in gross terms without any deduction for wastage or own use at the field unless otherwise stated by reference to net numerical data.

All references to production of "liquids" in this Prospectus mean production of crude oil, condensate and natural gas liquids.

The following abbreviations have the following meanings as used in this Prospectus:

"**bbl**" means barrels;

"**bcm**" means billions of cubic metres;

"**boe**" means barrels of oil equivalent;

"**bpd**" means barrels per day;

“**mbd**” means thousands of barrels per day;

“**mboed**” means thousands of barrels of oil equivalent per day;

“**mmb**” means millions of barrels;

“**mmbd**” means millions of barrels per day;

“**mmboe**” means millions of barrels of oil equivalent; and

“**mmboed**” means millions of barrels of oil equivalent per day.

Conversion of Hydrocarbon Volumetric Data

This Prospectus presents data relating to Bashneft’s production, refining and marketing operations, which is expressed in barrels. As is common in the reporting of hydrocarbon production in countries of the Commonwealth of Independent States (“**CIS**”), Bashneft maintains its internal records regarding such data in metric tonnes. Solely for the convenience of the reader, unless otherwise indicated, such metric data have been converted into barrels at the rate of 7.11 barrels per tonne of crude oil except for the reserves data which has been extracted from the relevant Reserves Reports. In addition, for natural gas, this Prospectus uses a conversion factor of one billion cubic metres of gas to six million boe.

Rounding

Certain figures included in this Prospectus have been subject to rounding adjustments; accordingly, figures shown for the same category presented in different tables may vary slightly and figures shown as totals in certain tables may not be an arithmetic aggregation of the figures which precede them.

FORWARD-LOOKING STATEMENTS

Matters discussed in this Prospectus may constitute forward-looking statements within the meaning of Section 27A of the Securities Act and Section 21E of the Exchange Act. The Private Securities Litigation Reform Act of 1995 (the “**Securities Reform Act**”) provides safe harbour protections for forward-looking statements in order to encourage companies to provide prospective information about their businesses. Forward-looking statements include statements concerning plans, objectives, goals, strategies, future events or performance, and underlying assumptions and other statements, which are other than statements of historical facts.

Sistema desires to take advantage of the safe harbour provisions of the Securities Reform Act and is including this cautionary statement in connection with this safe harbour legislation and other relevant law. This Prospectus and any other written or oral statements made by us or on our behalf, including in reports to shareholders or in other communications, may include forward-looking statements. We base these forward-looking statements largely on our current expectations and projections about future events and financial trends that we believe may affect our financial condition, results of operations, business strategy and financial needs. Forward-looking statements are identified by words such as “believes,” “anticipates,” “expects,” “estimates,” “forecasts,” “projects,” “intends,” “plans,” “will,” “may,” “should,” “could” and similar expressions, but these expressions are not the exclusive means of identifying such statements. Forward-looking statements appear, without limitation, under the headings “Risk Factors,” “Management’s Discussion and Analysis of Financial Condition and Results of Operations” and “Business.” Examples of such forward-looking statements include, but are not limited to:

- statements of our plans, objectives or goals, including those related to our strategy, products or services;
- statements of future economic performance;
- statements of general economic developments in the Russian Federation or the other countries in which we operate; and
- statements of assumptions underlying such statements.

Forward-looking statements that we may make from time to time (but that are not included in this Prospectus) may also include projections or expectations of revenues, income (or loss), earnings (or loss) per share, dividends, capital structure or other financial items or ratios.

The forward-looking statements in this Prospectus and elsewhere are based upon various assumptions, many of which are based, in turn, upon further assumptions, including without limitation: management’s examination of historical operating trends; data contained in our records; and other data available from third parties. Although we believe that these assumptions were reasonable when made, these assumptions are inherently subject to significant uncertainties and contingencies which are difficult or impossible to predict and are beyond our control. By their very nature, forward-looking statements involve inherent risks and uncertainties, both general and specific, and risks exist that the predictions, forecasts, projections and other forward-looking statements will not be achieved. Prospective investors should be aware that a number of important factors could cause actual results to differ materially from the plans, objectives, expectations, estimates and intentions expressed in such forward-looking statements. In addition to these important factors and matters discussed elsewhere herein, these factors include:

- changes in political, social, legal or economic conditions in the Russian Federation and the CIS;
- the effects of, and changes in, the policies of the government of the Russian Federation, including the President and his administration, the Prime Minister, the Cabinet and the Prosecutor General and his office;
- our ability to service our existing indebtedness;
- our ability to obtain and retain necessary regulatory approvals and licences for our businesses;
- our ability to fund our future operations and capital needs through borrowing or otherwise;
- our ability to successfully implement any of our business strategies;
- our ability to integrate our businesses, including recently acquired businesses, and to realise anticipated cost savings and operational benefits from such integration;
- our expectations about growth in demand for our products and services;

- the challenging conditions in the Russian economy;
- declines and increased volatility in global and Russian securities markets;
- fluctuations in prices for crude oil, gas, refined products and other commodities;
- the inherent uncertainties in estimating our reserves of crude oil;
- inflation, interest rate and exchange rate fluctuations in the Russian Federation;
- the effects of competition in the geographic and business areas in which we conduct our operations;
- the global financial crisis and European sovereign debt crisis and its impact on the global and Russian economies and financial markets;
- the effects of changes in laws, regulations, taxation or accounting standards or practices in the jurisdictions where we conduct our operations;
- our ability to increase market share for our products and services and control expenses;
- our ability to divest non-core assets and businesses on favourable terms;
- acquisitions or divestitures;
- our expansion in various geographic and business areas;
- technological changes;
- the effects of international political events;
- our ability to manage operational risks in our crude oil exploration, production and transportation activities and other business operations;
- our success at managing the risks associated with the aforementioned factors; and
- our success in identifying other risks to our businesses and managing the risks of the aforementioned factors.

This list of important factors is not exhaustive. When relying on forward-looking statements, prospective investors should carefully consider the foregoing factors and other uncertainties and events, especially in light of the political, economic, social and legal environment in which we operate. Such forward-looking statements speak only as at the date on which they are made. Accordingly, except to the extent required by law, neither we, nor any of our respective agents, employees or advisors intends or has any duty or obligation to supplement, amend, update or revise any of the forward-looking statements contained or incorporated by reference in this Prospectus, whether as a result of new information, future events or otherwise. We do not make any representation, warranty or prediction that the results anticipated by such forward-looking statements will be achieved, and such forward-looking statements represent, in each case, only one of many possible scenarios and should not be viewed as the most likely or standard scenario.

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ENFORCEABILITY OF JUDGMENTS

Sistema JSFC is an open joint stock company incorporated under the laws of the Russian Federation. Substantially all of Sistema JSFC's directors and executive officers named in this Prospectus reside outside the United Kingdom and the United States. Moreover, the majority of the assets of Sistema JSFC and substantially all of the assets of the directors and officers of Sistema JSFC are located in the Russian Federation. As a result, it may not be possible for the Noteholders to:

- effect service of process within the United Kingdom or the United States upon any of Sistema JSFC's directors or executive officers named in this Prospectus; or
- enforce, in the English or U.S. courts, judgments obtained outside English or U.S. courts against Sistema JSFC or any of its directors and executive officers named in this Prospectus in any action.

In addition, it may be difficult for the Noteholders to enforce, in original actions brought in courts in jurisdictions located outside the United Kingdom and the United States, liabilities predicated upon English laws or U.S. federal securities laws. Courts in the Russian Federation will generally recognise judgments rendered by a court in any jurisdiction outside the Russian Federation if an international treaty providing for the recognition and enforcement of judgments in civil cases exists between the Russian Federation and the country where the judgment is rendered or a federal law is adopted in the Russian Federation providing for the recognition and enforcement of foreign court judgments. No such treaty for the reciprocal recognition and enforcement of foreign court judgments in civil and commercial matters exists between the Russian Federation and certain other jurisdictions (including the United Kingdom and the United States), and no relevant deferral law on enforcement of foreign court judgments has been adopted in the Russian Federation. As a result of this, new proceedings may have to be brought in the Russian Federation in respect of a judgment already obtained in any such jurisdiction against Sistema JSFC or its officers or directors. In addition, Russian courts have limited experience in the enforcement of foreign court judgments. The limitations described above, including the general procedural grounds set out in Russian legislation for the refusal to recognise and enforce foreign court judgments in the Russian Federation, may significantly delay the enforcement of such judgment or deprive the Issuer and/or the Noteholders of effective legal recourse for claims related to the investment in the Notes or under the relevant Loans.

In the absence of an applicable treaty, enforcement of a final judgment rendered by a foreign court may still be recognised by a Russian court on the basis of reciprocity, if courts of the country where the foreign judgment is rendered have previously enforced judgments issued by Russian courts. While Russian courts have recently recognised and enforced English court judgments on these grounds, the existence of reciprocity must be established at the time the recognition and enforcement of a foreign judgment is sought, and it is not possible to predict whether a Russian court will in the future recognise and enforce on the basis of reciprocity a judgment issued by a foreign court, including an English court.

The Loan Agreement and any non-contractual obligations arising out of or in connection with any Loan Agreement will be governed by English law and will provide for disputes, controversies and causes of action brought by any party thereto against Sistema JSFC to be settled by arbitration in accordance with the rules of the LCIA (formerly the London Court of International Arbitration) (the "**LCIA Rules**"). The place of such arbitration shall be London, England. The Russian Federation and the United Kingdom are parties to the United Nations (New York) Convention on the Recognition and Enforcement of Foreign Arbitral Awards of 10 June 1958 (the "**New York Convention**"). Consequently, Russian courts should generally recognise and enforce in the Russian Federation an arbitral award from an arbitral tribunal in the United Kingdom on the basis of the rules of the New York Convention (subject to qualifications provided for in the New York Convention and compliance with Russian procedural regulations and other procedures and requirements established by Russian legislation).

The Arbitrazh Procedural Code of the Russian Federation (the "**Arbitrazh Procedural Code**") sets out the procedure for the recognition and enforcement of foreign arbitral awards by Russian courts. The Arbitrazh Procedural Code also contains an exhaustive list of grounds for the refusal of recognition and enforcement of foreign arbitral awards by Russian courts, which grounds are broadly similar to those provided by the New York Convention.

The Arbitrazh Procedural Code and other Russian procedural legislation could change, and other grounds for Russian courts to refuse the recognition and enforcement of foreign courts' judgments and foreign arbitral awards could arise in the future. In practice, reliance upon international treaties may meet with resistance or a lack of understanding on the part of a Russian court or other officials, thereby introducing delay and unpredictability into the process of enforcing any foreign judgment or any foreign arbitral award in the Russian Federation.

Furthermore, any arbitral award pursuant to arbitration proceedings in accordance with the LCIA Rules and the application of English law to each Loan Agreement and any non-contractual obligations arising out of or in connection with any Loan Agreement may be limited by the mandatory provisions of Russian laws relating to the exclusive jurisdiction of Russian courts and the application of Russian laws with respect to bankruptcy, winding up or liquidation of Russian companies and credit organisations in particular. Each Loan Agreement will provide for the Issuer to elect for disputes to be settled in the courts of England as an alternative to arbitration.

In addition, the enforcement of an award, duly obtained abroad, in Luxembourg is subject to the Luxembourg procedure code and applicable treaties and conventions. It may be possible to effect service of process within Luxembourg provided that The Hague Convention on the Service Abroad of Judicial and Extrajudicial Documents in Civil or Commercial Matters of November 15, 1965 is complied with.

The traditional requirements for a valid, final and conclusive judgment against the Issuer in any civil or commercial suit, action of proceeding arising out of or in connection with the Notes obtained from a court of competent jurisdiction in the United States (which judgment remains in full force and effect after all appeals as may be taken in the relevant state or federal jurisdiction with respect thereto have been taken) to be entered and enforced through a court of competent jurisdiction of Luxembourg were the following:

- the U.S. court awarding the judgment has jurisdiction to adjudicate the respective matter under its applicable laws, and such jurisdiction is recognized by Luxembourg private international and local law;
- the judgment is final and duly enforceable in the jurisdiction where the decision is rendered;
- the U.S. Court has applied the substantive law as designated by the Luxembourg conflict of laws rules;
- the U.S. Court has acted in accordance with its own procedural laws;
- the judgment was granted following proceedings where the counterparty had the opportunity to appear, and if appeared, to present a defense and
- the judgment does not contravene public policy as understood under the laws of Luxembourg or has been given in proceedings of a criminal nature.

If an original action is brought in Luxembourg, Luxembourg courts may refuse to apply the designated law if its application contravenes Luxembourg public policy.

In a judgment of the Luxembourg District court, dated January 10, 2008, the Court departed slightly from the traditional rules for enforcing a judgment described above.

Whether the District Court's opinion described above develops into the prevailing position of Luxembourg case law cannot be forecasted with certainty at this stage.

For a further description of the risks relating to your ability to enforce court judgments against us or any of our directors and executive officers, see "*Risk Factors*."

PROSPECTUS OVERVIEW

The following overview is qualified in its entirety by, and is subject to, information contained elsewhere in this Prospectus (including the U.S. GAAP Financial Statements and the notes thereto). Unless the context requires otherwise, all data in this Prospectus is presented on a consolidated basis. See “Risk Factors” for a discussion of certain risk factors that should be considered in connection with an investment in the Notes.

Overview

We are the largest publicly-traded diversified investment company in the Russian Federation and the CIS in terms of market capitalisation, managing companies that collectively serve over 100 million customers. We are focused on delivering long-term growth to our shareholders through returns on our diversified portfolio of investments and identifying new and profitable investment opportunities. Our investment portfolio is currently largely composed of stakes in Russian businesses operating in a variety of sectors, including telecommunications, oil, utilities, consumer, high tech and others.

We were founded in 1993 by Vladimir Evtushenkov and his close associates as an operating holding company and developed through the 1990s and early 2000s through various acquisitions and the creation of several successful strategic partnerships. We completed an initial public offering (“**IPO**”) in February 2005, when we conducted a standard listing of our Global Depositary Receipts (“**GDRs**”) on the London Stock Exchange. Our ordinary shares are listed on the MICEX-RTS Stock Exchange and on the Moscow Stock Exchange.

Since our founding, we primarily operated in the wireless communications, fixed line telecommunications, technology, insurance, real estate, media, banking, retail and travel sectors. In March 2009, we added the oil sector to our operations by acquiring a controlling interest in JSOC Bashneft and related companies. In October 2009, we sold our fixed line telecommunications operations to our wireless communication subsidiary, MTS OJSC, creating a leading supplier of integrated telecommunications solutions in the Russian Federation and the CIS.

In October 2010, we adopted a new strategy providing for our transition from an operating holding company to an investment company. In April 2011, in line with this strategy and to better allow us to identify and evaluate new investment opportunities and to manage our existing investments, we announced a new organisational and management structure which combines our investments into two units “**Core Assets**” and “**Developing Assets**” (as indicated in the table below). We consider OAO NK RussNeft (“**RussNeft**”), in which we hold a non-controlling 49% stake, to be one of our Developing Assets. See “*Management’s Discussion and Analysis of Financial Condition and Results of Operations—Acquisitions, Divestitures and Key Corporate Restructurings—Acquisitions—Acquisition of non-controlling stake in RussNeft.*”

Consolidated revenues, OIBDA and net income attributable to Sistema JSFC for the year ended 31 December 2011 were U.S.\$32,981.2 million, U.S.\$7,223.1 million and U.S.\$218.0 million, respectively. For the year ended 31 December 2011, MTS and Bashneft, two of our Core Assets, accounted for 88.6% of our consolidated revenues and RTI, MTS Bank and SSTL (as defined in the table below), three of our Developing Assets, accounted for 6.5% of our consolidated revenues. In 2011, MTS and Bashneft recorded an aggregate operating income of U.S.\$5,672.7 million and RTI, MTS Bank and SSTL recorded an aggregate operating loss of U.S.\$1,169.2 million.

Our businesses

Our portfolio of investments consists of two units: Core Assets, comprising mature, cash generative companies; and Developing Assets, consisting of companies with high potential for growth. Through this diversified approach to our portfolio, we are able to fund the early stages of development of our Developing Assets, as well as new acquisitions, with dividend payments from our Core Assets.

The following table sets forth our beneficial ownership interests in our principal subsidiaries and the sectors in which they operate as at 31 December 2011:

CORE ASSETS		
<i>Company</i>	<i>Beneficial Ownership</i>	<i>Industry</i>
MTS OJSC	53%	Telecommunications
JSOC Bashneft⁽¹⁾	69%	Oil
OJSC Bashkirenergo⁽²⁾	39%	Energy
DEVELOPING ASSETS⁽³⁾		
<i>Company</i>	<i>Beneficial Ownership</i>	<i>Industry</i>
Sistema Shyam TeleServices Ltd (“SSTL”)	57%	Telecommunications
OJSC MTS Bank (“MTS Bank”)	99%	Banking
OJSC RTI (“RTI”)	85%	High technology
Detsky Mir Group (“Detsky Mir”)	75%	Retail
Sistema Mass-Media (“SMM”)	75%	Media
OJSC Intourist (“Intourist”)	66%	Travel services
CJSC Medsi Group of Companies (“Medsi Group”)	100%	Private healthcare
JSC Binnopharm (“Binnopharm”)	100%	Pharmaceuticals
JSC Navigation- Information Systems (“NIS”)⁽⁴⁾	51%	High technology

Notes:

- (1) Our voting interest in Bashneft is 86%. See “*Management’s Discussion and Analysis of Financial Condition and Results of Operations—Overview.*”
- (2) Bashkirenergo is currently being reorganised so that its power and heat generation assets and heat distribution assets are controlled by one company, OJSC Bashenergoaktiv (“**Bashenergoaktiv**”), and its power transmission and distribution assets are controlled by another company, OJSC Bashkortostan Electricity Grid Company (“**BESK**”). See “*Business—Bashkirenergo—History and Development*” for more discussion on the ongoing reorganisation. Our voting interest in Bashkirenergo is 50.2%. See “*Management’s Discussion and Analysis of Financial Condition and Results of Operations—Overview.*”
- (3) We also consider RussNeft, in which we hold a non-controlling 49% stake, to be one of our Developing Assets.
- (4) In February 2012, we increased our stake in NIS to 70%. See “*Management’s Discussion and Analysis of Financial Condition and Results of Operations—Recent Developments.*”

Investment Approach

We seek opportunities to create value through the management of our portfolio, including through the acquisition of new companies that offer synergies with our existing portfolio companies, the restructuring of existing portfolio companies and exits through either sales to strategic investors or through the public equity markets. We seek to establish partnerships with leading local and international companies in order to maximise the value of our portfolio companies.

The primary key performance indicator (“**KPI**”) that we use in assessing our investments is total shareholder return (“**TSR**”). We compare this metric against internal hurdle rates for specific industries and investment types when making new investments or evaluating portfolio company performance. Depending on the particular asset, we target a TSR of at least 12% for our Core Assets and at least 15% for our Developing Assets. We and the senior management of our portfolio companies also monitor a number of other KPIs, including return on invested capital and certain operational metrics. The remuneration of our senior management and the management of our portfolio companies is linked to performance of these KPIs, particularly the TSR.

We seek to manage our portfolio companies primarily through board representation, with operational decisions taken by the management teams of each portfolio company. In certain circumstances, we may also assist our

portfolio companies, in particular Developing Assets, in relation to overall strategy, partnerships, risk management, corporate governance and internal controls, third party financing, management selection and identifying and implementing synergies with other portfolio companies.

Strengths

We have a number of key competitive strengths, which we believe have enabled us to become one of the largest publicly-traded diversified companies in the Russian Federation and the CIS in terms of market capitalisation and to provide a strong foundation for the implementation of our strategy.

- *Strong management track record in successfully developing our portfolio companies*

Our management has a proven ability to successfully develop companies from an early-growth stage to maturity, including MTS, which we developed from an early-stage business in 1996 to a company with over one hundred million subscribers in five countries through organic growth, acquisitions and restructurings of independent mobile service providers in the Russian Federation and leading telecommunications providers in the CIS; and ROSNO, which we developed in partnership with Allianz into one of the leading insurance companies in the Russian Federation leveraging Allianz's technical know-how, risk management expertise, planning and controlling procedures. Allianz subsequently purchased our stake in ROSNO.

In addition, our management has significant experience in creating value through corporate restructurings. In previous years, our management has successfully restructured a diverse range of telecommunications assets, including the combination of MTS, JSC Comstar-UTS ("**Comstar**") and Moscow City Telephone Network JSC ("**MGTS**") into one holding, MTS, thereby creating a leading integrated telecommunications company in the Russian Federation and CIS. Currently, our management is overseeing the reorganisation of Bashneft and its various subsidiaries into a transparent, streamlined and vertically-integrated oil company.

- *Significant experience with identifying acquisitions, joint ventures and exits*

Since our creation in 1993, our management has accumulated significant experience in identifying acquisitions and executing M&A transactions, including acquisitions, divestitures and joint ventures. We monitor opportunities to create value by targeting investments, which are complementary to our existing portfolio. Having identified profitable investment opportunities with high returns, our management completed several M&A transactions in recent years. For example, we have successfully executed the acquisition of Bashneft in 2009 and a non-controlling 49% stake in RussNeft in 2010 and have successfully created joint ventures, such as the venture between Thomas Cook and Intourist, and the Bashneft-LUKOIL joint venture for the development of the Trebs and Titov oil fields. The acquisition of Bashneft, in particular, demonstrates our management's ability to identify and execute attractive M&A opportunities, with Bashneft's stock having risen by over 900% since the time of the deal.

Furthermore, we have been able to crystallise gains on our investments through timely exits, including the sale of a controlling stake and later of our remaining position in ROSNO to Allianz.

- *Expertise in a wide range of sectors*

We have many years of experience in a wide range of the Russian Federation's most important and attractive sectors, including the telecommunications, oil, consumer and high tech sectors. We leverage this experience in evaluating potential investments and developing strategies for our portfolio companies. In addition, our management's industry expertise is instrumental in identifying opportunities for synergies between our existing portfolio companies as well as between our existing portfolio companies and potential acquisition targets. As an illustration of such activities, MTS Bank was rebranded in 2012 from the Moscow Bank for Reconstruction and Development (the "**MBRD**") in order to facilitate the cross-selling of our telecommunications and banking products. MTS Bank markets itself under the MTS brand and leverages MTS' client database to promote its financial services.

- *Established and transparent public profile*

As a Russian company listed on the London Stock Exchange, we are subject to strong corporate governance and public disclosure standards.

We also have a well-established presence on the capital markets, having issued our first international Eurobond in 2004 and gone public in 2005. In addition, a number of our portfolio companies have publicly issued equity or

debt instruments, including MTS OJSC, which is listed on the New York Stock Exchange. As a result, we have a strong understanding of capital markets and are well-known to investors, which, in turn, facilitate our access to capital and increase our options with regard to financing and to potential exits.

Our public profile and our transparency are critical factors in our ability to attract industry-leading international and local partners as investors in our portfolio companies. Investments by Deutsche Telekom in MTS, Allianz in ROSNO and Thomas Cook in Intourist underscore that major international companies seek to partner with us.

- *Sound financial management*

We have historically adhered to a conservative financial strategy with respect to both our existing portfolio assets and potential new investments. Similarly, we target any newly-acquired companies to be able to cover their own financing costs within five to seven years after our acquisition of them. Furthermore, while cross-guarantees are given within Sistema, we guarantee subsidiary debt only in early-stage development situations. We maintain a low debt to OIBDA ratio, which reduces exposure to the potential negative performance of one of our portfolio companies or the macroeconomic environment as a whole. Low leverage also allows us to make timely investments and access the debt markets (both bank and public). See “*Risk Factors*” and “*Management’s Discussion and Analysis of Financial Condition and Results of Operations.*”

Strategy

Our strategic goal is to ensure sustained growth in the shareholder value of our business. We intend to achieve this goal by increasing the level of return on capital invested in our current assets and by reinvesting a larger portion of our non-committed cash in new investment projects with high returns.

The key elements of our strategy are:

- *Develop a balanced and diversified asset portfolio*

We aim to maintain a balanced portfolio, consisting of mature, dividend generative Core Assets and relatively smaller Developing Assets with high potential for growth. For the foreseeable future, we expect that the Core Assets will continue to generate the substantial majority of our revenues. We view our Core Assets as long-term investments, except in relation to the reorganisation of Bashkirenegro, and do not currently intend to sell them or reduce our stake below control, provided they continue to perform to our expectations. The stable dividend streams generated by the Core Assets can be used to finance investments in high growth Developing Assets and new acquisitions.

Additionally, we seek to diversify our portfolio across a wide range of sectors in order to reduce risk and volatility. In particular, we have established a target portfolio through 2015 that sets out the investments we intend to make by region and sector in the Russian Federation and we regularly evaluate and revise the target portfolio as necessary to adapt to economic and market conditions.

Furthermore, we may, in the future, diversify the geographic presence of our portfolio companies outside the Russian Federation, where we believe it is complementary to our existing businesses and an adequate level of return can be achieved.

- *Focus on sectors and geographies where we have a competitive advantage*

We have a long history of investing in the Russian Federation and the CIS and across a range of industry sectors. We intend to invest in regions and sectors where we either have an existing presence or which are complementary to our existing businesses.

We have identified the following sectors as potentially attractive areas for future investments, in addition to those where we are already present: agriculture, fertilisers, infrastructure, transportation and logistics as well as chemicals and petrochemicals. Moreover, certain of our portfolio companies are considering international expansion complementary to their existing businesses.

In all cases, potential investments will be evaluated in light of our returns criteria, including TSR.

- *Pursue an active portfolio management approach*

We seek to actively manage our portfolio of investments by making value-accretive acquisitions and disposals where such decisions lead to the maximisation of returns. When considering an investment, we target a TSR above our internal hurdle rates for the applicable industry.

- *Attract leading international and local companies as partners in portfolio companies*

We will continue to seek to create partnerships with leading international and local companies as joint investors in our portfolio companies, which will allow us to benefit from the industry expertise and international best practices of our partners. We believe that such partnerships will also help us diversify our portfolio and free up capital for new investments.

OVERVIEW OF THE OFFERING

The following summary contains basic information about the Notes and the Loan and should be read in conjunction with, and is qualified in its entirety by, the information set forth under “The Loan Agreement” and the Conditions appearing elsewhere in this Prospectus.

The Issuer	SISTEMA INTERNATIONAL FUNDING S.A., a <i>société anonyme</i> incorporated in Luxembourg whose registered office is at 2, Boulevard Konrad Adenauer, L-1115 Luxembourg, Grand Duchy of Luxembourg, registered with the Register of commerce and companies of Luxembourg under number B 168486.
The Borrower	Sistema JSFC, an open joint stock company incorporated under the laws of the Russian Federation, having its administrative office at 13 Mokhovaya Street, building 1, Moscow, 125009, Russian Federation.
The Offer	U.S.\$500,000,000 6.95% Loan Participation Notes due 2019 in reliance on Regulation S and Rule 144A under the Securities Act.
Issue Price of the Notes	100% of the principal amount of the Notes.
Issue Date	18 May 2012
Maturity Date	17 May 2019
Interest	On each Interest Payment Date (being 17 May and 17 November commencing on 17 November 2012), or as soon thereafter as the same is received, the Issuer shall account to the Noteholders for an amount equivalent to amounts of interest actually received by or for the account of the Issuer pursuant to the Loan Agreement, which interest under the Loan is equal to 6.95% per annum.
Yield	Annual re-offer yield when the Notes are issued is 6.95%.
Form of the Notes	The Notes will be issued in registered form in the denominations of U.S.\$200,000 or higher integral multiples of U.S.\$1,000, without interest coupons attached. The Regulation S Notes and the Rule 144A Notes will initially be represented by a Regulation S Global Certificate and a Rule 144A Global Certificate, respectively, each without interest coupons. The Regulation S Notes will be registered in the name of a nominee of, and deposited with a common depository for, Euroclear and Clearstream, Luxembourg, on the Issue Date. The Rule 144A Notes will be registered in the name of Cede & Co. as a nominee for DTC, on the Issue Date. The Global Certificates will only be exchangeable for Definitive Certificates in the limited circumstances described under “Summary of the Provisions relating to the Notes in Global Form.”
Trustee	Deutsche Trustee Company Limited
Registrar	Deutsche Bank Luxembourg S.A. in respect of Notes issued in reliance on Regulation S and Deutsche Bank Trust Company Americas in respect of Notes issued in reliance on Rule 144A under the Securities Act
Principal Paying Agent	Deutsche Bank AG, London Branch
Luxembourg Paying Agent and Transfer Agent	Deutsche Bank Luxembourg S.A.

Irish Paying Agent

Deutsche International Corporate Services (Ireland) Limited

U.S. Paying Agent and Transfer Agent

Deutsche Bank Trust Company Americas

Limited Recourse

The Notes are secured limited recourse obligations of the Issuer. The sole purpose of the issue of the Notes is to provide the funds for the Issuer to make the Loan. The Notes constitute the obligation of the Issuer to apply the proceeds from the issue of the Notes solely to make the Loan and to account to the Noteholders for an amount equivalent to sums of principal, interest and additional amounts (if any) actually received and retained (net of tax) by or for the account of the Issuer pursuant to the Loan Agreement, excluding amounts paid in respect of the Reserved Rights (as defined in the Trust Deed). See “*Terms and Conditions of the Notes—Status.*”

Security

The Notes will be secured by a charge (the “**Charge**”) in favour of the Trustee, for the benefit of the Noteholders, of:

- (a) all rights, interest and benefit to principal, interest and additional amounts (if any) payable by the Borrower to the Issuer under the Loan Agreement;
- (b) the right to receive all sums that may be or may become payable by the Borrower under any claim, award or judgment relating to the Loan Agreement; and
- (c) all the rights, title and interest in and to all sums of money held from time to time in an account specified in the Loan Agreement, together with the debts represented thereby (including interest earned on the account, if any),

provided, in each case, that the Reserved Rights (as defined in the Trust Deed), and any amounts in respect thereof, are excluded from the Charge and that the Issuer remains the legal and beneficial owner of the Charged Property (as defined in the Trust Deed).

Furthermore, under the terms of the Trust Deed, the Issuer will assign absolutely all of its rights, interest and benefits, present or future under the Loan Agreement, except for any Reserved Rights (as defined in the Trust Deed) and rights subject to the Charge as described above, to the Trustee for the benefit of the Noteholders.

Status of Notes

The Notes will constitute senior obligations of the Issuer and the Loan will constitute senior obligations of the Borrower. The Notes and the Loan will rank (i) equal in right of payment with all existing and future senior obligations of the Issuer and the Borrower, respectively, and (ii) senior to any present or future subordinated obligations of the Issuer and the Borrower, respectively. The Notes and the Loan will effectively rank junior to all indebtedness of the Borrower’s subsidiaries and the Borrower’s secured obligations to the extent of the collateral securing such obligations. As of 31 December 2011, total debt of the Borrower and its subsidiaries was U.S.\$16,409.9 million. See “*Management’s Discussion and Analysis of Financial Condition and Results of Operations—Liquidity and Capital Resources—Loans and Borrowings.*”

Under the Loan Agreement, the Borrower shall ensure that the Net Leverage Ratio (as defined in the Loan Agreement) is 3.5 to 1 or lower as at 30 June and 31 December each year.

Redemption by the Issuer

If the Borrower prepays the Loan pursuant to the Loan Agreement, whether for tax reasons or by reason of increased costs or illegality, all Notes then remaining outstanding will thereupon become due and redeemable or repayable at 100% of the principal amount of such Notes, together with the accrued and unpaid interest and additional amounts (if any) all as more fully described in “*Terms and Conditions of the Notes—Redemption.*”

Other Optional Redemption

The Borrower may at its option from time to time on or prior to the three year anniversary of the Issue Date prepay up to 35% of the Loan then outstanding (in which case a corresponding principal amount of the Notes will be redeemed) out of the proceeds of a Public Equity Offering (as defined in the Loan Agreement) as described in more detail in “*Loan Agreement*” and “*Terms and Conditions of the Notes—Redemption.*”

Optional Redemption by the Noteholders upon a Change of Control

Upon the occurrence of a Change of Control (as defined in “*Loan Agreement*”) the Notes may be redeemed at the option of a Noteholder at their principal amount together with accrued and unpaid interest, if any, as more fully described in “*Loan Agreement*” and “*Terms and Conditions of the Notes.*”

Withholding Tax and Increased Costs

All payments in respect of the Notes by or on behalf of the Issuer will be made free and clear of, and without deduction or withholding for or on account of, any present or future taxes, duties, assessments or other governmental charges of whatever nature imposed, levied, collected, withheld or assessed by or on behalf of Luxembourg or any political subdivision or any authority thereof or therein having the power to tax, unless the deduction or withholding of such taxes or duties is required by law. In such event, the sum payable by the Issuer (subject to the receipt of additional amounts pursuant to the Loan Agreement) will be required (subject to certain exceptions) to be increased to the extent necessary to ensure that the Noteholders receive the sum which they would have received had no such deduction or withholding been required. See “*Terms and Conditions of the Notes—Taxation.*”

All payments of interest and principal under the Loan by the Borrower will be made free and clear of and without deduction for or on account of, any present or future taxes, duties, assessments or governmental charges of whatever nature imposed, levied, collected, withheld or assessed by or on behalf of the Russian Federation or Luxembourg or any political subdivision or any authority thereof or therein having the power to tax, unless the deduction or withholding of such taxes or duties is required by law. In such event the sum payable by the Borrower (subject to certain exceptions) will be required to be increased to the extent necessary to ensure that after such deduction or withholding, the Issuer receives the sum which it would have received had no such deduction or withholding been required.

Events of Default and Relevant Events

If either an Event of Default (as defined in the Loan Agreement) or a Relevant Event (as defined in the Trust Deed) occurs and, in the case of an Event of Default, for so long as such event is continuing, the Trustee may, subject to the provisions of the Trust Deed:

- (a) in the case of an Event of Default, declare all amounts payable by the Borrower under the Loan Agreement to be due and

payable and to do all such other acts in connection therewith that the Trustee may direct; or

- (b) in the case of a Relevant Event, enforce the security created by the Trust Deed.

Upon repayment of the Loan following an Event of Default, the Notes will be redeemed and repaid at their principal amount, together with interest accrued to the date fixed for redemption and thereupon shall cease to be outstanding.

Selling Restrictions

United Kingdom, United States, Luxembourg, the Russian Federation, Hong Kong, Singapore and Switzerland. See “*Subscription and Sale.*”

Further Issuances

The Issuer may, from time to time and without the consent of the Noteholders, create and issue further notes on the same terms as the existing Notes (except for the first payment of interest). Such further notes may be consolidated and form a single series with the existing Notes.

Ratings

The Notes have been rated:

- (a) “BB-” by Fitch Ratings CIS Ltd. (“**Fitch**”); and
- (b) “BB” by Standard & Poor’s Credit Market Services Europe Limited (“**S&P**”).

A rating is not a recommendation to buy, sell or hold securities and may be subject to revision, suspension or withdrawal at any time by the assigning rating organisation. Similar ratings on different types of notes do not necessarily mean the same thing. The ratings do not address the likelihood that the principal on the Notes will be prepaid or paid on a particular date before the legal final maturity date of the Notes. The ratings do not address the marketability of the Notes or any market price. Any change in the credit ratings of the Notes could adversely affect the price that a subsequent purchaser will be willing to pay for the Notes. The significance of each rating should be analyzed independently from any other rating.

Fitch and S&P are established in the European Union and registered under Regulation (EC) No 1060/2009, as amended (the “**CRA Regulation**”). As such, Fitch and S&P are included in the list of credit rating agencies published by the European Securities and Markets Authority on its website in accordance with the CRA Regulation.

Negative Pledge

The Issuer will have the benefit of a negative pledge granted by the Borrower, as fully described in the Loan Agreement.

Listing

Application has been made to the Irish Stock Exchange for the Notes to be admitted to the Official List and to trading on the Regulated Market. The Regulated Market is a regulated market for the purposes of Directive 2004/39/EC of the European Parliament and of the Council on markets in financial instruments.

ERISA Considerations

The Notes may not be acquired by any benefit plan investor as defined in the U.S. Employee Retirement Income Security Act of 1974, as amended (“**ERISA**”). Each purchaser and/or holder of the Notes and each transferee thereof will be deemed to have made representations that it is not such a benefit plan investor. Potential purchasers should read the sections entitled “Certain ERISA Considerations” and “Transfer Restrictions.”

Security Codes

Regulation S Notes ISIN:	XS0783242877
Regulation S Notes Common Code:	078324287
Rule 144A Notes ISIN:	US82977TAA16
Rule 144A Notes Common Code:	078370025
Rule 144A Notes CUSIP:	82977TAA1

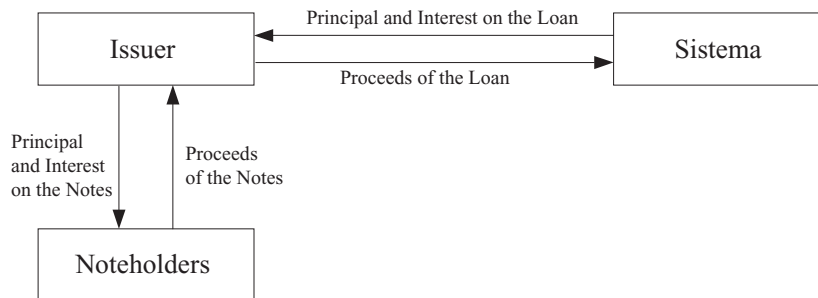
Governing Law

The Loan Agreement, the Notes and the Trust Deed and any non-contractual obligations arising out of or in connection with them shall be governed by, and construed in accordance with, English law.

An investment in the Notes involves a high degree of risk. See “*Risk Factors*.”

DESCRIPTION OF THE TRANSACTION

The following summary contains basic information about the Notes and the Loan and should be read in conjunction with, and is qualified in its entirety by, the information set forth under “The Loan Agreement” and “Terms and Conditions of the Notes” appearing elsewhere in this Prospectus.



The transaction will be structured as a loan from the Issuer to the Borrower. The Issuer will issue the Notes, which will be secured limited recourse loan participation notes issued for the sole purpose of making the Loan to the Borrower. The Notes are limited recourse obligations and the Issuer will not have any obligation to the Noteholders other than the obligation to account to the Noteholders for payment of principal, interest and additional amounts (if any) actually received and retained (net of tax) by it under the Loan. In the event that the amount due and payable by the Issuer under the Notes exceeds the sums so received or recovered and retained (net of tax), the right of any person to claim payment of any amount exceeding such sums shall be extinguished, and the Noteholders may take no further action against the Issuer to recover such amounts.

The Notes will have the benefit of, and be constituted by, the Trust Deed. As provided in the Trust Deed, the Issuer will charge, by way of the Charge in favour of the Trustee, for the benefit of the Noteholders, as continuing security for its payment obligations in respect of the Notes:

- all rights, interest and benefit to principal, interest and additional amounts (if any) payable to the Issuer by the Borrower under the Loan Agreement;
- the right to receive all sums that may be or become payable by the Borrower under any claim, award or judgment relating to the Loan Agreement; and
- all the rights, title and interest in and to all sums of money held from time to time in an account specified in the Loan Agreement, together with the debts represented thereby (including interest earned on the account, if any),

provided, in each case, that the Reserved Rights (as defined in the Trust Deed), and any amounts in respect thereof, are excluded from the Charge and that the Issuer remains the legal and beneficial owner of the Charged Property (as defined in the Trust Deed). In addition, the Issuer will assign to the Trustee certain administrative rights under the Loan Agreement.

In addition, the Issuer with full title guarantee will assign absolutely to the Trustee for the benefit of itself and the Noteholders all the rights, title, interest and benefits, both present and future, that may accrue to the Issuer as lender under or pursuant to the Loan Agreement (including, without limitation, the right to declare the Loan immediately due and payable and to commence proceedings to enforce the Borrower’s obligations thereunder), other than any rights, interests or benefits that are subject to the Charge and other than the Reserved Rights (as defined in the Trust Deed), and any amounts relating thereto. As a consequence of such assignment, the Trustee will assume the rights of the Issuer under the Loan Agreement, as the case may be, as set forth in the relevant provisions of the Trust Deed.

The Issuer will agree in the Trust Deed not to agree to any amendments to or modification or waiver of, and not to authorise any breach of, the Loan Agreement unless the Trustee has given its prior written consent or unless authorised to do so by an Extraordinary Resolution (as defined in the Trust Deed) of the Noteholders, except in respect of the Reserved Rights (as defined in the Trust Deed). The Issuer will agree to act at all times in accordance with any instructions of the Trustee with respect to the Loan Agreement, except as provided in the Trust Deed and except in respect of the Reserved Rights. The Trustee will notify the Noteholders of any amendments, modifications, waivers or authorisations made with the Trustee’s consent in accordance with “Terms and Conditions of the Notes—Notices,” which amendments, modifications, waivers or authorisations will be binding on the Noteholders. The Issuer does not intend to provide post-issuance transaction information regarding the Notes or the performance of the Loan.

Payments in respect of the Notes by or on behalf of the Issuer will be made without any deduction or withholding for or on account of taxes imposed or levied by or on behalf of any governmental or other taxing authority, except as required by law. If any deduction or withholding for taxes imposed by Luxembourg or any other taxing jurisdiction to which the Issuer becomes subject is required by law, the Issuer must, except in certain limited circumstances, pay additional amounts to the extent it receives corresponding amounts from the Borrower pursuant to the Loan Agreement. In addition, payments under the Loan Agreement will be made without deduction or withholding for or on account of taxes imposed or levied by or on behalf of any governmental or other taxing authority, except as required by law. If any deduction or withholding for taxes imposed by Luxembourg or any other taxing jurisdiction in which the Issuer becomes a tax resident is required by law with respect to payments under the Notes, or if any deduction or withholding for taxes is required by law with respect to the Loan Agreement, the Borrower must, except in certain limited circumstances, increase the amounts payable under the Loan Agreement to ensure that the Issuer receives a net amount equal to the full amount it would have received had payment not been made subject to taxes.

The Borrower may prepay the Loan at its principal amount, together with accrued and unpaid interest and additional amounts (if any), if it must increase the amount payable or pay additional amounts on account of the taxes in respect of which it is required to pay additional amounts under the Loan Agreement or if it must pay additional amounts on account of certain costs incurred by the Issuer. As set forth in the Loan Agreement, the Issuer may, at its own discretion, require the Borrower to prepay the Loan if it becomes unlawful for the Loan or the Notes to remain outstanding.

RISK FACTORS

Prospective investors should consider carefully the risks set forth below and the other information contained in this Prospectus prior to making any investment decision with respect to the Notes. Each of the risks highlighted below could have a material adverse effect on our business, results of operations, financial condition or prospects, or those of the Issuer, which, in turn, could have a material adverse effect on the amount of principal and interest which investors will receive in respect of the Notes. In addition, each of the risks highlighted below could adversely affect the trading price of the Notes or the rights of investors under the Notes and, as a result, investors could lose some or all of their investment.

Prospective investors should note that the risks described below are not the only risks that we and the Issuer face. Both we and the Issuer have described only those risks relating to our operations that we consider to be material. There may be additional risks that we currently consider not to be material or of which we are not currently aware, and any of these risks could have the effects set forth above.

Risks Relating to Our Business and Industry

General Risks

- *As a result of litigation proceedings involving SSTL, certain financing arrangements of SSTL and Sistema JSFC may well currently be capable of being accelerated. In addition, pursuant to a put option agreement exercisable between March 2016 and March 2017, we may be required to repurchase the stake in SSTL held by the Russian government. If the Russian government were to exercise its put option over its stake in SSTL, there can be no assurance that such exercise would not have a material adverse effect on our financial condition.*

On 2 February 2012, the Indian Supreme Court delivered its judgment (the “**Indian Judgment**”) on two public interest petitions seeking cancellation of 122 cellular phone licences granted by the Government of India in 2008, including licences granted to SSTL in 21 telecom circles (cellular zones in India), which SSTL relies upon to operate its mobile telecommunications business in India. The Indian Judgment granted the petition, with cancellation of the licences initially set to become effective as of 2 June 2012 and subsequently extended by the Indian Supreme Court on 24 April 2012 until 7 September 2012. The Indian Supreme Court also directed the Government of India to conduct 2G spectrum auctions and grant licences on or before 31 August 2012. Without the licences subject to cancellation under the Indian Judgment, SSTL will be unable to conduct more than 85% all of its operations in India in terms of 2011 revenues. See “*Business—Material Litigation.*”

The terms of the financing arrangements of SSTL and Sistema JSFC with various lenders include restrictive, financial and other covenants, representations, warranties and events of default. As a result of the impact of the situation related to the Indian Judgment on these provisions, the following financing arrangements may well currently be capable of being accelerated by the lenders: the \$69.9 million buyer credit agreement, dated 29 June 2009, with the Bank of China Limited, Shenzhen Branch (the “**SSTL-Bank of China Agreement**”), the \$255 million facility agreement, dated 23 December 2009, with the China Development Bank Corporation (the “**SSTL-China Development Bank Agreement**”), the \$230 million facility agreement, dated 22 December 2011, with Gazprombank (Switzerland) (the “**SSTL-Gazprombank Agreement**”), the INR 4.6 billion facility agreement with ICICI Bank Limited, dated 9 September 2011 (the “**SSTL-ICICI Bank Limited Agreement**”), the INR 4.6 billion facility agreement with Barclays Bank Plc, Mumbai Branch, dated 19 September 2011 (the “**SSTL-Barclays Bank Agreement**”), the INR 12.8 billion debenture trust deed with IDBI Trusteeship Services Limited, dated 23 December 2011 (the “**SSTL-IDBI Trusteeship Services Limited Agreement**”), the INR 5 billion loan agreement with the Central Bank of India, dated 22 March 2010 (the “**SSTL-Central Bank of India Agreement**,” and together with the SSTL-Bank of China Agreement and SSTL-China Development Bank Agreement, the SSTL-ICICI Bank Limited Agreement, the SSTL-Barclays Bank Agreement and the SSTL-IDBI Trusteeship Services Limited Agreement, the “**SSTL Agreements**”), the INR 7 billion letter of credit facility, dated 11 October 2010, with ING Bank N.V (the “**Sistema-ING Bank Agreement**”); the \$300 million facility agreement, dated 29 December 2011, with The Royal Bank of Scotland N.V. (the “**Sistema-Royal Bank of Scotland Agreement**”); and the INR 10.3 billion facility agreement, dated 30 March 2012, with Raiffeisen Bank International AG (the “**Sistema-Raiffeisen Bank International Agreement**,” and together with the Sistema-ING Bank Agreement and the Sistema-Royal Bank of Scotland Agreement, the “**Sistema JSFC Agreements**”). See “*Management’s Discussion and Analysis of Financial Condition and Results of Operations—Liquidity and Capital Resources—Capital Resources—Description of material loan agreements.*”

The Lenders under these loan agreements have not yet accelerated any payments thereunder or indicated that they intend to do so, and we do not expect them to accelerate in the context of the current circumstances. Nevertheless, there can be no assurance they will not ultimately do so. The total amount of indebtedness outstanding under the SSTL Agreements and the Sistema JSFC Agreements as of 26 April was \$1,656.1 million. If the lenders under these agreements were to accelerate all or a portion of our debt under these agreements, we believe that we have sufficient liquidity to meet these obligations when due from cash and other short-term assets and availability of credit pursuant to other credit facilities.

As a consequence of the potential cancellation of the licences with effect from 7 September 2012, we reassessed the carrying amount of assets in SSTL as at 31 December 2011. A total impairment loss of \$694.7 million was recognised. Of this total impairment loss, the loss from impairment of the operating licences amounted to \$346.0 million and the loss from impairment of goodwill amounted to \$348.7 million. In addition, because we may be required to pay on demand all of the outstanding indebtedness under the SSTL Agreements where we serve as guarantor and all of the outstanding indebtedness under the Sistema Agreements, we have reclassified all such outstanding indebtedness, in an amount of \$1,573.5 million, as short-term debt as at 31 December 2011. See *“Management’s Discussion and Analysis of Financial Condition and Results of Operations—Liquidity and Capital Resources—Capital Resources.”*

In addition, notwithstanding the potential or actual cancellation of the licences, at any time between March 2016 and March 2017 we may be required pursuant to a put option agreement with the Russian government to purchase the 17.1% stake in SSTL that is currently held by the Russian Federal Agency for State Property Management (**“Rosimushestvo”**) for the higher of \$777 million or the market value as determined by an independent valuator. See *“Management’s Discussion and Analysis of Financial Condition and Results of Operations—Commitments and Contingencies—Obligations under derivative contracts.”*

If the Russian government were to exercise its put option over its stake in SSTL between March 2016 and March 2017, there can be no assurance that such exercise would not have a material adverse effect on our financial condition. Furthermore, we would likely be compelled to divert resources away from other important funding requirements, such as planned capital expenditures, and there can be no assurance that such diversions would not have a material adverse effect on our business, results of operations, financial condition or prospects.

- *The servicing and refinancing of our indebtedness will require a significant amount of cash. Our ability to generate cash is subject to the terms of our existing indebtedness, which contains certain restrictive covenants and stringent events of default, and is dependent on other 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. As at 31 December 2011, our consolidated total debt, including capital lease obligations and short-term loans payable was U.S.\$16,409.9 million. Our interest expense for the year ended 31 December 2011 was U.S.\$1,742.7 million, net of amounts capitalised. This does not include the indebtedness under the Notes.

Our ability to service, repay and refinance our indebtedness will depend on our ability to generate cash in the future. Our ability to generate cash, in turn, is dependent on several factors, including our ability to generate sufficient operating cash flows, otherwise engage in cash-generative transactions or raise additional indebtedness. The terms of our existing indebtedness, however, contain certain restrictive covenants, which may limit our ability to incur new debt, create liens on our property, dispose of assets or otherwise engage in certain transactions that would generate sufficient cash flows. The terms of our indebtedness also contain stringent events of default, some of which may well be affected by matters such as litigation proceedings. See *“Business—Material Litigation—SSTL,” “Business—Material Litigation—Bashneft”* and *“Business—Material Litigation—MTS.”* We may enter into similar agreements in the future that further restrict us from engaging in these or other types of activities. Under the Loan Agreement, for example, we are restricted from creating liens on our property (other than certain permitted liens). Further, when disposing of our assets we need to meet certain requirements. See *“The Loan Agreement.”* To generate cash, we are also dependent on the earnings and dividend streams of our subsidiaries. The ability of our subsidiaries to generate sufficient earnings and pay sufficient dividends is subject to a host of factors, including economic, financial, competitive, legislative, regulatory and other factors that are beyond our control. Should the operations of our subsidiaries be limited for any reason, their earnings may fall, which, in turn, may limit our ability to use such earnings to service our indebtedness.

Our inability to generate sufficient cash flow or otherwise obtain funds necessary to service or repay our indebtedness or our failure to comply with any of the covenants under our indebtedness may cause a default, may

result in the debt becoming immediately due and payable and may potentially lead to cross-defaults under or acceleration of our other indebtedness, any of which would materially adversely affect our business, results of operations financial condition or prospects.

Furthermore, we are exposed to interest rate risk. As at 31 December 2011, approximately 17.3% of the debt we have incurred is at floating rates of interest linked to indices, such as LIBOR and EURIBOR, and we have hedged the interest rate risk only with respect to approximately 9.8% of our floating interest rate debt. As a result, our interest payment costs can increase if such indices rise. For a discussion of this exposure, see “*Management’s Discussion and Analysis of Financial Condition and Results of Operations—Market Risks—Interest rate risks.*”

In addition, we may be required to refinance all or portions of our indebtedness on or before maturity, sell assets, reduce or delay capital expenditures or seek additional capital. Refinancing or additional financing may not be available on commercially reasonable terms or at all, and we may not be able to sell our assets or, if sold, the proceeds therefrom may not 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, could materially adversely affect our business, results of operations, financial condition, results of operations or prospects.

- *There can be no assurance that our new business strategy will be successful, and we may experience problems in identifying profitable opportunities, both for acquisitions and disposals, and in integrating acquisitions and implementing restructurings in our business.*

In early 2011, our management team took the decision to transition Sistema into an investment company, and we are continuing to implement this strategy. The key elements of our strategy are to develop a balanced and a diversified asset portfolio, to focus on sectors and geographies where we have a competitive advantage, to pursue an active portfolio management approach and to attract leading international and local companies as partners in portfolio companies. See “*Business—Strategy.*”

There can be no assurance that we will be able to achieve the targets set out in our new strategy, or that we will be able to effectively manage our current portfolio companies, while at the same time identify new investment opportunities. There are risks of temporary deterioration of the efficiency and level of interaction between our units, and between our units and our portfolio companies. There are risks of untimely or incomplete transformation of the organisational structure and the respective human resources. Furthermore, even if our initiatives of transformation into an investment holding can be implemented, we cannot assure you that these initiatives will allow us to improve the financial performance of our assets. The success of our new strategy depends on many factors, including, but not limited to, receipt of necessary government approvals, proper identification of customer needs, successful development of technology, the ability to manage costs and expenses, timely completion and introduction of new services and products by our subsidiaries, differentiation from offerings of our subsidiaries’ competitors and market acceptance. The occurrence of negative developments in these circumstances may ultimately adversely affect the implementation of our portfolio strategy, and, in turn, our overall business, results of operations, financial condition or prospects.

We have in the past, and may in the future, expand our operations through acquisitions or change our asset portfolio through acquisitions and disposals. The process of identifying and implementing acquisitions entails certain risks, including the failure to identify and approach new suitable acquisition targets, the failure to conduct adequate due diligence on the target’s operations and/or financial condition, the overvaluation of the target and thus overpayment for the target, the incurrence of significantly higher than anticipated financing-related risks and operating expenses, and the discovery of larger than anticipated or previously undisclosed liabilities. Acquiring additional businesses could also place increased pressures on our cash flows, especially if the acquisition is paid for in cash. Furthermore, if an acquisition is not completed, or is not completed in a timely manner, this may adversely impact our strategic growth objectives or have a material adverse effect on our business, results of operations, financial condition or prospects.

In particular, MTS, one of our key subsidiaries, depends on its ability to effectively implement its geographic expansion strategy, which contemplates the acquisition of additional operations within the CIS in both the mobile and fixed broadband segments. These acquisitions may occur in countries that represent new operating environments and that are subject to greater political, economic, social and legal risks than more developed countries. For example, in December 2010, MTS discontinued its operations in Turkmenistan when its licences were suspended by the Turkmenistani authorities. In addition, MTS failed to gain operational control over Bitel,

a Kyrgyz company holding a GSM 900/1800 licence for the entire territory of Kyrgyzstan (“**Bitel**”), and thus was prevented from realising the expected benefits from this acquisition. See “*Business—Material Litigation.*” Therefore, new operating environments may negatively affect our business, results of operations, financial condition or prospects.

In addition, we may experience problems in integrating acquisitions into our business and managing them optimally or in implementing necessary restructurings. These risks include failing to effectively assimilate and integrate the operations and personnel of an acquired company into our business, failing to install and integrate all necessary systems and controls, including logistics and distribution facilities and arrangements, conflicts between majority and minority shareholders, hostility and/or lack of cooperation from the acquisition’s management and the potential loss of the acquisition’s customers. Furthermore, the broader disruptions in operations and the strain on management resources, including the diversion of attention from management’s normal day-to-day business, that often occur in conjunction with an acquisition may impose significant costs on us. Any of these problems or disruptions could have a material adverse effect on our business, results of operations, financial condition or prospects.

We may also dispose of certain of our operations. For example, Bashkirenergo is currently being reorganised so that its power and heat generation assets and heat distribution assets will be controlled by one company, Bashenergoaktiv, and its power transmission and distribution assets will be controlled by another company, BESK. We expect this reorganisation to be completed by the end of 2012 and anticipate that we will hold a 75% stake in the transmission and generation company, BESK, and no stake in Bashenergoaktiv. Such disposals entail certain risks, including potential failure in execution, potential undervaluation of the disposed asset, contingent liabilities with respect to the sold assets, delays in disposal and potential loss of synergies with the remaining assets. If any of such risks materialise in conjunction with the Bashkirenergo restructuring or any other potential reorganisation or disposal, or if any reorganisation or disposal is not completed as planned, or at all, this could have a material adverse effect on our business, results of operations, financial condition or prospects. Furthermore, completion of the pending or contemplated transactions, including restructurings, business combinations and financings, is, in each case, subject to a number of conditions, including corporate and governmental approvals. No assurance can be given that these pending or contemplated transactions will be completed on the terms and conditions described or at all.

- *Our business and operations are experiencing rapid growth, and we may fail to sustain our growth or manage it effectively.*

Certain of our businesses and operations have experienced or are currently experiencing rapid growth in operations, which has placed, and will continue to place, significant demands on management, operational and financial infrastructure. If we do not effectively manage this growth, the quality of our companies’ products and services could suffer, which could negatively affect our operating results. In addition, we may not be able to sustain our revenue growth rate and there may be downward pressure on our operating margin. To sustain or manage this growth effectively, we will need to continue to improve the operational, financial and management controls, and reporting systems and procedures at certain of our subsidiaries. Management of our growth will require, among other things:

- continued development of financial and management controls and information technology systems and their implementation in newly acquired businesses;
- the ability to adapt to changes in the markets in which we operate, including increased competition and demand for our products and services;
- the ability to manage risks associated with potential expansion into other emerging markets;
- increased marketing activities; and
- hiring and training of new personnel.

Our inability to successfully manage this growth could have a material adverse effect on our business, results of operations, financial condition or prospects.

- *We are substantially dependent on the success of MTS and Bashneft.*

Our financial results are substantially dependent on the financial results of, and dividends from, MTS and Bashneft. The inability of these businesses to generate necessary earnings may adversely affect their ability to

pay dividends, which, in turn may affect our ability to service our debt obligations and sustain our growth and expansion through restructurings and acquisitions. For the years ended 31 December 2009, 2010 and 2011, revenues from MTS accounted for 54.4%, 42.1% and 37.4%, respectively, of our total revenues, and Bashneft contributed 26.8%, 43.7% and 50.2%, respectively, to our total revenues. See “*Management’s Discussion and Analysis of Financial condition and Results of Operations—Consolidated Financial Results Overview*” for a discussion of methodology used to calculate segment revenues. As a consequence, risks and events that have a material adverse effect on MTS’ and Bashneft’s business, results of operations, financial condition or prospects could, in turn, have a material adverse effect on our business, results of operations, financial condition or prospects. See “*—Risks Relating to Our Oil and Energy Business—Bashneft’s development, exploration and production projects involve many uncertainties and operating risks that could prevent it from realising its production targets, profits and may cause substantial losses.*”

- *Our competitive position and future prospects depend on our senior managers and other key personnel.*

Our ability to maintain our competitive position and to implement our business strategy is dependent to a large degree on the services of our senior management team and other key personnel, including our controlling shareholder, Mr. Vladimir Evtushenkov. Our senior management team is essential to the implementation of our business strategy. Furthermore, the continued success of our core and developing businesses and the ability to execute our overall strategy effectively, including our growth and expansion plans, will depend, in large part, on the efforts of our separate management teams supervising each asset within our holding structure.

Moreover, competition in the Russian Federation, and in the other countries where we operate, for key personnel with relevant expertise, such as specialists in engineering and geology at Bashneft, is intense due to the small number of qualified individuals, and, as a result, we attempt to structure our compensation packages for our senior managers and key personnel in a manner consistent with the evolving standards of the Russian labour market. We are not insured against the detrimental effects to our business resulting from the loss or dismissal of our key personnel. The loss or decline in the services of members of our senior management team or an inability to attract, retain and motivate qualified key personnel could have a material adverse effect on our business, results of operations, financial condition or prospects.

- *Sistema JSFC is an investment company and its ability to meet its obligations depends to a large extent upon receipt of sufficient funds from its subsidiaries.*

Because Sistema JSFC is an investment company, its ability to meet its obligations depends to a large extent upon receipt of sufficient funds from its subsidiaries. Sistema JSFC depends in part on dividends from its subsidiaries to generate the funds necessary to meet its financial obligations, including the payment of principal and interest on its present debt and any of our borrowings incurred in the future. Sistema JSFC’s subsidiaries may from time to time be subject to restrictions on their ability to make such payments to Sistema JSFC as a result of regulatory, fiscal or other restrictions. For example, in the Russian Federation, where most of our operating subsidiaries are located, dividends can only be paid in an amount not exceeding net profits as determined under Russian accounting standards (“RAS”). In addition, dividends may only be paid if the value of the company’s net assets is not less than the sum of the company’s charter capital, the company’s reserve fund and the difference between the liquidation value and the par value of the issued and outstanding preferred stock of the company, if any, as determined under RAS. Our subsidiaries located in other jurisdictions are likely to be subject to similar or other limitations on their ability to declare and pay dividends as a result of regulatory, fiscal and other restrictions. Furthermore, certain loans to Sistema JSFC’s subsidiaries are subject to restrictive covenants, including, but not limited to, compliance with certain financial ratios, limitations on dispositions of assets and limitations on transactions within Sistema JSFC’s portfolio companies. There can be no assurance that such restrictions will not have a material adverse effect on Sistema JSFC’s ability to service its borrowings or meet any other costs it may incur.

- *In the event that deficiencies or ambiguities in privatisation legislation are successfully exploited to challenge our ownership in our privatised subsidiaries and we are unable to defeat these challenges, we risk losing our ownership interests in our subsidiaries or their assets.*

Our business includes a number of privatised companies, such as MGTS, Bashneft, Intourist and certain of our energy and technology subsidiaries, and our business strategy will likely involve future acquisitions of companies that have undergone privatisation. To the extent that Russian privatisation legislation is vague, inconsistent or in conflict with other legislation, including conflicts between federal and local privatisation legislation, many privatisations are vulnerable to challenge, including selective challenges. For instance, a series of presidential decrees issued in 1991 and 1992 that granted to the Moscow City Government the right to adopt

its own privatisation procedures were subsequently held to be invalid by the Constitutional Court of the Russian Federation (the “**Constitutional Court**”), which ruled, in part, that the presidential decrees addressed issues that were the subject of federal law. While this court ruling, in theory, did not require any implementing actions, the presidential decrees were not officially annulled by another presidential decree until 2000.

We won a privatisation tender for MGTS in April 1995 and were issued 25% of MGTS’ share capital. As part of our tender obligations, we committed to invest approximately U.S.\$106 million in MGTS over a three-year period in exchange for the right to purchase an additional issue of MGTS’ ordinary shares. In 1998, upon satisfying our tender obligations, we exercised this right and increased our stake to 50% of MGTS’ share capital. At the time we took possession of this interest, there were press reports that certain minority shareholders of MGTS had filed complaints with the prosecutor’s office and the Federal Commission on the Securities Market (currently the Russian Federal Service for the Financial Markets (the “FSFM”) objecting to the share issuance. In addition, certain members of the Russian parliament requested the Audit Chamber of the Russian Federation and other governmental agencies to investigate whether the relevant rules and regulations governing MGTS’ privatisation had been complied with.

Following the privatisation of the Bashkir Petrochemical Enterprise, Bashneft was incorporated in 1995. As a result of the privatisation, 63.7% of its shares were transferred to the Republic of Bashkortostan, and the remaining shares were sold to employees and Bashneft management. In 2005, we announced the acquisition of minority stakes in seven Bashkirian energy sector companies from Bashkirsky Capital. The assets acquired included among others minority stakes in JSOC Bashneft and Bashneft’s refineries. Then in 2009, we acquired control of Bashneft from a group of companies—Agidal Invest, Inzer-Invest, Ural-Invest and Yuryuzan-Invest for a total consideration of U.S.\$2.0 billion. Like the MGTS privatisation, the Bashneft privatisation may arguably be deficient, and, therefore, vulnerable to challenge. We cannot assure you that the privatisation of Bashneft or MGTS will not be challenged in the future. In the event that any of our privatised companies are subject to challenge as having been improperly privatised and we are unable to defeat this claim, we risk losing our ownership interest in the company or its assets, which could materially adversely affect our business, results of operations, financial condition, or prospects.

In addition, under Russian law, transactions in shares may be invalidated on many grounds, including a sale of shares by a person without the right to dispose of such shares, breach of interested party and/or major transactions rules and failure to register the share transfer in the securities register. As a result, defects in earlier transactions in the shares of our subsidiaries (where such shares were acquired from third parties) may cause our title to such shares to be subject to challenge.

- *If we are unable to obtain adequate capital or financing, we may have to limit our operations substantially.*

If we are unable to obtain capital or financing, we would not be able to make new investments. Future financings and cash flow from our operations may not be sufficient to meet our planned needs, including growth through restructurings and acquisitions and capital expenditures of our subsidiaries 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 licences;
- slower than anticipated subscriber growth;
- slower than anticipated revenue growth;
- regulatory developments;
- changes in existing interconnect arrangements; or
- a deterioration in the economies of the countries where we operate.

In particular, we will need to make significant capital expenditures in many of our businesses in the coming years. We spent approximately U.S.\$4.1 billion during 2011. We expect our capital expenditure level in 2012 to

remain at a similar level to 2011, and also do not expect a material difference for funding our operations in 2013 and 2014. Actual capital expenditures may vary depending on the availability of financing, including the availability of dividends from subsidiaries, demand, currency volatility and other factors. See “*Management’s Discussion and Analysis of Financial Condition and Results of Operations.*” These future capital expenditures estimates are subject to change. We may not be able to meet our planned capital spending needs in the event of the above potential developments. We will need to make significant capital expenditures in connection with the development, construction and maintenance of, and the purchasing of, software for MTS’ mobile and fixed line networks. In addition, the acquisition of third-generation (“3G”) licences and frequency allocations and the build-out of the 3G and broadband Internet networks will require additional capital expenditures. Furthermore, Bashneft will also require significant capital expenditures, including in the areas of exploration and development, production, refining, and to meet its obligations under environmental laws and regulations. In particular, assuming it is successful in retaining the relevant licences, Bashneft plans to significantly develop the Trebs and Titov oil fields in the Nenets Autonomous District. See “*Business—Bashneft—Exploration and Production,*” “*Business—Material Litigation*” and “*—We are involved in various legal proceedings that may result in material losses.*”

Our indebtedness and the limits imposed by covenants in our debt obligations could limit our ability to obtain additional financing and thereby constrain our ability to invest in our business and place us at a possible competitive disadvantage relative to our competitors. To meet our financing requirements, we may need to attract additional equity or debt financing. In addition, the current Russian securities regulations provide that no more than 25% of a Russian company’s shares may be circulated abroad through sponsored depository receipt programs. Prior to 31 December 2005 and at the time of our IPO, this threshold was 40%. Currently, 19% of our shares trade under our GDR programme. This limitation restricts our ability to raise funds through our GDR programme. There can be no assurance that the Russian government will not introduce additional restrictions on international offerings, which could further limit our ability to raise capital. 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, results of operations, financial condition or prospects.

- *If a change in control occurs, we may be required to redeem the Notes or repay other debt.*

Under the terms of the Loan, we are required to offer to purchase the Notes at the principal amount of the Notes (plus interest accrued up to the redemption date) if a change in control occurs. Similarly, under the terms of certain of our rouble bonds and certain bank loans, if a change in control occurs, we may be required to repay the relevant indebtedness at par (plus any interest accrued prior to the repayment day).

A change in control under the Notes will be deemed to have occurred in any of the following circumstances:

- (a) any person or group other than Vladimir Evtushenkov and/or persons related to him (each a “permitted holder”) becomes the “beneficial owner”, directly or indirectly, in the aggregate of more than 50% of the total voting power of the voting stock (as defined in the Loan Agreement) of Sistema JSFC; or
- (b) the holders of the capital stock (as defined in the Loan Agreement) of Sistema JSFC approve any plan or proposal for the liquidation or dissolution of the Sistema JSFC; or
- (c) Sistema JSFC consolidates with, or merges with or into, another person other than a permitted holder, or sells, transfers or otherwise disposes of all or substantially all of its assets to any person other than a permitted holder (except where the beneficial owners of the voting stock of Sistema JSFC before such transaction beneficially own a majority of the total voting power of the outstanding voting stock of the surviving person or transferee person).

A change of control under Sistema JSFC’s rouble bonds is deemed to occur if Vladimir Evtushenkov holds less than 50% plus 1 share in our charter capital. Some of our loan agreements contain similar change of control provisions.

If a change in control occurs, and the relevant debt becomes repayable (either upon the relevant debt holders exercising their right or otherwise), such event could have a material adverse effect on our business, results of operations, financial condition or prospects.

- *We are involved in various legal proceedings that may result in material losses.*

We are involved in a number of legal proceedings and we can give no assurance that we will not incur material losses in connection with any such legal proceedings. Such losses are difficult to predict because of: (i) uncertainty regarding the outcome of the various proceedings; (ii) the occurrence of new developments that we could not take into consideration when evaluating the likely outcome of each proceeding in order to accrue

the risk provisions as at the date of the latest financial statements; (iii) the emergence of new evidence and information; and (iv) errors in the estimate of probable future losses. Losses associated with legal proceedings could materially adversely affect our business, results of operations, financial condition or prospects. For information about certain pending legal proceedings that may have a significant effect on our financial position or profitability, see “*Business—Material Litigation.*” See also “—*As a result of litigation proceedings involving SSSL, certain financing arrangements of SSSL and Sistema JSFC may well currently be capable of being accelerated. In addition, pursuant to a put option agreement exercisable between March 2016 and March 2017, we may be required to repurchase the stake in SSSL held by the Russian government. If the Russian government were to exercise its put option over its stake in SSSL, there can be no assurance that such exercise would not have a material adverse effect on our financial condition*” and “*Risks Relating to Our Oil and Energy Business—Bashneft’s exploration and development licence to the Trebs and Titov oil fields is currently the subject of legal proceedings brought by a minority shareholder in Bashneft. A negative outcome in these proceedings may lead to significant delays in Bashneft’s exploration and development plans and may otherwise have a material adverse effect on Bashneft’s business and results of operations. In addition, the cancellation of Bashneft’s Trebs and Titov licence may well constitute an event of default under JSOC Bashneft’s pre-export facility, which, in turn, would trigger cross-default provisions under certain of our other financing agreements.*”

- *The licences and permits that we require for our business may be invalidated, suspended or may not be issued or renewed, or may contain onerous terms and conditions that restrict our ability to conduct our operations or could result in substantial compliance costs or administrative penalties.*

Our operations and properties are subject to regulation by various government entities and agencies in connection with obtaining and renewing various licences, approvals, authorisations and permits, as well as with ongoing compliance with existing laws, regulations and standards. Regulatory authorities exercise considerable discretion in matters of enforcement and interpretation of applicable laws, regulations and standards, the issuance and renewal of licences, approvals, authorisations and permits and in monitoring licensees’ compliance with the terms thereof.

For example, due primarily to delays in the issuance of permits, approvals and authorisations by regulatory authorities for MTS’ telecommunications business, it is frequently not reasonable to procure all of the permits before MTS puts base stations into commercial operation or to amend or maintain all of the permits when MTS makes changes to the location or technical specifications of its base stations. At times, there can be a significant number of base stations or other communications facilities and other aspects of its networks for which MTS does not have final permits to operate and there can be delays in obtaining the final permits, approvals and authorisations for particular base stations or other communications facilities and other aspects of its networks.

Our failure to comply with existing laws and regulations or to obtain all approvals, authorisations and permits required to operate telecommunications equipment (or to comply with all the terms and conditions thereof) or the findings of government inspections may also result in the imposition of fines or penalties or more severe sanctions including the suspension, amendment or termination of the licences, approvals, authorisations and permits, or in requirements that our telecommunications assets cease certain of its business activities, or in criminal and administrative penalties applicable to its officers. For example, on 2 February 2012, the Indian Supreme Court delivered the Indian Judgment on two public interest petitions seeking cancellation of 122 cellular phone licences granted by the Government of India in 2008, including licences granted to SSSL in 21 telecom circles, which SSSL relies upon to operate its mobile telecommunications business in India. The Indian Judgment granted the petition, with cancellation of the licences effective as at 2 June 2012 and subsequently extended by the Indian Supreme Court on 24 April 2012 until 7 September 2012. See “*Business—Material Litigation.*”

In addition, MTS may be unable to broadcast certain television channels if entities that provide television content to it do not possess the requisite licences. In December 2011, the Federal Service for Supervision in the Area of Communications, Information Technologies and Mass Media of the Russian Federation (the “**Federal Service for Supervision in the Area of Communications**”) issued a formal order to OAO TRK TVT (“**TVT**”), MTS’ cable network subsidiary operating in the Republic of Tatarstan, to cease broadcasting certain television channels because the entities that provide television content to TVT did not possess the requisite licences for the broadcast of those channels in the Republic of Tatarstan. In case such providers of television content do not obtain the required licences, or have their existing licences suspended or terminated, MTS’ selection of potential television channels for broadcast could be significantly limited. Furthermore, MTS could be subject to fines and other penalties, including forced suspension of its cable network operators’ activity for up to 90 days. Any of these consequences could have a material adverse effect on our business, results of operations, financial condition or prospects.

Our oil business also operates on the basis of numerous licences for geological study, exploration and production of hydrocarbons and refining and sale of oil products. Bashneft is also obliged to obtain and extend the validity of other licences, permits, agreements, and rights to land use and approvals for development of its fields. However, any suspension, restriction or termination of Bashneft's licences could have adverse effect on its and our business results and its financial position. For example, in December 2011, Bashneft transferred its licence to develop and explore the Trebs and Titov field to its wholly-owned subsidiary at that time, OOO Bashneft-Polus ("**Bashneft-Polus**"). Subsequently, on 12 December 2011, the Federal Agency for Subsoil Usage ("**Rosnedra**"), which had originally issued the licence to Bashneft, reissued it to Bashneft-Polus. In March 2012, a minority shareholder in Bashneft filed a lawsuit with the Moscow Arbitrazh Court against Rosnedra, seeking to invalidate the reissuance of the licence, terminate Bashneft-Polus' right to use the licence and otherwise terminate the licence itself on the grounds that Rosnedra reissued the licence with no proof that Bashneft-Polus was solvent and employed suitably qualified persons and without having received approval of the Federal Antimonopoly Service (the "**FAS**"), which, according to the plaintiff, was required in order to validate the licence transfer. JSOC Bashneft and Bashneft-Polus are joined in these proceedings as third parties. On 20 and 23 April 2012, the Moscow Arbitrazh Court held preliminary hearings regarding the claim of the minority shareholder. The court hearing on the merits is scheduled to take place on 21 May 2012. If the claim of the minority shareholder is granted, Bashneft's licence to Trebs and Titov may be transferred back to JSOC Bashneft or cancelled. While we believe it is unlikely that Bashneft's licence to Trebs and Titov will be transferred back to JSOC Bashneft or cancelled, there can be no assurance that such transfer or cancellation will not occur. See "*Business—Material Litigation.*" See also "*Risks Relating to Our Oil and Energy Business—Risks Relating to Our Oil and Energy Business—Bashneft's exploration and development licence to the Trebs and Titov oil fields is currently the subject of legal proceedings brought by a minority shareholder in Bashneft. A negative outcome in these proceedings may lead to significant delays in Bashneft's exploration and development plans and may otherwise have a material adverse effect on Bashneft's business and results of operations. In addition, the cancellation of Bashneft's Trebs and Titov licence may well constitute an event of default under JSOC Bashneft's pre-export facility, which, in turn, would trigger cross-default provisions under certain of our other financing agreements.*"

Our energy business depends on Bashkirenergo's ability to identify and obtain the licences that it requires, the continuing validity of some of its licences and permits, the issuance of new licences and the compliance with the terms of such licences and permits. Currently, under Russian law, it is not necessary to obtain a specific licence in order to generate power, although licences are required to perform necessary related activities, particularly in connection with the use of explosive and incendiary industrial facilities or the storage, transportation, processing and disposal of dangerous wastes, and there can be no guarantee that licences will not be required in the future for power and heat transmission or other related activities. There can be no guarantee that additional licences for other activities in the electricity sector will not be required in the future.

No assurances can be made that our existing licences and permits, including those held by our subsidiaries, will be renewed, that any new licences and permits for which we apply will be granted or that we will be able to comply with the terms of all applicable licences. There can also be no assurance that any of our current or future licences or permits will not be suspended or revoked on any ground. Any of these circumstances could have a material adverse effect on our business, results of operations, financial condition or prospects.

- *Certain of our subsidiaries' directors and executive officers may also serve as directors or officers of our subsidiaries' competitors, which may lead to certain conflicts of interest.*

Certain of our subsidiaries' directors and executive officers also serve as directors or officers of some of our competitors. As a result, potential conflicts of interest exist between these directors' and officers' duties to our subsidiaries and their duties arising from their positions with such other entities. For example, Mr. Gutseriyev, RussNeft's president and founder, Mr. Melamed, chairman of RussNeft's board of directors, and Mr. Abugov, a member of RussNeft's board of directors, are also on the board of directors of JSOC Bashneft, a competitor of RussNeft in the Russian market. Mr. Gutseriyev, Mr. Melamed and Mr. Abugov could use their influence at RussNeft or JSOC Bashneft in a manner which could conflict directly with JSOC Bashneft's or RussNeft's interests. These managers are in possession of a substantial amount of confidential information as it relates to us and JSOC Bashneft, and it may be contrary to our and Bashneft's interests for any such information to be disclosed to RussNeft or for that information to inform any of the decisions they make as directors of Bashneft or any of the views they take in their capacity as directors of JSOC Bashneft. This involvement in the management of JSOC Bashneft may increase the risk of potential conflicts that may arise between the role of Mr. Gutseriyev, Mr. Melamed and Mr. Abugov as members of the board of directors of JSOC Bashneft and their management positions in RussNeft. Any of these conflicts could have a material adverse effect on our business, results of operations, financial condition or prospects.

- *We have engaged and may continue to engage in transactions with related parties that may present conflicts of interest, potentially resulting in the conclusion of transactions on less favourable terms than could be obtained in arm's length transactions.*

We have engaged in transactions with affiliated parties and may continue to do so. For example, we have engaged in transactions with certain of our shareholders, directors and executive officers and companies controlled by them, including equity purchases and sales, supply contracts, loan arrangements and real property acquisitions. See “*Related Party Transactions.*” While we believe that all such transactions have been conducted on an arm's length basis, there can be no assurance that we could not have achieved more favourable terms had such transactions not been entered into with related parties. Furthermore, it is likely that we may enter into related party transactions in the future. Conflicts of interest may arise between our affiliates and us, potentially resulting in the conclusion of transactions on terms not determined by market forces. There can be no assurance that such transactions, individually or in the aggregate, will not have an adverse effect on our business, results of operations, financial condition or prospects.

- *Certain of our subsidiaries do not carry the types of insurance coverage customary in more economically developed countries for businesses of their size and nature, and a significant event could result in substantial property loss and inability to rebuild in a timely manner or at all.*

The insurance industry is not yet well developed in the Russian Federation, and many forms of insurance protection common in more economically developed countries are not yet available in the Russian Federation on comparable terms, including coverage for business interruption. We maintain insurance against some, but not all, potential risks and losses affecting our operations. Our insurance may not be adequate to cover all of our losses or liabilities. In addition, we may not be able to continue to access insurance on commercially reasonable terms. At present, we have no coverage for business interruption or loss of key management personnel. In the event that a significant event was to affect one of our facilities or networks, we could experience substantial property loss and significant disruptions in the provision of goods and services, which our property damage insurance may not fully cover. Additionally, depending on the severity of the property damage, we may not be able to rebuild damaged property in a timely manner or at all. We do not maintain separate funds or otherwise set aside reserves for these types of events. Any such loss or third-party claim for damages may have a material adverse effect on our business, results of operations, financial condition or prospects.

- *We may be subject to claims and liabilities under health, safety and environmental laws and regulations, and future changes to such regulations may materially increase the cost of compliance.*

Our operations are subject to the risk of liability arising from various environmental, health, safety and other laws and regulations. In particular, oil and gas and energy operations are subject to extensive federal and regional environmental laws and regulations. These laws and regulations set various standards for health and environmental quality, provide for penalties and other liabilities for the violation of such standards, and establish, in certain circumstances, obligations to compensate for environmental damage and to restore environmental conditions. Issues of environmental protection in the Russian Federation are regulated primarily by the Federal Law No. 7-FZ “On Environmental Protection” dated 10 January 2002, as amended (the “**Environmental Protection Law**”), as well as by a number of other federal laws and regulations.

Our operations are subject to periodic inspection by the authorities responsible for compliance with such environmental and health and safety laws and regulations. Although we endeavour to comply with all environmental and health and safety laws and regulations at all times, we may become involved in claims, lawsuits and administrative proceedings relating to environmental or health and safety matters in the future. Breaches of such laws would also be deemed to be a breach of our licences. An adverse outcome in any of these proceedings or any other breach of environmental or health and safety laws could have a significant negative impact on our business, prospects, financial condition and results of operations and may include the imposition of civil, administrative or criminal liability on us or our officers.

Russian regulatory authorities exercise considerable discretion in matters of enforcement and interpretation of applicable laws, regulations and standards, the issuance and renewal of permits and in monitoring compliance with the terms thereof. Compliance with new requirements may be costly and time consuming and may result in delays in the commencement or continuation of our operations. There can be no assurance that we will be able to comply with new requirements and, as a result, we may be required to cease certain of our business activities, pay monetary sanctions and/or remedy past infringements. Any such decisions, requirements or sanctions may restrict our ability to conduct our operations or to do so profitably.

With respect to our technology and telecommunications operations, alleged medical risks of cellular technology may subject us and/or MTS to negative publicity or litigation, decrease its 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. Each of these potential circumstances may adversely affect our business, financial condition, results of operations or prospects.

Bashneft is also subject to an array of health, safety and environmental risks and compliance costs. For example, Bashneft is limited in the volumes of flared associated gas it may release. Bashneft may be subjected to significant additional costs in order to modify its equipment so as to comply with regulations governing flared gas emissions, or alternatively may have to pay higher costs for exceeding the requisite emissions threshold, which from 1 January 2012, is 5%. In 2011, due to an increase in production, flared gas emissions exceeded the 5% threshold. Furthermore, Bashneft faces the risk of hazardous oil spills at its facilities. For example, in April 2012, a spill at the Trebs and Titov fields resulted in the release of approximately 600 tonnes of oil. The accident was likely caused by malfunctioning equipment. It is currently unclear what clean-up or other costs Bashneft may incur as a result of the spill, but they could be substantial and could have a material adverse effect on our business, results of operations, financial condition or prospects. In addition, the accident and other accidents of this nature could materially adversely affect the health of the local population or the environment.

Certain of our other subsidiaries, such as Bashkirenergo, are also involved in industries bearing health, safety and environmental risks. We incur, and expect to continue to incur, capital and operating costs in order to comply with increasingly complex health, safety and environmental laws and regulations. Despite such endeavours, we may not always be in compliance with applicable laws and regulations. Although the costs of the measures taken to comply with applicable laws and regulations have not had a material adverse effect on us to date, in the future, the costs of such measures and non-compliance related liabilities may increase, and this could have a material adverse effect on our business, results of operations, financial condition or prospects.

- *We are dependent on our ability to maintain a favourable brand image and reputation and avoid leaks of confidential information.*

Developing and maintaining awareness of the brands of our core and developing businesses is critical to informing and educating the public about their current and future products and services. We believe that the importance of brand recognition is increasing as the markets become more competitive. Successful promotion of the brands of our subsidiaries will depend largely on the effectiveness of their marketing efforts and on their ability to provide reliable and useful products and services at competitive prices. Brand promotion activities may not yield increased operating revenues, and even if they do, such operating revenues may not offset the expenses our subsidiaries incur in building their brands.

Furthermore, the ability of our subsidiaries to attract new customers and retain existing customers depends, in part, on their ability to maintain what we believe to be their favourable brand image. Negative publicity or rumours regarding our subsidiaries, their shareholders and affiliates or the services provided by our subsidiaries or failure to successfully and efficiently promote and maintain the brands of our subsidiaries may limit the ability of our subsidiaries to maintain their reputation and materially adversely affect our and our subsidiaries' business, results of operations, financial condition or prospects.

In the past, we have experienced certain developments that have had a negative impact on our brand image. For example, Bashneft has been subject to certain actions involving illegal use of the name of Bashneft and its subsidiaries in the sale of crude oil and petroleum products. In addition, although MTS makes efforts to protect its confidential information, it at times has experienced breaches of security and leaks of confidential information, including information relating to its customers. For example, in January 2003, MTS discovered that part of its 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 MTS' subscribers. In addition, in May 2003, certain subscriber databases of several operators in the North-West region, including those of MTS, Open Joint Stock Company MegaFon ("MegaFon"), Delta Telecom and two other operators, were stolen. In each case, the stolen databases were thereafter available for sale in the Russian Federation. In December 2003, MTS completed its internal investigation relating to the theft of its subscriber databases and found that these incidents were due to

weaknesses in its internal security in relation to physical access to such information. MTS' failure to protect its confidential information may negatively impact MTS reputation and brand image and lead to a loss of market share and may also lead to claims brought by customers and liability for damages. While we, MTS and Bashneft have taken measures that we believe will prevent such incidents from occurring in the future, such incidents may nonetheless recur, which could materially adversely affect our and our subsidiaries' business, results of operations, financial condition or prospects.

- *We encounter competition from other companies in all areas of operations.*

The markets in which we operate are highly competitive.

For example, MTS is facing particular competition in the Russian Federation and Ukraine where the mobile telecommunications markets are heavily saturated. MTS also faces increased competition in its fixed line business, where the market for alternative fixed line communications services in the Russian Federation is rapidly evolving and becoming increasingly competitive. Competition is generally based on price, product functionality, range of service offerings and customer service. MTS principal wireless competitors in the Russian Federation are Open Joint Stock Company Vimpel Communications ("**Vimpelcom**") and MegaFon. MTS also faces competition from several regional operators and Tele2, which has entered the market in several regions with aggressive pricing. In addition, in April 2011, the Russian government completed the reorganisation of state-controlled telecommunications companies Svyazinvest Telecommunications Investment Joint Stock Company ("**Svyazinvest**") and Open Joint Stock Company Long-Distance and International Telecommunications Rostelecom ("**Rostelecom**"). As a result, Rostelecom is currently the largest fixed-line operator and one of the largest mobile operators in the Russian Federation. In May 2011, Rostelecom announced its plans to acquire Sky Link and in November 2011 the FAS approved the acquisition. Also in November 2011, Rostelecom won tenders for 39 out of 40 licences to provide fourth-generation ("**4G**"), wireless services within the 2.3-2.4 GHz frequency band and received permission from the Russian Ministry of Defence to use the allotted frequencies for the creation of a 4G network. We believe that Rostelecom, as a state controlled company, is able to influence telecommunications policy and regulation in the Russian Federation and may cause substantial increases in interconnect rates for access to fixed line operators' networks by mobile cellular operators. Similarly, Rostelecom may cause substantial decreases in interconnect rates for access to mobile cellular operators' networks by fixed line operators, which could cause MTS' revenues to decrease. The emergence of Rostelecom as an integrated nationwide provider of fixed line local and long distance communications services and mobile communications services may significantly increase competition in MTS' markets. In addition, there can be no assurance that our competitors, including Rostelecom, will not be given preferential treatment from the government. Increased competition, including from the potential entry of new mobile operators, government-backed operators, including those that may be given preferential treatment by the governments who support them, mobile virtual network operators and alternative fixed line operators in the markets where we operate, as well as the strengthening of existing operators and increased use of Internet protocol telephony may adversely affect the MTS' ability to increase the number of subscribers and could result in reduced operating margins and a loss of market share, as well as different pricing, service or marketing policies, and have a material adverse effect on our business, results of operations, financial condition or prospects. MTS also faces significant competition in the other markets in which it operates, including Ukraine, Armenia, Uzbekistan and Belarus. See "*—Risks Relating to Our Technology and Telecommunications Business—If MTS cannot interconnect cost-effectively with other telecommunications operators, it may be unable to provide services at competitive prices and therefore lose market share and revenues*" for further discussion of competition facing MTS.

Furthermore, competition with major Russian and transnational oil companies for access to new sources of raw hydrocarbons could mean that our oil business will not be able to obtain access in the future to new hydrocarbon fields resources. This risk could lead to a reduction in the volume of Bashneft's production and to a lack of opportunities of acquiring additional reserves. Furthermore, competition in oil refining markets and in the marketing of crude oil and petroleum products may lead to a reduction in revenues and growth in expenses of Bashneft. Bashneft competes with many companies for available supplies of crude oil and other feedstocks and for outlets for its refined products. Many of Bashneft's competitors, including certain refineries that are part of vertically-integrated companies like OAO NK Rosneft ("**Rosneft**") and OAO LUKOIL ("**LUKOIL**") obtain a significant portion of their feedstock from company-owned production, and some have more extensive retail outlets than Bashneft has. Competitors that have their own production, modernise their facilities to operate more complex refineries than Bashneft currently has or more diverse operations may be better able than Bashneft to withstand volatile industry conditions, including shortages of crude oil, volatility in prices for crude oil or refined petroleum products or intense price competition at the wholesale level. Furthermore, with the adoption of stricter environmental standards in Europe and the United States, plans to require certain Russian products to be Euro-5

compliant and the historically high level of refining margins in the Russian Federation, many of Bashneft's competitors are expected to upgrade their refining facilities, which could increase the competition Bashneft faces in the oil products market. In addition, Russian oil majors have financial and other resources substantially greater than Bashneft's. Therefore, an intensification of competition, including an increase in refining capacity, could cause price reductions, reduce Bashneft's refining margins or result in the loss of market share for its products, any of which could have a material adverse effect on our business, results of operations, financial condition or prospects. See "*—Risks Relating to Our Oil and Energy Business*" for more information.

An anticipated increase in competition may also adversely affect Bashkirenergo if it is unable to compete effectively in the future. Although Bashkirenergo has operated in a competitive electricity and electricity supply market for a number of years, the scale of the competition has increased significantly in recent years as a result of the reduction in the volume of electricity and capacity covered by regulated contracts (effectively take-or-pay contracts at regulated tariff rates ("**Regulated Contracts**")) and the level of competition is expected to increase further as a result of the liberalisation of the wholesale electricity market and the introduction of the long-term capacity market under which prices for electricity capacity are set on the basis of competitive bids. If Bashkirenergo is unable to compete effectively with other suppliers of electricity and electricity capacity in the future, our business, results of operations, financial condition or prospects may be materially adversely affected.

The operations of our banking, retail, media, tourism, private healthcare and pharmaceuticals businesses can be affected by a variety of economic and other factors. Each business is subject to significant competition from a large number of companies in the Russian Federation and other countries, and each business competes on the basis of various factors, including, but not limited to, price, performance and service. The inability of our businesses to compete effectively could have a material adverse effect on our business, results of operations, financial condition or prospects.

- *We are subject to anti-corruption laws in the jurisdictions in which we operate, including anti-corruption laws of the Russian Federation and the U.S. Foreign Corrupt Practices Act (the "**FCPA**"), and we may be subject to the U.K. Bribery Act of 2010 (the "**U.K. Bribery Act**"), and our failure to comply therewith could result in penalties and reputational harm.*

We are subject to the FCPA, which generally prohibits companies and their intermediaries from making improper payments to foreign officials for the purpose of obtaining or keeping business and/or other benefits, along with various other anti-corruption laws. We may also be subject to the recently enacted U.K. Bribery Act. The U.K. Bribery Act is broader in scope than the FCPA in that it directly addresses commercial bribery in addition to bribery of government officials and it does not recognise certain exceptions, notably facilitation payments that are permitted by the FCPA. Although we regularly review and update our policies and procedures designed to ensure that we, our employees, distributors and other intermediaries comply with the anti-corruption laws to which we are subject, there is no assurance that such policies or procedures will work effectively all of the time or protect us against liability under these or other laws for actions taken by our employees, distributors and other intermediaries with respect to our business or any businesses that we may acquire. We operate primarily in the Russian Federation and other countries of the former Soviet Union, many of which pose elevated risks of violations of applicable anti-corruption laws. We are in frequent contact with persons who may be considered "foreign officials" under the FCPA and U.K. Bribery Act, and therefore, are subject to an increased risk of potential FCPA and U.K. Bribery Act violations. If we are not in compliance with the FCPA, the U.K. Bribery Act and other laws governing the conduct of business with government entities (including local laws), we may be subject to criminal and civil penalties and other remedial measures, which could have an adverse impact on our business, results of operations, financial condition and liquidity. Any investigation of any potential violations of the FCPA, the U.K. Bribery Act or other anti-corruption laws by U.S., U.K. or foreign authorities could also have an adverse impact on our brand image, business, financial condition and results of operations.

- *Our intellectual property rights are costly and difficult to protect.*

We regard our copyrights, trademarks, trade secrets and similar intellectual property, including our rights to certain domain names, as important to our continued success. We rely upon trademark and copyright law, trade secret protection and confidentiality or licence agreements with our employees, customers, partners and others to protect our proprietary rights. Nonetheless, intellectual property rights are especially difficult to protect in the markets where we operate. In these markets, the regulatory agencies charged to protect intellectual property rights are inadequately funded, legislation is underdeveloped, piracy is commonplace and enforcement of court decisions is difficult. For example, in the Russian Federation, legislation in the area of copyrights, trademarks and other types of intellectual property was significantly changed in 2008, and Russian courts have limited experience in applying and interpreting the new laws.

In addition, litigation may be necessary to enforce our intellectual property rights, to determine the validity and scope of the proprietary rights of others, or to defend against claims of infringement. Any such litigation may result in substantial costs and diversion of resources, and, if decided unfavourably to us, could have a material adverse effect on our business, results of operations, financial condition or prospects. We may also incur substantial acquisition or settlement costs where doing so would strengthen or expand our intellectual property rights or limit our exposure to intellectual property claims of third parties.

- *Emerging markets such as the Russian Federation are generally subject to greater risks than more developed markets.*

Prospective investors should exercise particular care in evaluating the risks involved in investing in emerging market securities, such as the Notes, and must decide for themselves if, in light of those risks, their investment is appropriate. Generally, investment in emerging markets is suitable only for sophisticated investors who are familiar with, and fully appreciate the significance of, the risks involved in investing in such markets. Investors should be aware that emerging markets such as the Russian Federation are subject to greater risks than more developed markets, including in some cases significant economic, political and social, and legal and legislative risks. Prospective investors should also note that emerging economies are subject to rapid change and that the information set forth herein may become outdated relatively quickly. 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 the Russian Federation and adversely affect the Russian economy. In addition, during such times, businesses that operate in emerging markets can face severe liquidity constraints as funding sources are withdrawn. Financial turmoil in other emerging or developing markets could materially adversely affect our business, results of operations, financial position or prospects, as well as the value of the Notes. Prospective investors are urged to consult with their own legal and financial advisors before making an investment in the Notes.

Risks Relating to Our Technology and Telecommunications Business

- *MTS is dependent on its ability to implement the necessary infrastructure to manage its growth and partnerships, develop its network and avoid service disruptions.*

MTS' ability to increase its subscriber base depends upon the success of its network expansion. MTS has expended considerable amounts of resources to enable both organic expansion and expansion through acquisitions and partnerships and plans to continue to do so. Limited information regarding the markets into which MTS has or is considering expanding, either through acquisitions, new licences or partnerships, complicates accurate forecasts of future revenues from those regions, increasing the risk that MTS may overestimate these revenues.

The build-out of MTS' 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 the Russian Federation, Ukraine and other CIS countries is subject to governmental certification and periodic renewals of the same. MTS is also required to obtain permits for the operation of telecommunications equipment as well as governmental certification and/or permission for the import and export of certain network equipment, which can result in procurement delays and slow network development. MTS' expansion plans could be hindered by the failure of any equipment it uses to receive timely certification or re-certification.

For example, the import and export of products containing cryptographic hardware is subject to special documentation requirements and approvals. As telecommunication networks comprise various components with cryptographic hardware, MTS must comply with these requirements in order to import such components. Moreover, where imported equipment does not contain cryptographic hardware, the federal customs service requires manufacturers to provide written confirmation regarding the absence of such hardware. The range of goods requiring the provision of "certificates of conformance" by suppliers and manufactures prior to their import into the Russian Federation has also been expanded to cover most of MTS' key network components, and imported radio-electronic equipment is required to be licensed by the Russian Ministry of Industry and Trade.

Furthermore, as a result of the current downturn in the global financial markets, certain banks have curtailed their lending programs, which may limit MTS' ability to obtain external financing and, in turn, result in the reduction of its capital expenditure program. To the extent that MTS fails to expand its network on a timely basis, MTS could experience difficulty in expanding its subscriber base.

- *Failure to effectively implement MTS' geographic expansion strategy could hamper its continued growth and profitability.*

MTS' continued growth depends, in part, on its ability to identify attractive opportunities in markets that will grow and on its ability to manage the operations of acquired or newly established businesses. MTS' strategy contemplates the acquisition of additional operations within the CIS in both the mobile and fixed broadband segments. These acquisitions may occur in countries that represent new operating environments for MTS and, in many instances, may be located a great distance from MTS' corporate headquarters in the Russian Federation. MTS therefore may have less control over its activities. MTS may also face uncertainties with respect to the operational and financial needs of these businesses, and may, in the course of its acquisitions, incur additional debt to finance the acquisitions and/or take on substantial existing debt of the acquired companies. In addition, MTS anticipates that the countries into which MTS may expand will be emerging markets and, as with countries of its current presence, subject to greater political, economic, social and legal risks than more developed markets. For example, in December 2010, MTS discontinued its operations in Turkmenistan when its licences were suspended by the Turkmenistani authorities. In addition, MTS failed to gain operational control over Bitel and thus was prevented from realising the expected benefits from this acquisition. The ownership of Bitel by Tarino Limited ("**Tarino**") is currently the subject of ongoing litigation in the British Virgin Islands and the United Kingdom. In the event that any of these claims are resolved against Tarino, as the most negative outcome, MTS may potentially lose its ownership interest in Bitel. Should this occur, our business, results of operations, financial condition or prospects could be materially adversely affected. See "*Business—Material Litigation*" for further discussion.

MTS' failure to identify attractive opportunities for expansion into new markets and to manage the operations of acquired or newly established businesses in these markets could hamper our continued growth and profitability, and have a material adverse effect on our business, results of operations, financial condition or prospects.

- *MTS is dependent on the proper functioning of its network systems and on its ability to avoid disruptions.*

The ability of MTS to deliver services is dependent on its ability to protect its network systems against damage from communications failures, computer viruses, power failures, natural disasters and unauthorised access. Any system failure, accident or security breach that causes interruptions in MTS' operations could impair its ability to provide services to the customers and materially adversely affect its business and results of operations. In addition, to the extent that any disruption or security breach results in a loss of or damage to customers' data or applications, or inappropriate disclosure of confidential information, MTS may incur liability as a result, including costs to remedy the damage caused by these disruptions or security breaches.

While MTS maintains back-up systems for its telecommunications equipment, network management, operations and maintenance systems, these systems may not ensure recovery in the event of a network failure. In particular, in the event of extensive software and/or hardware failures, significant disruptions to its systems could occur, leading to the inability to provide services. Disruptions in MTS' provision of services could lead to a loss of subscribers, damage to the reputation, violations of the terms of the licences and subscriber contracts and penalties.

MTS' 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, interconnect failures, physical or software break-ins, viruses and similar events. Although MTS' computer and communications hardware is insured against fires, storms and floods, MTS does not carry business interruption insurance to protect it in the event of a catastrophe, even though any such an event could have a material adverse effect on our business, results of operations, financial condition or prospects.

- *The telecommunications services market is characterised by rapid technological change, which could render MTS' services obsolete or non-competitive and result in the loss of its market share and a decrease in its revenues.*

The telecommunications industry is subject to rapid and significant changes in technology and is characterised by the continuous introduction of new products and services. The mobile telecommunications industry in the Russian Federation is also experiencing significant technological change, as evidenced by the introduction in recent years of new standards for radio telecommunications, such as wireless fidelity ("**Wi-Fi**"), Worldwide Inter-operability for Microwave Access ("**Wi-Max**"), Enhanced Data Rates for GSM Evolution ("**EDGE**"),

Universal Mobile Telecommunications System (“UMTS”), and Long Term Evolution (“LTE”), as well as ongoing improvements in the capacity and quality of digital technology, shorter development cycles for new products and enhancements and changes in customer requirements and preferences. Such continuing technological advances make it difficult to predict the extent of the future competition MTS may face and it is possible that existing, proposed or as yet undeveloped technologies will become dominant in the future and render the technologies MTS uses less profitable or even obsolete. New products and services that are more commercially effective than MTS’ products and services may also be developed. Furthermore, MTS may not be successful in responding in a timely and cost-effective way to keep up with these developments. Changing products or services in response to market demand may require the adoption of new technologies that could render many of the technologies that MTS currently uses less competitive or obsolete. To respond successfully to technological advances and emerging industry standards, MTS may require substantial capital expenditures and access to related or enabling technologies in order to integrate the new technology with its existing technology.

- *MTS may be unable to develop additional sources of revenue.*

According to AC&M Consulting, mobile penetration in the Russian Federation and Ukraine exceeds 100%, which means that all operators combined have more active subscribers than the number of people in each of these markets. While customer growth has been, and is expected to continue to be, a principal source of revenue growth, increasing competition and market saturation will likely cause the increase in subscribers to continue to slow in comparison to MTS’ historical growth rates. As a result, MTS will need to continue to develop new competitive services, including value-added, 3G, Internet, Blackberry services, integrated telecommunications services and others, as well as consider vertical integration opportunities through the development or acquisition of dealers in order to provide new sources of revenue in addition to standard voice services. MTS’ inability to develop additional sources of revenue could have a material adverse effect on our business, results of operations, financial condition or prospects.

- *The reduction, consolidation or acquisition of independent dealers and MTS’ failure to further develop its distribution network may lead to a decrease in its subscriber growth rate, market share and revenues.*

MTS has historically enrolled a large majority of its subscribers through a network of independent dealers. In October 2008, Vimpelcom acquired a 49.9% stake in Morefront Holdings Ltd., a company that owns 100% of the Euroset Group (“Euroset”), the largest mobile handset retailer and leading dealer for major mobile network operators in the Russian Federation. Although FAS approval relating to the sale of Euroset specifically prohibits Euroset from discriminating against or providing preferential treatment to any mobile operator following the acquisition, MTS believes that it faces discriminatory treatment following Vimpelcom’s acquisition, including the promotion of Vimpelcom’s services over those of MTS at Euroset outlets, notwithstanding these regulatory prohibitions. Although MTS continues to work with Euroset, its ability to attract new customers through Euroset outlets may be limited. If Euroset continues to expand its footprint in the Russian Federation through the acquisition of Svyaznoy operations or otherwise, MTS’ opportunities for marketing its services may be restricted. As a result, MTS has accelerated the development of its proprietary distribution network and has been working to increase its relationship with small regional dealers following Vimpelcom’s acquisition of its stake in Euroset and in view of the deteriorating financial condition of many nationwide dealer networks. If MTS is not successful in expanding its proprietary network and maintaining and further developing its distribution network of national, regional and local retailers, its subscriber growth rate, market share and revenues may decrease, which would have a material adverse effect on our business, results of operations, financial condition or prospects.

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

MTS’ ability to provide commercially viable services depends on its ability to continue to interconnect cost-effectively with zonal, intercity and international fixed line and mobile operators in the Russian Federation, Ukraine and other countries in which MTS operates. Fees for interconnecting are established by agreements with network operators and vary depending on the network used, the nature of the call and the call destination.

In the Russian Federation, the government has previously expressed its intent to privatise Svyazinvest and to obtain a listing of Rostelecom Global and American Depositary Receipts after completion of the Svyazinvest reorganisation. In Ukraine, the government completed the privatisation of Ukrtelecom, which, according to its public disclosure, has a 71% share of the local telephony market and an 83% share of the domestic and international long distance market in Ukraine. It is currently unclear how the privatisations of Svyazinvest and Ukrtelecom will affect MTS’ interconnect arrangements and costs, but there is a chance that its ability to interconnect cost-effectively with other telecommunications operators could be hampered.

Although Russian legislation requires that operators of public switched telephone networks that are deemed “substantial position” operators cannot refuse to provide interconnects or discriminate against one operator over another, MTS believes that, in practice, some operators attempt to impede wireless operators by delaying interconnect applications and establishing technical conditions for interconnect feasible only for certain operators. Any difficulties or delays in interconnecting cost-effectively with other networks could hinder MTS’ ability to provide services at competitive prices or at all, causing MTS to lose market share and revenues, which would have a material adverse effect on our business, results of operations, financial condition or prospects.

In addition, as a result of the restructuring of Svyazinvest and Rostelecom, the latter has become a fourth national mobile operator in the Russian Federation. As Rostelecom controls regional fixed line operators in all regions of the Russian Federation (other than Moscow), it may receive preferential terms for interconnecting with these operators, which would allow it greater flexibility in setting tariffs and put MTS at a competitive disadvantage.

Trimob (formerly known as Utel), a subsidiary of Ukrtelecom, is the only UMTS licence holder in Ukraine. Trimob is expected to be sold in the first quarter of 2012, subject to approval by the Antimonopoly Committee of Ukraine (“AMC”) and certain other regulatory bodies. A sale of Trimob to one of MTS’ competitors would provide that competitor with a significant advantage over MTS and would adversely affect MTS’ competitiveness in Ukraine, as well as its business, financial condition and results of operations. The Ukrainian government has previously indicated that funds required for the conversion of the remaining UMTS frequencies have not been provided in Ukraine’s 2012 State Budget. Therefore, there is a possibility that auctions for additional UMTS licences will not be held in 2012. Nevertheless, if MTS does not acquire Trimob and MTS is unable to acquire a UMTS licence when an auction is ultimately held, and its competitors do, those competitors would have an advantage over MTS, which could adversely affect our business, results of operations, financial condition or prospects. See “—Risks Relating to Our Business and Industry—General Risks—We encounter competition from other companies in all areas of operations” for further discussion of our competition, including with respect to MTS.

- *MTS may not realise the benefits it expects to receive from its investments in and deployment of 3G and 4G wireless services in the Russian Federation.*

In May 2007, the Federal Service for Supervision in the Area of Communications awarded each of MegaFon, Vimpelcom and MTS a licence to provide 3G services in the Russian Federation. The 3G licence allows MTS to provide mobile radio telephone services using the International Mobile Telecommunications-2000, or IMT-2000/UMTS standard. Historically, mobile operators that have developed 3G networks have experienced various difficulties and challenges, including a limited supply of 3G-compatible handsets, limited international roaming capabilities, as well as 3G software and network-related problems. MTS may experience similar problems or encounter new difficulties when developing its 3G network and may be unable to fully resolve them. For example, MTS cannot be certain that:

- it will be able to build-out the 3G network in a timely manner;
- its 3G network and services will deliver the quality and level of service that MTS’ customers demand or prefer;
- it will be able to provide all contemplated 3G services at reasonable prices and within a reasonable timeframe;
- manufacturers and content providers will develop and offer products and services for its 3G network on a timely basis;
- there will be sufficient demand for 3G services in the markets where MTS operates;
- its 3G network will be commercially viable in all of the locations MTS is required to operate pursuant to its 3G licence;
- its competitors will not offer similar services at lower prices; and
- changes in governmental policies, rules, regulations or practices will not affect its network rollout or its business operations.

In addition, Russian military authorities also use frequencies on the 3G spectrum, which may limit the availability of 3G frequencies for commercial use in certain areas. During the construction of MTS’ 3G network, there is also a risk that the frequencies assigned to MTS for commercial use may overlap with frequencies used by the Russian military. For example, conflicts over the availability of frequency long reserved for military use in

Moscow caused delays in the commercial launch of 3G services in Moscow by all of the 3G licence holders, although some of these frequencies were released for commercial use in 2009. If additional overlap were to occur, it could cause problems or delays in the development and operation of MTS' 3G network in the Russian Federation.

MTS may also face competition from operators using 2G, or other forms of 3G technology. For example, licences for the use of CDMA technology have already been granted for the provision of fixed wireless services in a number of regions throughout the Russian Federation. CDMA is a 2G digital cellular telephony technology that can be used for the provision of both wireless and fixed services. If CDMA operators were able to develop widespread networks throughout the Russian Federation, MTS would face increased competition. In addition, the development of Wi-Max networks will likely pose additional competition for 3G providers operating in the IMT-2000/UMTS standard.

The next step in the development of Russian telecommunications is the deployment of 4G/LTE networks. The cost of 4G/LTE network development and quality of services (data speed, quality of coverage) depend on the band and the width of frequency range given to an operator.

In September 2011, the Russian government announced its intention to auction frequencies for LTE use on a national level in 2012. Additionally, the State Radio Frequencies Commission gave OOO Scartel ("Scartel") (which operates under the Yota brand) two ranges of LTE frequencies, 30 MHz each, in the 2.5-2.7 GHz band for use on the whole territory of the Russian Federation in exchange for 4G frequencies held by Scartel for Wi-Max technology of total width of 70MHz (the exchange was completed on a non-auction basis). Four sets of frequencies in the 791-862 MHz band are planned to be sold during the auction in 2012, after which the winners of the frequencies will also receive frequencies in the 2.5-2.7 GHz band. The remaining frequencies that are to be sold during the auction comprise 40 MHz of the 2.5-2.7 GHz band. Therefore, other operators may receive frequency ranges much later than Scartel and the ranges they receive may be much smaller than those given to Scartel.

Initially, it was planned that all operators would receive equal access to the Scartel infrastructure, which would allow each operator to reduce its 4G/LTE network development costs. In March 2011, MTS, MegaFon, Vimpelcom and Rostelecom signed a non-binding memorandum of understanding with Yota, according to which MTS, MegaFon, Vimpelcom and Rostelecom were to receive access to Scartel's 4G network infrastructure (which was to be built) and were to receive options to purchase shares in Scartel in 2014 at a price determined by an independent appraisal. MTS considered a preliminary value assessment of Scartel to be unduly high. Currently, MTS is still considering its further actions in regards to this arrangement.

In December 2011, Scartel reached an agreement with MegaFon and Rostelecom to allow them to provide LTE services through Scartel's network in exchange for permitting Scartel to use the two companies' network infrastructure. In February 2012, Scartel and MegaFon received the necessary licences to allow MegaFon to provide such services over the Scartel LTE network.

According to recent news reports, MegaFon is negotiating a possible acquisition of Scartel. If this transaction takes place, MegaFon may obtain significant short term competitive advantage both in terms of frequency resources and LTE network development costs.

Furthermore, the limited number of available frequencies may prevent MTS from realising the full benefits it expects to receive from the development of a 4G network, because its network capacity would be constrained and its ability to expand limited. Moreover, if MTS cannot develop a commercially viable 4G network, and one of its competitors does, that competitor would have an advantage over MTS, which in turn may have a material adverse effect on our business, results of operations, financial condition or prospects.

Potential competition from other 3G, CDMA, and 4G providers, together with any substantial problem with the rollout of MTS' 3G and 4G networks and provision of 3G and 4G services in the future, could materially adversely affect our business, financial condition and results of operations.

- *MTS is subject to extensive regulation of its tariffs, and these tariffs may not fully compensate MTS for the cost of providing required services.*

As the public switched telephone network ("PSTN") operator in Moscow, MGTS is considered to be a company holding a dominant position as well as a natural monopoly in the Moscow telecommunications market under

Russian antimonopoly regulations. Consequently, the Federal Tariff Service (the “FTS”) regulates MGTS’ tariffs for most services provided to its PSTN subscribers, including installation fees, monthly subscription fees (for subscribers to the unlimited tariff plan) and local call charges (for subscribers who do not use the unlimited tariff plan). In addition, the Federal Law No. 126-FZ “On Communications” dated 7 July 2003, as amended (the “**Communications Law**”), also provides for the special regulation of telecommunications operators occupying a “substantial position,” *i.e.* operators which together with their affiliates have, in the Russian Federation generally or in a geographically defined specific numerical zone, 25% or more of installed capacity or capacity to carry out transmission of not less than 25% of traffic. Comstar and MGTS were added to the register of telecommunications operators occupying a substantial position in 2005 and 2006, respectively. Accordingly, the interconnect tariffs established by Comstar, prior to its merger with MTS, and MGTS are also subject to regulation by the Federal Agency on Communications. Although MTS has not been formally recognised as a telecommunications operator occupying a substantial position in the market, MTS believes that interconnect tariffs previously approved by the Federal Agency on Communications for Comstar also apply to MTS following the merger completed on 1 April 2011. While MTS believes the tariffs currently set by the FTS and the Federal Agency on Communications are sufficient to compensate MTS for the costs of providing these services, future tariffs may not be set at a level that fully compensates MTS for the provision of these services or increased in parallel with corresponding increases in MTS’ costs and/or inflation.

Although MTS is permitted to petition the FTS for increases in tariffs based on such criteria as inflation, increased costs and the need for network investments, it is possible that future requested increases may not be granted or that the FTS may not adequately take such factors into account in setting tariffs. If the tariffs applicable to Comstar (prior to its merger with MTS, but now, applicable to MTS), and MGTS do not compensate MTS for the cost of providing services, our business, results of operations, financial condition or prospects could be materially adversely affected.

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

A limited number of frequencies are available for wireless operators in each of the regions in which MTS operates or holds licences to operate. MTS is dependent on access to adequate spectrum allocation in each market in which it operates in order to maintain and expand its subscriber base. If frequencies are not allocated to MTS in the future in the quantities, with the geographic span and for time periods and at prices that would allow it to provide wireless services on a commercially feasible basis throughout all of its licence areas, our business, results of operations, financial condition or prospects may be materially adversely affected.

A loss of allocated spectrum, which is not replaced by other adequate allocations, could also have a substantial adverse impact on MTS’ network capacity. In addition, frequency allocations are often issued for periods that are shorter than the terms of the licences, and such allocations may not be renewed in a timely manner or at all. If MTS’ frequencies are revoked or it is unable to renew its frequency allocations, its network capacity would be constrained and its ability to expand limited, resulting in a loss of market share and lower revenues.

- *An increase in the fees for frequency spectrum usage could have a negative effect on MTS’ financial results.*

The terms of MTS licences in the Russian Federation and the CIS require that MTS makes payments for frequency spectrum usage. Any significant increase in the fees payable for the frequency channels that MTS uses or additional frequency channels that MTS needs in the Russian Federation or the CIS could have a negative effect on MTS’ financial results. For example, new rules on the calculation of fees for frequency spectrum usage in the Russian Federation effective as of 1 January 2012 will lead to the increase of the fees MTS pays for frequency spectrum usage by 40-45% in 2012 as compared to 2011. Similarly, in April 2010, the Cabinet of Ministers of Ukraine significantly increased the fees for frequency spectrum usage in Ukraine for cellular communications. Furthermore, according to the Tax Code of Ukraine, the fees payable for frequency usage shall be determined based in part on the rate of inflation and reviewed annually effective 1 January 2011. Accordingly, the fees for frequency usage were increased by 9.4% in 2011 as compared to 2010, and by 8.9% in 2012 as compared to 2011.

- *Changes to the rules and regulations involving roaming charges in the Russian Federation may result in lower revenues generated from the provision of roaming services.*

In 2010, the Russian government announced its intent to monitor the pricing of roaming services. As a result, the FAS conducted an investigation of the activities of Russian telecommunications operators and found that MTS,

Vimpelcom and MegaFon violated antimonopoly laws relating to the pricing of roaming services. Subsequently, the FAS imposed an administrative fine on MTS in the amount of RUB 21.9 million which represented 1.0% of MTS' revenues derived from roaming services in the CIS countries in 2009. Since this decision, several draft laws were submitted for consideration to the State Duma, which are intended to change the regulation of so-called "national" (between networks) and "intra-network" (within network) roaming in the Russian Federation by introducing a flat national roaming tariff and eliminating intra-network roaming tariffs for incoming calls. It is not currently clear whether this legislation will be adopted. However, if the new legislation is adopted, MTS believes that its revenues from the provision of roaming services would decline considerably, which could have a material adverse effect on our business, results of operations, financial condition or prospects.

In addition, in 2011, the Russian government continued its efforts to decrease the price level of international roaming services and entered into discussions with the European Commission regarding the roaming pricing strategy of both Russian and European telecommunications operators due to an increasing number of complaints from subscribers. Further to MTS' conversations with the FAS and in response to public discussions initiated by various Russian consumers associations, MTS, MegaFon and Vimpelcom have voluntarily lowered international roaming tariffs and introduced certain tariff plans and options aimed at the reduction of prices for roaming services.

However, if the Russian government determines the decrease of roaming tariffs to be insufficient, it may require MTS to decrease its prices for roaming services, which may adversely affect our revenues and financial condition.

- *Compliance with the new regulations on International Mobile Equipment Identity ("IMEI") numbers may present MTS with technical difficulties and may lead to the expenditure of significant resources.*

On 11 January 2012, the Ministry of Communications and Mass Media published a draft regulation, which will require all handsets and other telecommunications devices to be assigned individual IMEI numbers. It is still unclear if and when this regulation will be adopted. If this regulation is adopted, MTS may be required to develop a system to monitor IMEI numbers, and it may need to establish and maintain a database of IMEI numbers, which would necessitate the expenditure of significant technical and financial resources.

- *The enactment of regulations allowing mobile network subscribers to select their long distance providers could have a material adverse effect on our business, results of operations, financial condition or prospects.*

MTS currently provides long distance services to its subscribers pursuant to the licence for mobile services and routes the long distance traffic through long distance transit operators. MTS receives revenue from its subscribers for these calls and remits an interconnect fee to the long distance transit operators. In providing long distance services, MTS selects the transit operators based on cost and quality considerations. Subscribers making domestic or international long distance ("DLD" and "ILD," respectively) calls on their mobile phones do not have the option of selecting their long distance provider. In contrast, fixed line telephone users in the Russian Federation have the legal right to select their long distance operator, either by pre-selecting the operator for all of their future calls, or through a "hot choice" option, the latter of which allows callers to select their preferred long distance provider before each long distance call.

The Ministry of Communications and Mass Media is currently considering whether to extend the right to select long distance providers to mobile network subscribers. In the event that this occurs, MTS will need to make substantial investments in its network infrastructure to support the "hot choice" feature. In addition, allowing MTS' subscribers to select their long distance providers may result in their selection of higher cost providers, causing higher interconnect fees to be payable by MTS and, consequently, lower revenues. As a result, extending the right to select long distance providers to mobile subscribers could have a material adverse effect on our business, results of operations, financial condition or prospects.

- *Failure to fulfil the terms of MTS' licences, renew and receive renewed or new licences with similar terms to MTS' existing licences could result in their suspension or termination.*

Each of MTS' mobile licences requires service to be offered by a specific date and some contain further requirements as to network capacity and territorial coverage to be reached by specified dates. In addition, all of MTS' mobile licences require MTS to comply with various telecommunications regulations relating to the use of radio frequencies and numbering capacity allocated to MTS, network construction and interconnect rules, among

others. The licence requirements applicable to MTS' fixed line businesses include participation in a federal communications network, adherence to technical standards, investment in network infrastructure, employment of Russian technical personnel and the provision of certain services to the federal government and PSTN subscribers at regulated tariffs, among others. If MTS fails to comply with the requirements of Russian, Ukrainian or other applicable legislation or MTS fails to meet any terms of its licences, MTS' licences and other authorisations necessary for its operations may be suspended or terminated. In addition to the impact on MTS' operations, the suspension or loss of certain licences could also cause an event of default under certain of MTS' debt obligations. A suspension or termination of MTS' licences or other necessary governmental authorisations could therefore have a material adverse effect on our business, results of operations, financial condition or prospects.

MTS' telecommunications licences expire in various years from 2012 to 2022. These licences may be renewed upon application to the relevant governmental authorities. Government officials in the Russian Federation and the other CIS countries in which MTS operates have broad discretion in deciding whether to renew a licence, and may not renew licences after their expiration. Licence renewals may be subject to additional conditions, such as revenue sharing or the mandatory modernisation of MTS' network. These and similar conditions would constitute indirect payment obligations.

In addition, MTS may be subject to penalties or MTS' licences may be suspended or terminated for non-compliance with the new licences requirements. The suspension or loss of certain licences could significantly limit MTS' operations and cause certain of MTS' debt to be accelerated.

Failure to renew MTS' telecommunications licences, or failure to receive renewed or new licences with similar terms to existing licences, could significantly limit MTS' operations, which could have a material adverse effect on our business, results of operations, financial condition or prospects.

- *Much of MTS' fixed line infrastructure is outdated, and MTS may be required to make significant investments beyond those that are currently planned to modernise it.*

A significant portion of MGTS' infrastructure has not been modernised. For example, although MGTS has recently completed the digitalisation of its network, the newly installed equipment may not function properly within parts of the network that have not yet been upgraded. In addition, MGTS' network switching equipment may become obsolete or unusable, in which case MTS may be required to make significant investments to modernise MGTS' infrastructure in order to ensure that it fulfils its regulatory obligation to provide telephony services as a PSTN operator. The overburdening of MGTS' infrastructure may inconvenience subscribers by causing incoming and outgoing calls to have lower completion rates. If MGTS is not able to upgrade its network in a timely manner or if it is required to make significant investments beyond those that are currently planned, our business, results of operations, financial condition or prospects could be materially adversely affected.

Risks Relating to Our Oil and Energy Business

- *Bashneft's exploration and development licence to the Trebs and Titov oil fields is currently the subject of legal proceedings brought by a minority shareholder in Bashneft. A negative outcome in these proceedings may lead to significant delays in Bashneft's exploration and development plans and may otherwise have a material adverse effect on Bashneft's business and results of operations. In addition, the cancellation of Bashneft's Trebs and Titov licence may well result in JSOC Bashneft's pre-export facility being capable of being accelerated, which, in turn, would trigger cross-default provisions under certain of our other financing agreements.*

In December 2011, Bashneft transferred its licence to develop and explore the Trebs and Titov field to its wholly-owned subsidiary at that time, Bashneft-Polus. Subsequently, on 12 December 2011, Rosnedra, which had originally issued the licence to Bashneft, reissued it to Bashneft-Polus. In March 2012, a minority shareholder in Bashneft filed a lawsuit with the Moscow Arbitrazh Court against Rosnedra, seeking to invalidate the reissuance of the licence, terminate Bashneft-Polus' right to use the licence and otherwise terminate the licence itself on the grounds that Rosnedra reissued the licence with no proof that Bashneft-Polus was solvent and employed suitably qualified persons and without having received approval of the FAS, which, according to the plaintiff, was required in order to validate the licence transfer. JSOC Bashneft and Bashneft-Polus are joined in these proceedings as third parties. On 20 and 23 April 2012, the Moscow Arbitrazh Court held preliminary hearings regarding the claim of the minority shareholder. The court hearing on the merits is scheduled to take place on 21 May 2012. See "*Business—Material Litigation.*"

If the claim of the minority shareholder is granted, Bashneft's licence to Trebs and Titov may be transferred back to JSOC Bashneft or cancelled. While we believe it is unlikely that Bashneft's licence to Trebs and Titov will be

transferred back to JSOC Bashneft or cancelled, there can be no assurance that such transfer or cancellation will not occur. Should the licence be transferred back to JSOC Bashneft or cancelled, there may be significant delays in Bashneft's exploration and development plans and Bashneft may be prevented from adequately replenishing its reserves base, which, in turn, may have a material adverse effect on our business and results of operations. See "*Risks Relating to Our Business and Industry—General Risks—The licences and permits that we require for our business may be invalidated, suspended or may not be issued or renewed, or may contain onerous terms and conditions that restrict our ability to conduct our operations or could result in substantial compliance costs or administrative penalties*" and "*Business—Material Litigation*"

Furthermore, the cancellation of the licence may well result in under JSOC Bashneft's \$300 million pre-export finance agreement being capable of being accelerated, dated 16 August 2011, with BNP Paribas ZAO, Deutsche Bank AG, Amsterdam Branch, Goldman Sachs International Bank and ING Bank N.V. (the "**Bashneft Pre-Export Finance Agreement**"). A default under the Bashneft Pre-Export Finance Agreement would, in turn, trigger cross default provisions under the Sistema Agreements and, if it resulted in acceleration of the loan, under Bashneft's loan agreements with Sberbank of Russia ("**Sberbank**"). See "*Management's Discussion and Analysis of Financial Condition and Results of Operations—Liquidity and Capital Resources—Capital Resources—Description of material loan agreements.*" Lenders under these agreements would, as a result, be entitled to declare all outstanding amounts under these loans immediately due and payable, which, as at 31 March 2012, amounted to \$2.4 billion.

- *The Russian government has been increasing its influence in the Russian oil and gas sector.*

Over the past several years, the Russian government has progressively increased its control over the Russian oil and gas sector and increased the strength of the companies that it controls. For example, in December 2004 the Russian government effectively nationalised approximately 10% of the Russian Federation's crude production capacity through the sale of OAO NK Yukos's primary production subsidiary, OAO Yuganskneftegaz, to state-controlled Rosneft, and in September 2005 state-owned Gazprom acquired a 72.6% stake in Sibneft (which was renamed Gazpromneft in May 2006) thereby increasing its ownership interest in Sibneft from 3% to 75.6%.

On a number of other occasions, the Russian government has (through its relevant governmental bodies or state-owned enterprises) acquired, directly or indirectly, controlling interests in various companies in various industrial sectors on the premise that those companies were experiencing financial difficulties or facing insolvency. In some instances, the price of such distressed acquisition was unilaterally imposed by the Russian government on the sellers. Although Russian government officials, including former Russian Prime Minister and current President, Vladimir Putin, have on several occasions in the past noted that state intervention measures are temporary and limited to companies with significant social obligations, the scope and scale of the Russian government's further intervention in the private section during the economic downturn may not be predicted with certainty. The Russian government may enact laws applicable to oil companies in particular, including limits on the price of oil or restrictions on export or sale. In addition, state-owned oil and gas companies may have a significant advantage in obtaining rights to develop the Russian Federation's natural resources and utilisation of the existing transportation infrastructure which may limit Bashneft's growth opportunities in the Russian Federation.

The Russian government has enacted legislation to protect property against expropriation and nationalisation. Furthermore, in the event that Bashneft's property is expropriated or nationalised, legislation provides for fair compensation to be paid to Bashneft. However, there can be no certainty that such protections will be enforced. This uncertainty is due to several factors, including the lack of an independent judicial system or sufficient mechanisms to enforce judgments and corruption among Russian state officials.

The concept of property rights is not well developed in the Russian Federation and there is a lack of experience in enforcing legislation enacted to protect private property against nationalisation and expropriation. As a result, Bashneft may not be able to obtain proper redress in the courts and may not receive adequate compensation if, in the future, the Russian government decides to nationalise or expropriate some or all of Bashneft's assets. The expropriation or nationalisation of any of Bashneft's or its subsidiaries' assets without fair compensation may have a material adverse effect on our business, results of operations, financial condition or prospects.

- *The Russian government can mandate deliveries of crude oil and refined products, including at less than market prices.*

The Russian government has the authority to direct Bashneft to deliver crude oil or refined products to certain government-designated customers, which may take precedence over market sales. In addition, the Russian government has used, and may continue to use, various administrative and fiscal measures to ensure sufficient supplies of crude oil and refined products are made available to domestic customers.

Government-directed deliveries may take several forms. Bashneft may be directed to make deliveries to government agencies, the military, railways, agricultural producers, remote regions, specific consumers or refineries or to domestic refineries in general. Requirements for the delivery of domestic crude oil and refined products, with or without a corresponding limitation or ban of export sales, could be used or extended if the domestic market starts experiencing a shortage of crude oil or refined products. In addition, some of Bashneft's oil production licences require Bashneft to sell crude oil that it produces to local government agencies. Bashneft has in the past and may in the future be directed to make such deliveries. Bashneft's deliveries of refined products under government-directed programmes in 2009-2011 were made at domestic market prices. However, no assurance can be given that the Russian government will not require that Bashneft delivers its products to government-designated customers at below market prices.

Depending on the level of such required supplies, any government-directed deliveries may force Bashneft to curtail its export of crude oil or refined products, which have been generally made at higher prices than domestic sales. In addition, any government-directed deliveries may disrupt Bashneft's relations with its customers and lead to delays in payments for crude oil and refined products. In addition, any failure to make government-directed deliveries may affect Bashneft's ability to export its crude oil. For example, the Russian government has previously threatened to limit the access of Russian oil companies to export pipelines for failing to provide domestic refineries with steady supplies of oil. An increase in the levels of government-directed deliveries, or a revocation of export rights, could materially adversely affect our business, results of operations, financial condition or prospects.

- *An increase in export duties on oil products, including the introduction of the "60-66-90" export duty regime, could materially adversely affect our business, results of operations, financial condition, or prospects.*

Export duties on oil products constitute Bashneft's single largest tax expense. Bashneft's export duties on crude oil increased by U.S.\$590 million, or 67.4%, from U.S.\$876 million in the year ended 31 December 2010 to U.S.\$1,466 million in the year ended 31 December 2011 due to an increase in export sales volumes and export duties. See "*Management's Discussion and Analysis of Financial Condition and Results of Operations—Key Factors Affecting Our Results of Operations—Export Duties and Taxes.*"

The Russian government has introduced a new procedure for calculating the marginal export duty rates on crude oil and oil products (the "**60-66-90 Scheme**"). According to Resolution 716 signed by Prime Minister Putin on 26 August 2011, beginning 1 October 2011, export duties for refined products have been calculated at 66% of the export duty on crude oil, with the exception of export duty on gasoline which is set at 90% of the export duty on crude oil. In addition, the 60-66-90 Scheme included the reduction in the maximum marginal crude oil export duty from 65% to 60%. The relevant amendments to the Tax Code of the Russian Federation were made in November 2011 and became effective on 1 January 2012. See "*Regulatory Overview—Regulation of the Oil Industry in the Russian Federation—Current System of Oil-Related Taxes and Payments—Oil-Related Export Duties.*"

Since oil products comprise a substantial share of Bashneft's production, the recent increase in export duties on oil products will likely have a negative impact on Bashneft's downstream business, financial condition and results of operations. More generally, any future increase in oil products export duties, depending on the nature and scope of the increase, may have a material adverse effect on our business, results of operations, financial condition or prospects.

- *Bashneft's development, exploration and production projects involve many uncertainties and operating risks that could prevent it from realising its production targets, profits and may cause substantial losses.*

According to Bashneft, fluctuations in volumes of oil production generally depend on each field's production and development plan, depletion rates and natural declines in production. For example, according to Bashneft, its depletion rate at four fields was more than 80% in 2011. Bashneft's long-term production is therefore dependent upon its success in finding or acquiring as well as developing additional reserves. See "*Business—Bashneft—Exploration and Production—Reserves and Resources.*"

The development of oil and natural gas fields is subject to many risks. Bashneft is exploring and producing in various geographical areas, including certain remote areas where environmental conditions are challenging, access is limited and costs can be high. The cost of drilling, completing and operating wells is often uncertain. As a result, Bashneft may incur costs overruns or may be required to curtail, delay or cancel drilling operations

because of a variety of factors, including unexpected drilling conditions, dry holes, pressure or irregularities in geological formations, equipment failures or accidents, adverse weather conditions, compliance with licences and governmental requirements (including those relating to environmental protection) and shortages or delays in the availability of drilling rigs and the delivery of equipment. See “—General Risks—The licences and permits that we require for our business may be invalidated, suspended or may not be issued or renewed, or may contain onerous terms and conditions that restrict our ability to conduct our operations or could result in substantial compliance costs or administrative penalties,” “General Risks—We are involved in various legal proceedings that may result in material losses” and “Business—Material Litigation.”

Bashneft intends to continue to explore for further reserves in its licence areas and seek to add new reserves to its reserve base. However, Bashneft cannot assure you that its exploration programs will be successful. Unless Bashneft completes successful exploration and development projects or acquires properties containing proven reserves, or both, its reserves will decline as its reserves are depleted. Bashneft’s future production is highly dependent upon its ability to develop its existing reserve base and, in the longer term, finding or acquiring additional reserves. If Bashneft is unsuccessful in developing its current reserve base, it may not be able to meet its production and future net revenues targets, and, in the longer term, if Bashneft fails to add new reserves through exploration or acquisitions, its total proved reserves, production and net revenues will decline, which would adversely affect our business, results of operations, financial condition or prospects.

- *Bashneft may be unable to compete in the oil products retail sector, which is highly competitive, find suitable locations to open new gas stations or encounter delays or greater than anticipated costs in remodelling existing gas stations.*

The retail sale of petroleum and non-fuel goods in the Russian Federation is increasingly competitive, and changing demographics and consumer preferences in individual geographic locations may greatly impact the operations of gas stations in those locations. As at 31 December 2011, the Bashneft retail network of petrol stations consists of 724 stations, both owned and franchised. Approximately 45% of Bashneft’s petrol stations are located in Bashkortostan, and 14% and 7%, respectively, in the neighbouring regions of Orenburg and Udmurtia. Bashneft expects to continue focusing its expansion plans on these regions, as well as other neighbouring regions within 1,000 km of Ufa and the growing markets of Moscow and St. Petersburg. See “Business—Business Description—Core Assets—Bashneft—Sales and Marketing—Oil Products—Retail Network.”

Bashneft’s ability to carry out its expansion strategy depends, in part, on its ability to successfully make acquisitions of existing gas stations, select locations for new gas stations and/or remodel existing gas stations to add facilities for non-fuel sales, such as shops and car wash facilities. Desirable acquisitions of existing gas stations or appealing locations for new gas stations may not be available at an acceptable cost or on acceptable terms. Bashneft may experience delays or higher than anticipated costs in opening new stations or remodelling existing stations or in obtaining any governmental approvals required for opening new stations or remodelling existing stations. In addition, Bashneft may not correctly anticipate consumer preferences in choosing to remodel or close certain locations or may face higher than anticipated costs in closing existing locations. There can be no assurance that new or remodeled locations will operate profitably or deliver increased revenue or margins sufficient to justify the capital expenditures necessary to build and maintain such stations. Furthermore, Bashneft may face increased competition from companies that have more established brand names or more experience in combining fuel and non-fuel sales, including OAO Tatneft (“**Tatneft**”), and other vertically-integrated companies, such as LUKOIL and Rosneft. See “—Risks Relating to Our Oil and Energy Business—Bashneft and Bashkirenergo are dependent upon the services provided by, and the assets and infrastructure of, third parties.” The impact of any of these factors could materially adversely affect our business, results of operations, financial condition or prospects.

- *Bashneft and Bashkirenergo have been involved in corporate reorganisations, which may adversely affect their business, results of operations, financial condition or prospects.*

In April 2012, Bashneft has approved a reorganisation through a consolidation of its refining and marketing subsidiary companies. According to Russian law and Bashneft’s credit facilities, Bashneft has to notify all its creditors about such reorganisation within specified timeframes. The merger is aimed at improving the transparency of Bashneft’s operations and corporate governance. However, there can be no assurance that governmental authorities or minority shareholders of Bashneft or of other companies that will participate in the reorganisation will not challenge the reorganisation. Should any such challenge be successful, the composition of Bashneft, and our business, results of operations, financial condition or prospects may be materially adversely affected.

Furthermore, in 2001, a decision was taken by the Russian government to significantly reform the Russian power market by, among other things, breaking up almost all of the then existing vertically-integrated power companies and forming new companies to operate in separate power market segments, such as generation, transmission and distribution. In accordance with legislation applicable to the Russian electricity market, starting from 1 January 2011, it is prohibited for an entity (or a group of entities) to operate as an integrated business model including generation and transmission of electricity. In response to these regulations, Bashkirenergo obtained approval from the FAS in October 2010 to perform a reorganisation of Bashkirenergo in the form of spin-off of its electricity transmission activities. However, the reorganisation plan was not approved by the shareholders at an extraordinary general shareholders' meeting that took place in December 2010.

While Bashkirenergo has continued to operate its generation and transmission businesses as an integrated business model after 1 January 2011, the government has not taken any administrative, judicial or other actions against Bashkirenergo either to compel it to undergo reorganisation or penalise it for not having reorganised before the 1 January 2011 deadline. Nevertheless, there can be no assurance that Bashkirenergo will not be subject to penalties in the future, should it not separate its generation and transmission assets in accordance with Russian legislation. In March 2012, Bashkirenergo approved the reorganisation of its generation, distribution and transmission businesses with the result that its power and heat generation assets and heat distribution assets are controlled by one company, Bashenergoaktiv, and its power transmission and distribution assets are controlled by another company, BESK. On 12 May 2012, we entered into an agreement with Open Joint Stock Company "INTER RAO UES" ("INTER RAO UES") in respect of the proposed reorganisation of Bashkirenergo where we have given certain warranties, indemnities and other undertakings to INTER RAO UES. As a result of this reorganisation, we expect to receive a combination of cash and promissory notes from INTER RAO UES. Subject to the approval of shareholders of Sistema and of Bashkirenergo and certain other conditions, including receipt of necessary government approvals and the execution of additional ancillary agreements, the reorganisation is expected to be completed in the fourth quarter of 2012 or first quarter of 2013. Following the reorganisation, we expect to hold a 75% stake in the power transmission and distribution company, BESK, and no stake in Bashenergoaktiv. Although Bashkirenergo's reorganisation has not yet been approved by FAS, FAS has approved the purchase of Bashenergoaktiv by INTER RAO UES.

There can be no assurance that the aforementioned reorganisations will be successful. The uncertainties in connection with the reorganisations may relate to, among other matters, the approvals of the reorganisations and related transactions, the determination of exchange ratios for share distributions, the determination of the redemption price for dissenting shareholders, the issuance and distribution of shares in the reorganisations and compliance with rules relating to valuations of property, interested party transactions, major transactions and anti-monopoly issues.

- *A substantial or extended decline in crude oil, refined products, natural gas, power or petrochemical products prices would have a material adverse effect on our business, results of operations, financial condition or prospects.*

Our oil and energy businesses, their financial conditions and results of operations depend substantially upon prevailing prices of oil, refined products, natural gas, power and petrochemical products. Historically, prices for oil, refined products, power, natural gas and petrochemical products have fluctuated in response to changes in many factors. We do not and will not have control over the factors affecting prices for oil, refined products, natural gas, power and petrochemical products. These factors include, but are not limited to:

- global and regional supply and demand and expectations regarding future supply and demand for crude oil, refined products, natural gas, power or petrochemical products;
- the cost of exploring for, developing, producing, processing and marketing crude oil, gas, refined products and petrochemical products;
- the ability and willingness of the Organisation of Petroleum Exporting Countries and other producing nations to influence global production levels and prices;
- the worldwide military and political environment and uncertainty or instability resulting from an escalation or additional outbreak of armed hostilities or further acts of terrorism, including in the United States, the Middle East, the CIS or other resource-producing regions;
- prices and availability of alternative and competing fuels;
- Russian and foreign governmental regulations and actions, including export restrictions and taxes;
- global and regional economic conditions;

- unexpected failure in the infrastructure;
- prices and availability of new technology; and
- weather and climate conditions and natural disasters.

Crude oil prices have been volatile in recent years, rising dramatically through July 2008 and then falling sharply over the second half of 2008. Crude oil prices began to stabilise in the first quarter of 2009 and have generally increased since then. According to Bloomberg, the price of Brent crude, an international benchmark oil blend (and which is a significant factor in the price of crude oil produced in the Russian Federation), as at 31 December 2008, 31 December 2009, 31 December 2010 and 30 December 2011 was U.S.\$41.76, U.S.\$77.20, U.S.\$94.30 and U.S.\$107.38 per barrel, respectively.

Bashneft's crude oil is currently sold both in the Russian Federation on the domestic market and on the international markets. In 2011, according to Bashneft, 24.21% of oil was exported to non-CIS countries, 68.9% of oil was destined for refining and 6.9% of oil was sold on the domestic market. See "*Business—Business Description—Core Assets—Bashneft—Sales and Marketing.*"

While domestic crude oil and oil product prices are generally linked to international crude oil and oil product prices, sometimes domestic prices deviate from international crude oil prices due to variances in the levels of regional supply, timing of the setting of prices for domestic sales and demand for crude oil and oil products. No assurance can be given that domestic prices will not be significantly lower than international prices in the future. Bashneft's profitability is determined, in large part, by the difference between the revenue received for crude oil and oil products that Bashneft produces and its operating costs, taxation costs upon extraction (which are assessable irrespective of sales) as well as costs incurred in transporting and selling its crude oil. Therefore, lower prices may reduce the amount of crude oil and oil products that Bashneft is able to produce economically or may reduce the economic viability of the production levels of specific wells or of projects planned or in development to the extent that production costs exceed anticipated revenue from such production.

Any decline in crude oil, refined products or petrochemical products prices and/or any curtailment in Bashneft's overall production volumes could impair Bashneft's ability to make planned capital expenditures and to incur costs that are necessary for the development of Bashneft's fields and could materially adversely affect our business, results of operations, financial condition or prospects.

With respect to our energy business, should the process of power market liberalisation continue, price levels in the free market for power will have a direct and potentially more significant impact on the revenues and profitability of Bashkirenergo. If free-market prices for power are not sufficient to cover the costs of Bashkirenergo, our business, results of operations, financial condition or prospects may be materially adversely affected.

- *Unexpectedly long scheduled repair and maintenance shutdowns or unscheduled shutdowns at Bashneft's production facilities could disrupt its business. In addition, as refining margins are volatile, it is possible that periods of expected low refining margins during which Bashneft undertakes scheduled turnarounds could turn out to be high margin periods.*

Bashneft needs to carry out regular maintenance at its refineries at least every four years. During these maintenance shutdowns, Bashneft makes necessary repairs, performs preventative maintenance, replaces catalysts and implements capital improvements. These shutdowns vary in duration depending on the complexity of the work to be performed, but typically last between two to four weeks and require the complete stoppage of Bashneft's refinery operations. In addition, portions of Bashneft's production facilities may be shut down for shorter periods to perform more limited maintenance. Although Bashneft attempts to schedule shutdowns during periods of low refining margins, usually during the spring months, it is possible that the production units at Bashneft's refineries may be shut down during high margin periods as a result of, for example, weather patterns, the volatility and unpredictability of refining margins or scheduled shutdowns taking longer to complete than expected. Furthermore, should Bashneft's production units be damaged for any reason or should Bashneft experience any disruption in its electricity or feedstock supplies, Bashneft may need to shutdown its facilities the production units at Bashneft's refineries outside the normal period for scheduled shutdowns. Planned shutdowns that last longer than expected or that occur during high margin periods or unplanned shutdowns may have a material adverse effect on our business, results of operations, financial condition or prospects.

- *Prices for refined products in the Russian market may be subject to government control.*

While prices in the Russian Federation for refined products are generally determined by the market, occasionally they may still be subject to government control. Furthermore, Russian oil companies may, from time to time, be

subject to political pressure to reduce domestic refined product prices. Accordingly, Bashneft cannot be certain that governmental price controls will not be implemented for political or other reasons. Should the government introduce price controls on Bashneft's domestic sales, there can be no assurance that Bashneft would be able to adjust its sales in favour of exports, or take other effective measures, to offset the effects of the price controls. This, in turn, may have a material adverse effect on our business, results of operations, financial condition or prospects.

- *The crude oil reserves data in this Prospectus are only estimates and Bashneft's actual production, revenues and expenditures with respect to its reserves may differ materially from these estimates.*

The information concerning Bashneft's crude oil reserves as at 31 December 2011 included in this Prospectus has been prepared in accordance with the definitions contained in the SEC Standards at that time and has been primarily derived or extracted from the 31 December 2011 report of Miller and Lents.

Data relating to the Trebs and Titov fields are presented based on Russian standards, which are not comparable to SEC Standards.

Petroleum engineering is a subjective process of estimating underground accumulations of oil and gas that cannot be measured in an exact manner. Estimates of the value and quantity of economically recoverable oil reserves, rates of production, future net revenues and the timing of development expenditures are based on existing economic and operating conditions using prices and costs as at the date the estimate is made. In addition, estimates necessarily depend upon a number of variable factors and assumptions, including the following:

- historical production from the area compared with production from other comparable producing areas;
- interpretation of geological and geophysical data; and
- the assumed effects of regulations by governmental agencies.

Because all reserves estimates are subjective, each of the following items may differ materially from those assumed in estimating reserves:

- the quantities of oil that are ultimately recovered;
- the production and operating costs incurred;
- the amount and timing of future development expenditures; and
- oil prices.

Many of the factors, assumptions and variables involved in estimating reserves are beyond Bashneft's control and may prove to be incorrect over time. Results of drilling, testing and production after the date of the estimates may require substantial upward or downward revisions in Bashneft's reserves data. Furthermore, different reservoir engineers may make different estimates of reserves and cash flows based on the same available data. Actual production, revenues and expenditures with respect to reserves will vary from estimates and the variances may be material. Any downward adjustment could lead to lower future production and, thus, materially adversely affect our business, results of operations, financial condition or prospects.

Additionally, in estimating Bashneft's proved oil reserves, Bashneft has assumed that the production licences for its Russian fields would be renewed and the fields would be produced until the economic limit of production is reached. If any production licences for its Russian fields are not renewed, Bashneft's estimated oil reserves may materially decrease.

- *Bashneft and Bashkirenergo are dependent upon the services provided by, and the assets and infrastructure of, third parties.*

All of the crude oil produced by Bashneft is currently transported through the OAO AK Transneft ("Transneft") pipeline system. Transneft is a Russian state-owned pipeline monopoly. Although Transneft has generally avoided serious disruptions in the transport of crude oil by using multiple pipelines and, to date, Bashneft has not suffered significant losses arising from the failure of the pipeline system, much of the Transneft-operated pipeline is over ten years old, with certain parts having been constructed over 40 years ago. Furthermore, much of the Transneft-operated pipeline is located in regions with harsh climates where construction, maintenance and refurbishment are difficult and costly. As a result, the Transneft pipeline system may experience outages or capacity constraints during required maintenance periods and it is likely that maintenance work will increase in the future. During these maintenance periods, Bashneft may experience delays in or be prevented from

transporting crude oil through the Transneft pipeline system. These delays, outages or capacity constraints could have a material adverse effect on our business, results of operations, financial condition or prospects. Bashneft, along with all other Russian oil producers, must pay transportation fees to Transneft in order to transport its crude oil through the Transneft network. The FTS is responsible for setting Transneft's tariffs on a "cost plus" basis to recover Transneft's operating, pipeline construction and other costs. Although Transneft's tariffs are set annually, the Russian regulatory system permits Transneft to apply to the FTS for the revision of tariffs in case of an increase of Transneft's costs that were not factored into the regular annual tariff calculation. From 2006 to 2009, the FTS revised Transneft's tariffs twice a year.

The Russian government and its agencies regulate access to Transneft's pipeline network and is required to provide access on a non-discriminatory basis.

Pursuant to Federal Law No. 147 FZ "On Natural Monopolies" dated 17 August 1995, as amended (the "**Natural Monopolies Law**"), the Ministry of Energy, based on information provided by Transneft and oil producers, allocates access to Transneft's pipeline network and sea terminal capacity to oil producers on a quarterly basis, generally in proportion to the amount of crude oil produced and delivered to Transneft's pipeline network in the prior quarter. Each producer's export quota via the Transneft system is generally set at about 40% of the producer's total oil throughput in Transneft's pipeline during the previous quarter.

In recent years, constraints on access to the export pipelines, the ability of producers to export crude oil and the use of port, shipping and railway facilities have eased. Recent upgrades of ports not controlled by Transneft, increase in the railways' capacity to transport crude oil and the opening of new pipeline capacity via the Baltic Pipeline System to the Transneft-controlled port of Primorsk and the East Siberia-Pacific Ocean Pipeline have all enabled oil companies to export crude oil with greater flexibility. However, Bashneft has no control over its access to Transneft's pipeline network as access and export quotas are determined by the Russian government.

Transneft has a very limited ability to transport individual batches of crude oil, which results in the blending of crude oil of differing qualities. Transneft does not currently operate a "quality bank" system. Under a quality bank system, oil companies that supply lower-quality (heavy and sour) crude oil to the system pay more for the use of pipelines than those who supply higher-quality crude oil. Alternatively, suppliers of lower-quality crude oil might directly compensate suppliers of higher-quality crude oil for the deterioration in crude quality due to blending. Although Transneft and the Russian government are currently discussing the introduction of a quality bank for the Transneft system, such proposals generally meet with resistance from producers with lower-quality reserves, as well as regional authorities where such reserves are located.

In addition, access to the Transneft pipeline may be disrupted as a result of lawsuits. In 2001, a Russian court enjoined Transneft from accepting shipments of crude oil from a Russian oil company in response to a lawsuit by one of that company's minority shareholders. In 2002, Russian courts on several occasions granted similar requests in lawsuits against other Russian companies. Although such rulings were overturned quickly, there can be no assurance that similar lawsuits will not be brought in the future. Any operational disruption in the Transneft pipeline system, or any failure by Bashneft to obtain or maintain access to the Transneft pipeline system at commercially reasonable tariffs or at all, could prevent or inhibit Bashneft from fully exploiting its reserves or shipping its crude oil, and increase its costs. Any one or more of such factors could materially adversely affect our business, results of operations, financial condition or prospects.

Bashneft's reliance on pipeline transport also exposes it to risks, such as potential delivery disruptions, due to ageing infrastructure or other reasons. To date, Bashneft has not experienced material disruptions in the receipt of crude oil or the transport of oil products through Transneft's pipeline network. However, as with any such pipeline system, the Transneft pipeline system is subject to breakdowns and leakage. Despite ongoing efforts on the part of Transneft to decommission and replace obsolete segments of the pipeline, parts of the pipeline system may require reconstruction and replacement due to their age. Much of the Transneft-operated pipeline system is over ten years old, with certain parts having been constructed over 40 years ago, and much of the system is located in regions with harsh climates where construction, maintenance and refurbishment are difficult and costly. As a result, the Transneft-operated system has experienced and may continue to experience outages or capacity constraints during required maintenance periods, and it is likely that maintenance work will increase in the future. Transneft prepares a maintenance program on an annual basis, and unscheduled maintenance work is rare. More generally, Bashneft may experience capacity constraints in the future, especially with respect to the transport of Euro-5 compliant diesel fuel and motor gasoline. Should Transneft fail to carry out the modifications on a timely basis or at all, Bashneft may be unable to deliver Euro-5 compliant products to market or be forced to use more costly means to deliver such products to market, and therefore may be subject to lost profits.

Any operational disruption in the Transneft pipeline system, and any failure by Bashneft or its crude-oil suppliers to obtain or maintain access to the Transneft pipeline system at commercially reasonable tariffs or at all, could prevent Bashneft from producing or shipping its oil products, or increase its costs. Any one or more of such factors could materially adversely affect our business, results of operations, financial condition or prospects.

Furthermore, the business of Bashkirenergo relating to the sale of electricity on the wholesale market is or may be to a significant extent dependent upon services provided by third parties, including, in particular, the System Operator (for administration of regional dispatch services), the Trade System Administrator (for management of the trading system within the wholesale market) and its subsidiary CJSC Financial Settlements Centre. For example, the System Operator is responsible for the allocation of loads to power stations, on the basis of several criteria, including, in particular, technical characteristics and price. As a result, in the event that Bashkirenergo becomes less competitive in relation to other producers, including as a result of a failure to modernise Bashkirenergo's plants or the construction of new facilities by its competitors, Bashkirenergo's ability to utilise its capacity may be restricted, which could have a material adverse effect on our business, results of operations, financial condition or prospects.

- *Reform of the Russian wholesale electricity market, price liberalisation and tariff regulation in the heat and electricity industry are associated with a number of risks that may materially adversely affect our energy business.*

In 2001, the Russian government embarked on a large-scale power sector reform with the aim of creating a competitive and sustainable power industry. Subsequently, from 2001 to 2008, the Russian electricity industry underwent significant restructuring intended to: (i) reform the market structure; (ii) liberalise the competitive segments of the power sector, including power generation, electricity supply and ancillary services (e.g., repair services); and (iii) improve regulatory pricing for non-competitive segments of the power sector. Although the most significant changes to the regulatory structure of the power industry occurred from 2001 to 2008, additional reforms have continued into 2011. See *“Regulatory Overview—Regulation of the electric power industry in the Russian Federation—Russian Electric Power Industry Reform.”*

The current regulatory regime contemplates that there will be a gradual expansion of the competitive segment of the Russian electricity and electricity capacity markets, and consequently, a reduction in the portion of the market that is subject to tariff regulation. This reform provides for the development of a fully liberalised market for electricity generation, in which electricity and electricity capacity prices will be established on the basis of supply and demand, subject to exceptions which allow for an increase in competitively set electricity capacity tariffs to fund certain permitted investments. The current process of liberalisation does not extend to the retail electricity market or to the wholesale market in the Republic of Komi, Arkhangelsk and Kaliningrad Regions and certain regions of the Far East, which remain subject to regulated tariffs, nor does it currently contemplate the creation of a free market for transmission, distribution and dispatch services.

The reform has also led to the break-up of the Unified Energy System of Russia (“**RAO UESR**”), previously the largest state-controlled power holding company, and certain other power companies into the following separate businesses: electricity generation; transmission and distribution; the sale of electricity to retail customers; and repairs and servicing. Generation, sales and repair companies now engage in competition with each other.

As part of the reform process, the rules governing the Russian power market, including the rules related to market liberalisation, the determination of tariffs for electricity and electricity capacity, the operation of the capacity market and the framework for relations between power generators and consumers have all undergone significant change. As a result, the Russian power market has changed significantly but continues to operate in conditions of relative uncertainty. Bashkirenergo may, therefore, be subject to a large number of operational, business, technical, managerial, regulatory and other risks, which are currently difficult or impossible to predict and which are not within its control. In addition, regulated tariff setting will continue to apply to certain markets and regions in which Bashkirenergo operates and no assurance can be given that social and other factors will cause such tariffs to be set at rates that are adequate to cover the fixed expenses of Bashkirenergo's heat and power plants. The changes described above and the uncertainty associated with them may have a material adverse effect on our business, results of operations, financial condition or prospects.

In addition, the electricity capacity market in the Russian Federation may not operate in a manner that allows Bashkirenergo to receive adequate returns on its investments. The framework for gradual wholesale electricity market liberalisation was established by the new wholesale market rules which were adopted in August 2006 and amended in 2007 (the “**New Wholesale Market Rules**”). Under these rules, capacity and electricity are treated

as separate economic products. Under the New Wholesale Market Rules, both electricity and capacity are sold under Regulated Contracts and in certain unregulated markets. Since the volume of electricity and capacity covered by Regulated Contracts was steadily reduced, such contracts ceased to be applicable from 1 January 2011, subject to certain limited exceptions.

Starting from 1 January 2011, Regulated Contracts in wholesale market prices zones may only be concluded for the supply of electricity and capacity to the population, to consumer groups equated to the population, as well as last-resort suppliers operating in the North Caucasia republics, the Tyva Republic and the Republic of Buryatia. Electricity volumes not covered by Regulated Contracts are sold at non-regulated prices, and a long-term capacity market has come into effect. Marginal pricing is to be applied to this long-term capacity market within the zones of free flow of capacity (zones in which the capacity of one power generator can be replaced with the capacity produced by another power generator in the same zone or in another zone with certain limitations). If the new electricity capacity market mechanism fails to enable Bashkirenergo to receive adequate returns on its investments in new electricity generation capacity, our business, results of operations, financial condition or prospects may be materially adversely affected.

In January 2012, the process of price liberalisation was somewhat interrupted when Federal Law No. 401-FZ on Amendments to the Federal Law on Protection of Competition and Certain Legislative Acts of the Russian Federation and Federal Law No. 404-FZ on Amendments to the Code of Administrative Offenses of the Russian Federation (the “**Third Antimonopoly Package**”) came into effect. The Third Antimonopoly Package introduced a definition of price manipulation on the wholesale market for electricity/capacity by way of an amendment of Article 3 of Federal Law No. 35-FZ “On Electric Power Industry” dated 26 March 2003, as amended (the “**Electric Power Industry Law**”). Moreover, the Third Antimonopoly Package provides that agreements resulting in price manipulation on the wholesale and/or retail markets for electricity/capacity between wholesale and/or retail vendors or buyers of electricity/capacity are prohibited, with the exception of certain limited circumstances. It is not yet clear, however, how the new antimonopoly rules will be implemented.

Since a liberalised electricity market is relatively new to the Russian Federation and the latest antimonopoly regulations may limit the trend towards greater liberalisation, it is difficult to predict future price levels for electricity, and there is no guarantee that such price levels will increase. Moreover, such liberalisation may be completely suspended or reversed, and existing and future tariff regulations applicable to the Russian power industry may result in a tariff system that inadequately compensates Bashkirenergo for its cost base, which could materially adversely affect our business, results of operations, financial condition or prospects. We expect regulation of the Russian electricity industry to continue to evolve, and will continue to monitor the situation and participate in the development of the system to the extent we are in a position to do so.

- *Bashkirenergo’s transmission assets may not be able to address daily, seasonal or yearly fluctuations in demand for electricity, which may adversely affect Bashkirenergo’s business and operations.*

The demand for electricity may vary significantly on a daily, seasonal and yearly basis due to weather conditions and other factors. Demand for electricity is usually higher during the period from October to March due to longer nights and colder weather, and it is generally lower in the period from April to September due to longer days and warmer weather. In addition, demand for electricity is usually higher during normal business hours during the day and for a longer duration during the period from October to March due to fewer daylight hours. Demand may also fluctuate from year to year due to changes in weather patterns. Therefore, Bashkirenergo’s transmission capacities may be fully utilised during certain parts of the day or during certain months, and under-utilised during other parts of the day and year. Accordingly, the expenses may fluctuate based on the above electricity demand and weather patterns. Further, due to daily and seasonal fluctuations in electricity demand, Bashkirenergo’s transmission assets may be overutilised leading to temporary inability to supply adequate amounts of electricity to selected regions and potential blackouts, which could have a material adverse effect on our business, results of operations, financial condition or prospects.

Risks Relating to the Russian Federation and Other Emerging Markets

A significant part of our business is carried out in the Russian Federation. Nevertheless, our subsidiaries also maintain operations in other emerging markets. For example, MTS operates in Ukraine, Uzbekistan, Armenia and Belarus and SSTL operates in India. Because a substantial amount of our assets are located in the Russian Federation, we face significant risks specific to the Russian Federation. Similar risks, common to most emerging markets, also exist in Ukraine, Uzbekistan, Armenia, Belarus and India.

Economic Risks

- *The instability of the global and the Russian economies and financial markets could have a material adverse effect on our business, results of operations, financial condition or prospects.*

The majority of our assets and customers are located in, or have businesses related to, the Russian Federation. As a result, we are substantially affected by the health of the Russian economy, which is, to a significant degree, dependent on exports of key commodities, such as oil, gas and other raw materials.

The Russian economy, for example, was adversely affected by the global economic crisis that began in the second half of 2008. The crisis manifested itself through extreme volatility in debt and equity markets, reductions in foreign investment and sharp decreases in GDP around the world. The impact of the global financial crisis on the Russian economy led to, among other things, several suspensions of trading on the MICEX Stock Exchange and RTS Stock Exchange by market regulators, a sharp fall in government revenues, a reduction in the disposable income of the general population, a crisis of bank liquidity, rouble depreciation against the U.S. dollar and euro, a sharp decrease in industrial production and a rise in unemployment.

In addition, the strength of the Russian Federation's economy, and to a considerable extent, the Russian Federation's budget, is tied to international oil and gas prices. Beginning with the onset of the global economic crisis in the second half of 2008, oil and gas prices have fluctuated sharply. In 2008, for example, the average price per barrel of Urals oil was U.S.\$94.37, which fell to U.S.\$60.89 in 2009, before rising to U.S.\$78.20 in 2010 and U.S.\$109.33 in 2011. International natural gas prices have likewise fluctuated in recent years. The increase in these prices is generally a positive development for the Russian budget. Nevertheless, should these prices continue to fluctuate, and, in particular, experience a sustained decrease, the Russian economy may experience another downturn.

Bank lending, together with world equity and debt markets, has been negatively affected by the sovereign debt crisis and credit crunch in the European Union. The default, or a significant decline in the credit rating, of one or more sovereigns or financial institutions could cause severe stress in the financial system generally and could adversely affect our access to creditors or other counterparties, directly or indirectly, in ways which are difficult to predict. In October 2011, Moody's Investor Services, Inc. ("**Moody's**"), the international rating agency, adjusted its ratings outlook for the Russian banking system from "stable" to "negative." The change reflected concerns that market volatility was weakening the Russian Federation's operating environment, which could potentially negatively affect Russian banks through a system-wide liquidity contraction, slower credit growth and pressured asset quality over 12 to 18 months from the outlook adjustment date. In January 2012, Fitch Ratings Ltd. lowered its credit rating of the Russian Federation from positive to stable based on perceived increased political uncertainty and the global economic outlook. The bankruptcy or insolvency of one or more of the banks in which we hold our funds could prevent us from accessing our funds for several days or affect our ability to complete banking transactions in the Russian Federation, which may result in the loss of our deposits altogether or may impact our ability to arrange debt financing.

Any future deterioration of the economic situation in the world, including the Russian Federation, may disrupt our ability to conduct our operations effectively, which could have a material adverse effect on our business, results of operations, financial condition or prospects.

In addition, a deterioration in macroeconomic conditions could require us to reassess the value of goodwill on certain of our assets, recorded as a difference between the fair value of assets acquired and their purchase price. This goodwill is subject to impairment tests on an ongoing basis. The weak macroeconomic conditions in many of the countries in which we operate and/or a significant difference between the performance of an acquired company and the business case assumed at the time of acquisition could require us to write down the value of the goodwill or portion of such value. Future write downs relating to the value of the goodwill or portion of such value could have a material adverse effect on our business, results of operations, financial condition or prospects.

- *Inflation could increase our costs.*

The Russian economy has been characterised by high rates of inflation. According to the Federal State Statistics Service ("**Rosstat**"), the annual inflation rate in the Russian Federation was approximately 8.8% in 2009, 8.8% in 2010 and 6.1% in 2011, as measured by the consumer price index. Rates based on the producer price inflation index were even higher, equalling 13.9% in 2009, 16.7% in 2010 and 12.0% in 2011. Many of our costs, including, for example, salaries and utility costs, are sensitive to rises in the general price level in the Russian Federation. An increase in inflation, therefore, could increase certain of our costs and thereby exert downward

pressure on our profit margin and may also negatively impact domestic demand for the products of our subsidiaries. There can be no assurance that we will be able to maintain or increase our margins commensurately in order to offset such increases. See “*Management’s Discussion and Analysis of Financial Condition and Results of Operations—Key Factors Affecting Our Results of Operations—Inflation.*”

- *Depreciation of the rouble against the U.S. dollar and euro could increase our costs and reduce our revenues, or make it more difficult for us to comply with financial ratios and to repay our debts.*

Most of our operations are in roubles, and a significant part of our capital expenditures and borrowing costs, including those of MTS and Bashneft, are denominated in foreign currency, including the U.S. dollar, the euro, and, with respect to SSTL, the Indian rupee, or tightly linked to the U.S. dollar.

The depreciation of the rouble against the U.S. dollar or the euro would likely have an overall negative effect on our financial position, notwithstanding the fact that a significant share of Bashneft’s revenues are linked to the U.S. dollar, as it would lead to an increase in the rouble equivalent of our borrowings and associated costs denominated in U.S. dollars and euros. Depreciation of the rouble against the U.S. dollar would also increase our costs denominated in roubles, both in absolute terms and relative to rouble-denominated revenues. Rouble depreciation would also subject our investments in rouble-denominated monetary assets to the risk of loss in U.S. dollar terms and may also make it more difficult to comply with financial ratios or timely fund cash payments on indebtedness. While we could seek to raise our prices and tariffs to compensate for the increase in costs resulting from depreciation of the rouble, competitive pressures may not permit increases that are sufficient to preserve our operating margins. In addition, a decline in the value of the rouble against the U.S. dollar will also result in a translation loss when we translate our rouble revenues into U.S. dollars for inclusion in our audited consolidated financial statements.

The rouble’s value has stabilised in recent years, although it declined considerably during the global financial crisis. For example, the average rouble/U.S. dollar exchange rate in 2008 was 24.98, compared to 31.93 in 2009, and the average rouble/euro exchange rate in 2008 was 36.41, compared to 44.13 in 2009. This depreciation of the rouble had a negative effect on our financial condition, and a similar depreciation of the rouble in the future could likewise have a material adverse effect on our business, results of operations, financial condition or prospects.

- *Exchange controls and repatriation restrictions could adversely affect our ability to transact business and may lower the value of our investments in the Russian Federation.*

Notwithstanding significant liberalisation of the Russian currency control regime and the abolishment of certain restrictions from 1 January 2007, Federal Law No. 173-FZ “On Currency Regulation and Currency Control” dated 10 December 2003, as amended, and current regulations still contain a number of limitations on foreign currency operations. For example, several restrictions still exist, designed, in part, to support the stability of the Russian Federation’s balance of payments. In addition, Russian residents must post-notify the Russian tax authorities after they open accounts in foreign banks.

Currency regulations established by the CBR restrict investments by Russian companies outside the Russian Federation and in most hard-currency denominated instruments in the Russian Federation, and there are only a limited number of rouble denominated instruments in which we may invest our excess cash. Additionally, subject to certain exceptions, Russian companies must repatriate 100% of their offshore foreign currency earnings to the Russian Federation. In 2005, Russian companies were required to convert 10% of those earnings into roubles within seven days of receipt. While this conversion requirement was abolished in April 2006, Russian legislation allowed the CBR to reinstate the conversion requirement in any amount up to 30% until liberalisation in 2007. Current Russian legislation does not provide for any conversation requirements to the offshore foreign currency earnings.

Furthermore, the rouble remains largely non-convertible outside of the Russian Federation. A market exists within the Russian Federation for the conversion of roubles into other currencies, but it is limited in size and is subject to rules limiting such conversion.

Any delay or other difficulty in converting roubles into a foreign currency to make a payment or delay in or restriction on 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, results of operations, financial condition or prospects.

Additionally, the introduction of further limitations on currency operations or repatriation requirements in the future could also have a material adverse effect on our business, results of operations, financial condition or prospects.

- *We could experience disruptions in our normal business activities as a result of problems associated with the Russian Federation's physical infrastructure.*

Much of the Russian Federation's physical infrastructure dates back to Soviet times and has not been adequately funded, maintained or developed over the past decades. Particularly affected are the rail, road and pipeline networks, power generation and transmission infrastructure, communication systems and buildings. Road conditions throughout the Russian Federation are poor, with many roads not meeting minimum quality requirements. The country's pipeline network is also in need of modernisation and expansion. Power disruptions also periodically occur. For example, in August 2009, an accident occurred at the Sayano-Shushenskaya Hydroelectric Power Plant, the largest hydro power plant in the Russian Federation in terms of installed capacity, when water from the Yenisei River flooded the turbine and transformer rooms at the power plant's dam killing more than 70 people and causing billions of roubles in damage. As a result of the accident, the plant halted power production, leading to severe power shortages for both residential and industrial consumers.

The poor condition or further deterioration of the Russian Federation's physical infrastructure may harm the national economy, disrupt the transportation of goods and supplies, add costs to doing business in the Russian Federation and interrupt business operations, all of which may have a material adverse effect on our business, results of operations, financial condition or prospects.

Political and Social Risks

- *Political and governmental instability or changes in government lead to a deterioration in the Russian Federation's investment climate and may make it more costly for us to conduct our business.*

Future political instability and any significant struggle over the direction of future political developments could lead to increased capital flight and an overall deterioration in the Russian Federation's investment climate. The Russian political system remains vulnerable to popular dissatisfaction, as well as to unrest by certain social and ethnic groups. For example, following the Russian parliamentary elections in December 2011, controversy surrounding alleged voter fraud led to organised protests in several Russian cities, including several in Moscow that were attended by tens of thousands of people.

Sustained political instability, including after the inauguration of the current President, Vladimir Putin, or unexpected changes in the government or in the reform process may constrain our ability to obtain financing in the international capital markets, limit the sales of our subsidiaries in the Russian Federation or otherwise have a negative adverse effect on our business, results of operations, financial condition or prospects.

- *Unlawful, selective or arbitrary government action could create a difficult business climate in the Russian Federation.*

Russian regulatory authorities have a high degree of discretion and at times appear to exercise their discretion selectively, without hearing or prior notice. Selective governmental actions have reportedly included denial or withdrawal of licences, sudden and unexpected tax audits, criminal prosecutions and civil actions. Federal and local government entities have also used common 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. We may from time to time be required to grant law enforcement authorities conducting investigations or regulatory inspections access to users' personal data, mailboxes and other account information. Finally, the possibility of unlawful, selective or arbitrary government action also enhances opportunities for official corruption, which is widely reported to be very high in the Russian Federation.

The use of governmental power against particular companies or persons, for example through tax, environmental or prosecutorial authorities, could adversely affect the Russian Federation's economic climate. Russian authorities have recently challenged some Russian companies and prosecuted their executive officers and shareholders on tax evasion and related charges. In some cases, the results of such prosecutions and challenges have been significant claims against companies for unpaid taxes and the imposition of prison sentences on individuals. If the use of such government power is directed against us, it could have a material adverse effect on our business, results of operations, financial condition or prospects.

- *Terrorist attacks or the involvement of the Russian Federation in any future economic and military conflicts could lead to instability and hinder our planning ability.*

Over the last several years, the Russian Federation has been involved in conflicts, both economic and military, with other countries, including former members of the Soviet Union. On several occasions, this has resulted in the deterioration of the Russian Federation's relations with other members of the international community, including the United States and various countries in Europe. For example, a military conflict in August 2008 between the Russian Federation and Georgia resulted in the deterioration of the Russian Federation's relations with certain other countries. The Russian stock exchanges experienced heightened volatility and significant overall price declines following these events. The emergence of new or escalated tensions between the Russian Federation and other countries, including any escalation of such conflicts, or the imposition of economic or other sanctions in response to the tensions, could negatively affect economies in the region, including the Russian economy. In addition, ethnic, religious, historical and other divisions have, on occasion, given rise to tensions and, in certain cases, military conflict and terrorist attacks. For example, the conflict in Chechnya brought normal economic activity within Chechnya to a halt for a period of time and also had a negative effect on the economic and political situation in neighbouring regions. Violence and attacks relating to the conflicts in the North Caucasus region also spread to other parts of the Russian Federation and resulted in terrorist attacks in Moscow and in various other places in the Russian Federation. For example, on 24 January 2011, a terrorist attack at one of Moscow's busiest international airports resulted in numerous casualties and led to declines in Russian stock market indices. In the future, such tensions, military conflicts or terrorist activities could have significant economic and political consequences in the Russian Federation, including the imposition of a state of emergency in some or all regions of the Russian Federation, and may consequently have a material adverse effect on our business, results of operations, financial condition or prospects.

- *Organised crime, fraud, corruption and social instability could create an uncertain operating environment for us and make it more costly to conduct business.*

Levels of organised criminal activity continue to be significant in the Russian Federation. The Russian and international press have reported high levels of corruption in the Russian Federation, including the bribery of officials. Additionally, published reports indicate that a significant number of Russian media regularly publish biased articles in exchange for payment. Our reputation, business, financial condition, results of operation, financial condition or prospects could be materially adversely affected by illegal activities and corruption or by claims implicating us in the involvement of illegal activities.

Social instability in the Russian Federation, coupled with difficult economic conditions and the failure of salaries and benefits generally to keep pace with the rapidly increasing cost of living, have led in the past to labour and social unrest (principally in urban areas). The rising level of unemployment and deteriorating standards of living in the Russian Federation that were principally caused by the global financial and economic crisis make labour and social unrest more likely in the future. Such labour and social unrest may have political, social and economic consequences, such as increased support for a renewal of centralised authority, increased nationalism, including restrictions on foreign involvement in the Russian economy and increased violence, and the expropriation of property without fair compensation. Any of these events could material adversely affect our business, financial condition, results of operations or prospects.

- *Conflicts between Russian federal and regional authorities and legislation could create an uncertain operating environment for us.*

The Russian Federation is currently a federation of various sub-federal political units. Some of these political units exercise considerable autonomy over their internal affairs pursuant to agreements with the federal authorities. In practice, the division of authority between federal and regional authorities, in certain instances, remains uncertain and contested, which may lead to disputes over the power to levy and collect taxes and other regulatory authority. This uncertainty could hinder our long-term planning efforts and may create uncertainties in our operating environment, any of which may prevent us from effectively and efficiently carrying out our business strategy.

Legal Risks and Uncertainties

- *Weaknesses relating to the legal system and legislation create an uncertain environment for investment and business activity.*

Risks associated with the Russian legal system include, to varying degrees, the following:

- inconsistencies among, and ambiguities and anomalies regarding: (i) federal laws; (ii) decrees, orders and regulations issued by the President, the government and federal ministers; and (iii) regional and

local laws, rules and regulations (See “—*Political and Social Risks—Conflicts between Russian federal and regional authorities and legislation could create an uncertain operating environment for us,*” above);

- a lack of judicial and administrative guidance on interpreting the laws as well as a lack of sufficient commentaries on judicial rulings and legislation;
- the relative unavailability of Russian legislation and court and administrative decisions in an organised manner that facilitates understanding of such legislation and court decisions;
- the relative inexperience of lawyers, judges and courts in interpreting newly-adopted legislation, complex commercial arrangements and many aspects of business and corporate law;
- substantial gaps in the legal framework due to the delay or absence of implementing regulations for certain legislation;
- the untested nature of the enforceability and underlying constitutionality of recently enacted law;
- a lack of judicial independence from political, social and commercial forces;
- alleged corruption within the judiciary and the governmental authorities;
- problematic, time-consuming and unpredictable enforcement of both Russian and non-Russian judicial orders and international arbitration awards;
- ambiguous and inconsistent court practice with regard to interlocutory remedies that may disrupt our ordinary business activities;
- a certain degree of discretion on the part of governmental authorities, leaving significant opportunities for arbitrary and capricious government action; and
- bankruptcy procedures that are not well-developed and are subject to abuse.

These risks, many of which do not exist to the same extent in countries with more developed market economies, could affect our ability to enforce our legal rights in the Russian Federation or to defend against claims by others in the Russian Federation and may have a material adverse effect on our business, results of operations, financial condition or prospects. These risks could also affect the ability of holders of Notes to obtain effective redress in Russian courts.

- *Lack of developed corporate and securities laws and regulations in the Russian Federation may limit our ability to attract future investment.*

Corporate governance standards in the Russian Federation are not as high as those in Western Europe and the United States, and there are fewer protections for investors than would otherwise be the case in member states of the European Union or in the United States.

The regulation and supervision of the securities markets, financial intermediaries and issuers are considerably less developed in the Russian Federation than in more developed countries. Securities laws, including those relating to corporate governance, disclosure and reporting requirements, have only recently been adopted in the Russian Federation, whereas laws relating to anti-fraud safeguards and fiduciary duties are rudimentary. In addition, the Russian securities markets are regulated by several different authorities, which are often in competition with each other. These include the FSFM, the Russian Ministry of Finance, the FAS, the CBR, and various professional self-regulatory organisations. Rules and regulations of these various authorities are not always consistent with each other and may be contradictory. In addition, Russian corporate and securities rules and regulations can change rapidly. Any of these factors may disrupt our ability to conduct securities transactions in the Russian Federation in the future, which, in turn, may have a material adverse effect on our business, results of operations, financial condition or prospects.

- *The new customs code among the Russian Federation, Belarus and Kazakhstan may adversely affect our business and financial condition.*

The Russian Federation, Belarus and Kazakhstan have worked together to create a customs union and single economic space among the three nations. In pursuit of this goal, they concluded several agreements unifying customs tariff and non-tariff regulations among the three nations, which came into force on 1 January 2010. On 1 July 2010, a new customs code came into effect that is expected to harmonise customs procedures among the

Russian Federation, Belarus and Kazakhstan. The process of finalising customs integration among the three parties is expected to continue through 2012. Because the customs procedures are new, untested and vaguely drafted, it is unclear to what extent they will impact our business.

- *It is not yet clear how the Strategic Foreign Investment Law will affect us and our foreign shareholders.*

On 7 May 2008, Federal Law No. 57-FZ “On the Procedure for Making Foreign Investments in Commercial Entities Having Strategic Importance for the National Defence and State Security” dated 29 April 2008 (the “**Strategic Foreign Investment Law**”), came into force in the Russian Federation. This law sets forth certain restrictions relating to foreign investments in Russian companies of “strategic importance.” According to the Strategic Foreign Investment Law, a company is considered to be of “strategic importance” to the national defence and security of the Russian Federation, if (i) it is included in the register of natural monopolies, with certain exceptions, (ii) it holds a dominant position in the market for communication services in the Russian Federation or in the market for fixed line communication services in five or more regions of the Russian Federation and/or in cities of federal importance; or (iii) it is involved in the geological exploration of subsoil plots and/or the production of natural resources on subsoil plots of federal significance. Foreign investments in such companies are subject to regulations and restrictions set out by the Strategic Foreign Investment Law.

Starting from the effective date of the Strategic Foreign Investment Law, a foreign investor seeking to obtain direct or indirect control over a strategically important company is required to have the respective transaction pre-approved by an authorised governmental agency. In addition, foreign investors are required to notify this authorised governmental agency about any transactions undertaken by them resulting in the acquisition of 5% or more of the charter capital of strategically important companies. Within 180 days from the effective date of the Strategic Foreign Investment Law, foreign investors having 5% or more of the charter capital of strategically important companies are required to notify the authorised governmental agency about their current shareholding in such companies. See “*Regulatory Overview—Foreign Investment in Strategic Enterprises.*”

As some of our subsidiaries, including, among others, Bashneft and RTI, are classified as strategically important companies, our current and future foreign investors are subject to the notification requirements described above and our current and potential investors may be limited in their ability to acquire a controlling stake in, or otherwise gain control over, such companies. Such increase in governmental control or limitation on foreign investment could impair the value of your investment and could hinder our access to additional capital. In addition, the Strategic Foreign Investment Law contemplates the adoption of a number of implementing regulations. It is currently unclear how these regulations will affect us and our foreign shareholders.

- *The accession of the Russian Federation into the World Trade Organisation may lead to uncertain legislative and other changes in our operating environment.*

On 16 December 2011, the Russian Federation signed the accession protocol in order to enter into the World Trade Organisation (“WTO”) which may lead to significant changes in Russian legislation including, among others, regulation of foreign investments in Russian companies, competition laws, as well as changes in the taxation system and customs regulations in the Russian Federation. In addition, implementation of the WTO rules may lead to the increase of competition on the markets in which we operate. It is unclear yet if and when these legislative developments may take place. However, if the new legislation is implemented in the Russian Federation as a result of accession to the WTO and there is an increase in competition, this could have a material adverse effect on our business, results of operations, financial condition or prospects.

- *Shareholder rights provisions under Russian law may impose additional costs on us.*

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

- a reorganisation;
- the execution of a “major transaction” that involves property worth more than 50% of the book value of assets of the company, calculated in accordance with RAS; and
- the amendment of a company’s charter or adoption of a new version thereof in a manner limiting shareholder rights.

Our obligation to purchase shares in these circumstances, which is limited to 10% of our net assets, calculated according to RAS at the time the matter at issue is voted upon, could have a material adverse effect on our cash flow and ability to service our indebtedness.

- *Shareholder liability under Russian corporate law could result in us becoming liable for the obligations of our subsidiaries.*

Russian law generally provides that shareholders in a Russian joint stock company or participants in a limited liability company are not liable for the obligations of such a company and bear only the risk of loss of their investment. This may not be the case, however, when one legal entity is capable of determining decisions made by another entity. The legal entity capable of determining such decisions is called the effective parent (“osnovnoye obshchestvo” in Russian). The legal entity whose decisions are capable of being so determined is called the effective subsidiary (“docherneye obshchestvo” in Russian). The effective parent bears joint and several liability for transactions entered into by the effective subsidiary in carrying out business decisions if:

- the effective parent gives binding instructions to the effective subsidiary; and
- the right of the effective parent to give binding instructions is set forth in the charter of the effective subsidiary or in a contract between such entities.

Moreover, under Russian law, an effective parent is secondarily liable for an effective subsidiary’s debts if an effective subsidiary becomes insolvent or bankrupt as a result of the action of an effective parent. In these instances, the other shareholders of the effective subsidiary may claim compensation for the effective subsidiary’s losses from the effective parent that causes 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, in our position as an effective parent, we could be liable in some cases for the debts of our effective subsidiaries. Consequently, our business, results of operations, financial condition or prospects may be materially adversely affected.

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

We own less than 100% of the shares in some of our subsidiaries. In addition, certain of our subsidiaries have had other shareholders in the past. Some of our subsidiaries have in the past carried out, and continue to carry out, numerous transactions with other subsidiaries and affiliates. Russian law requires a joint stock company that enters into transactions with certain related persons, referred to as “interested party transactions,” to comply with special approval procedures. Under Russian law, an interested party transaction is a transaction with an “interested party,” which is (i) a member of the board of directors (supervisory council) or the management board of a company, (ii) the chief executive officer (“CEO”) of the company, or the external manager or management company, (iii) any shareholder that, together with its affiliates, owns at least 20% of the company’s voting shares or (iv) a person that is entitled to give mandatory instructions to the company, if any of the foregoing persons, or any of these persons’ spouses, close relatives, adoptive parents or children or affiliates:

- is a party to, or beneficiary of, a transaction with the company, whether directly or as a representative or intermediary;
- owns, individually or collectively at least 20% of the shares in a company that is a party to, or beneficiary of, a transaction with the company, whether directly or as a representative or intermediary;
- holds office in any management body of a company (or in any management body of the managing company of such company) that is a party to, or a beneficiary of, a transaction with the company, whether directly or as a representative or intermediary; or
- is otherwise deemed an “interested party” under the company’s charter.

Under applicable Russian law, in a joint stock company with 1,000 shareholders or less with a right to vote, interested party transactions must be approved by a majority vote of disinterested directors of the company, or by a majority vote of disinterested shareholders of the company in the event that (i) the number of the disinterested directors of the company is not sufficient to constitute a quorum, (ii) the value of the transaction is equal to or exceeds 2% of the company’s assets as determined under RAS as at the latest reporting date or (iii) the transaction involved issuance of primary shares, or securities convertible into the shares, in the amount equal to or exceeding 2% of the company’s previously issued shares. Failure to obtain a minority shareholder’s approval for an interested party transaction when required to do so could cause the transaction to be invalidated by a Russian court upon a motion by the company or any of its shareholders.

In the event that minority shareholders in any of our subsidiaries were to successfully contest existing or future interested party transactions, or prevent the approval of these transactions in the future, this could limit our operational flexibility and have a material adverse effect on our business, results of operations, financial condition or prospects.

Moreover, the provisions of Russian law that define which transactions must be approved as “interested party” transactions are subject to different interpretations, and we cannot be certain that our and our subsidiaries’ application of these concepts will not be subject to challenge by former and current shareholders. See “—*Risks Relating to Our Business and Industry—General Risks—We have engaged and may continue to engage in transactions with related parties that may present conflicts of interest, potentially resulting in the conclusion of transactions on less favourable terms than could be obtained in arm’s length transactions.*”

- *If the FAS was to conclude that Sistema JSFC or any of its significant subsidiaries acquired or created a new company in contravention of antimonopoly legislation, or otherwise violated competition rules, it could impose administrative sanctions.*

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 FAS 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 FAS 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.

In addition, if MTS or any of its subsidiaries were to be classified by the FAS or the AMC with respect to MTS’ operations in Ukraine, as a dominant market force or as having a dominant position in the market, the FAS or the AMC, as the case may be, would have the power to impose certain restrictions on their operations. These restrictions could result in competitive disadvantages and could materially adversely affect the business and results of operations of these entities. In particular, such finding could result in the imposition of government-determined tariffs, and a refusal by MTS to adjust its tariffs to such government-determined rates could result in the withholding of all or a substantial part of its revenues by the Russian authorities. Additionally, restrictions on expansion and government-mandated withdrawal from regions or markets could reduce MTS’ subscriber base and prevent it from implementing its business strategies. Moreover, MTS could be required to make additional licence applications at an additional unexpected cost.

In October 2011, FAS began an investigation of MTS’ and Vimpelcom’s actions, suspecting violation of antimonopoly laws by coordinated pricing of iPhone 4 handsets. The investigation is currently in progress. Although MTS believes that it has not violated antimonopoly laws, MTS could be liable for fines of up to 15% of the revenues it derived from iPhone 4 sales if a violation is found.

In December 2011, the AMC opened an investigation into whether MTS’ subsidiary, MTS Ukraine Private Joint Stock Company (“**MTS Ukraine**”), violated antimonopoly legislation with its pricing of international roaming services. The AMC stated that the average price of international roaming services offered by MTS Ukraine and its roaming partners is higher than the corresponding prices in the European Union, which may demonstrate that the prices charged by MTS Ukraine are not economically justified. The investigation will examine whether MTS Ukraine used its dominant position in the Ukrainian telecommunications market to establish prices that would not be possible if there was significant competition on the telecommunications market. Although MTS believes that it did not violate antimonopoly laws, it could be liable for up to 10% of MTS Ukraine revenues. MTS plans to submit its arguments to the AMC regarding the matter of this investigation. However, the AMC may determine that MTS violated antimonopoly legislation in this or other matters, and may impose fines on MTS.

Furthermore, on 26 December 2011, Bashneft was subject to a fine in the amount of RUB 778,245,170 (approximately U.S.\$26 million) for violations of antimonopoly law, including for abusing the dominant position by fixing and maintaining monopolistically high prices for motor gasoline in the second and third quarters of 2011.

Any administrative sanction imposed on us or any of our significant subsidiaries by anti-monopoly authorities may have a material adverse effect on our business, results of operations, financial condition or prospects.

- *Russian legal entities may be forced into liquidation, their ownership structure may be challenged or their subsidiaries' indebtedness may be accelerated on the basis of formal non-compliance with certain requirements of Russian law.*

Certain provisions of Russian law may allow a court to order liquidation of a Russian legal entity on the basis of its technical non-compliance with certain requirements during formation, reorganisation or its operation. There have been cases in the past in which formal deficiencies in the establishment process of a Russian legal entity, or non-compliance by a Russian legal entity with provisions of Russian law, have been used by Russian courts as a basis for liquidation of that legal entity. Some Russian courts, in deciding whether or not to order the liquidation of a company, have looked beyond the fact that a company failed to comply fully with all applicable legal requirements and have taken into account other factors, such as the financial standing of a company or its ability to meet its tax obligations, as well as the economic and social consequences of its liquidation. This judicial approach is supported by a decision of the Constitutional Court of the Russian Federation which held that even repeated violations of law may not serve as a basis for an involuntary liquidation of a company, and that consideration should be given to whether the liquidation would be an adequate sanction for such violations.

In accordance with Russian legislation, if the net assets of a Russian limited liability company (determined in accordance with RAS) fall below its charter capital at the end of its second financial year or any subsequent financial year, the limited liability company is required to decrease its charter capital to match the net assets. If the net assets of a Russian joint stock company (determined in accordance with RAS) fall below its charter capital at the end of its third financial year or any subsequent financial year, the joint stock company is required either to decrease its charter capital to match the net assets or liquidate. In addition, if the net assets of a Russian company (both a limited liability company and a joint stock company) at the end of its second or any subsequent financial year fall below the statutory minimum charter capital, the company must voluntarily liquidate. If a company fails to comply with either of the requirements stated above within the required period of time after the end of the relevant financial year, the company's creditors may accelerate their claims or demand early performance of the respective company's obligations and compensation of damages, and governmental authorities may seek the involuntary liquidation of the company.

In addition, if a Russian joint stock company's net assets calculated on the basis of RAS are lower than its charter capital by more than 25% as at the end of three, six, nine or twelve months of the financial year that follows its second or any subsequent financial year, at the end of which the net assets of such company were lower than its charter capital, a joint stock company is obliged to make a public disclosure of this fact and certain of the company's creditors will have the right to accelerate their claims or demand early performance of the company's obligations owed to them and demand compensation of damages. However, if a Russian joint stock company is able to demonstrate that the creditors' rights were not violated as a result of the decrease of its charter capital or the decrease of the amount of its net assets, as the case may be, and that the security provided for due performance of the company's obligations is sufficient, a court may dismiss the creditors' claims.

It is unclear under Russian law and court practice whether a historical violation of either of these requirements may be retroactively cured, even if a company later comes into compliance with these requirements. On occasion, Russian courts have ordered the involuntary liquidation of a company for having negative net assets even if the company has continued to fulfil its obligations and had net assets in excess of the minimum amount at the time of liquidation. We are also aware of certain court practice where a company's negative net assets position was interpreted by courts as entailing a duty of the company to file for bankruptcy in accordance with Russian bankruptcy law. A debtor's chief executive officer responsible to file for bankruptcy may be held liable for the company's obligations that arose after the failure to perform such duty.

If we or any of our subsidiaries were to be liquidated involuntarily or if claims for early repayment of obligations or for damages were to occur, we would be forced to halt or reorganise our operations. In addition, from time to time, we may merge certain subsidiaries for operational reasons. Under Russian law, such mergers would be considered a "reorganisation," and the merged subsidiaries would be required to notify their creditors of this reorganisation. Russian law also provides that, for a period of 30 days after notice, these creditors would have a right to accelerate the merged subsidiaries' indebtedness and demand compensation for all related losses. In the event that we decide to undertake any such merger and all or part of certain of our subsidiaries' indebtedness is accelerated, we may not have the ability to raise the funds necessary for repayment. Any of these events would have a material adverse effect on our business, results of operations, financial condition or prospects.

- *We have engaged in transactions that could be challenged on the basis of non-compliance with applicable legal requirements, and any successful challenge could result in the invalidation of such transactions, loss of property, the imposition of other liabilities, fines, penalties or other sanctions or liquidation of members of our group that engaged in such transactions.*

We have taken a variety of actions relating to, among other things, the valuation or acquisition of property, share issuances, share disposals and acquisitions, interested-party transactions, major transactions and other corporate matters. Under Russian law, transactions may be invalidated on many grounds, including for example a sale of shares by a person without the right to dispose of such shares, breach of interested party transaction and/or major transaction approval rules or failure to register the share transfer in the securities register. Defects in earlier transactions may cause our interest arising from such transactions to be subject to challenge. Although no actions have been brought seeking to invalidate our corporate status, alleging non-compliance with applicable laws and regulations with respect to transactions with property or other corporate matters or challenging any of our share issuances, there can be no assurance that such actions may not be brought in the future. If any transactions were successfully challenged on the basis of non-compliance with applicable legal requirements by competent state authorities, counterparties to such transactions, shareholders or their predecessors in interest or any other interested party, it could result in the invalidation of such transactions, loss of property or the imposition of other liabilities, which may have a material adverse effect on our business, results of operations, financial condition or prospects.

- *The difficulty of enforcing court decisions and the discretion of governmental authorities to file and join claims and enforce court decisions could prevent us or investors from obtaining effective redress in court proceedings.*

The independence of the judicial system and its immunity from economic and political influences in the Russian Federation is also developing. The court system is understaffed. The Russian Federation is a civil law jurisdiction and, as such, judicial precedents generally have no binding effect on subsequent decisions. Additionally, court claims are often used in furtherance of aims different from the formal substance of the claims. We may be subject to such claims, and courts may render decisions with respect to those claims that are adverse to us and our investors. State authorities have a high degree of discretion in the Russian Federation and at times exercise their discretion arbitrarily, without due process or prior notice, and sometimes in a manner that is contrary to law. Unlawful or unilateral state actions could include the withdrawal of licences, sudden and unexpected tax audits, criminal prosecutions and civil actions. Federal and local government entities could also use common defects in matters surrounding share issuances and registration as a basis for court claims and other demands to invalidate such issuances and registrations and/or to void transactions, often to further interests different from the formal substance of the claims. Such state action, if directed at us, could have a material adverse effect on our business, results of operations, financial condition or prospects.

- *Our assets may be nationalised or expropriated despite existing legislation to protect against nationalisation or expropriation.*

Although the Russian government has enacted legislation to protect property against expropriation and nationalisation and to provide fair compensation to be paid if such events were to occur, there can be no certainty that such protections will be enforced. This uncertainty is due to several factors, including the lack of state budgetary resources, the lack of an independent judicial system and the lack of sufficient mechanisms to enforce judgments as well as other political and economic reasons.

The concept of property rights is not as well established in the Russian Federation as in western economies and there is not a great deal of experience in enforcing legislation enacted to protect private property against nationalisation and expropriation. As a result, we may not be able to obtain proper redress in the courts, and may not receive adequate compensation if in the future the Russian government decides to nationalise or expropriate some or all of our assets. Although we are currently not aware of any plans, actions or decisions which may result in the expropriation or nationalisation of any of our or our respective shareholders' assets, should such expropriation or nationalisation occur without fair compensation in the future, it may have a material adverse effect on our business, results of operations, financial condition or prospects.

- *There is a lack of reliable official data in the Russian Federation.*

Official statistics and other data published by the CBR, federal, regional and local governments and federal agencies are substantially less complete or transparent than those of Western countries, and there can be no assurance that the official sources from which certain of the information set forth herein has been drawn are

reliable or complete. Official statistics may also be produced on the basis of methodologies different from those used in Western countries. Any discussion of matters relating to the Russian Federation herein may therefore be subject to uncertainty due to concerns about the completeness or reliability of available official and public information.

- *Russia's unpredictable acknowledgement and enforcement of foreign court judgments or arbitral awards give rise to significant uncertainties.*

The Russian Federation is not a party to any multilateral or bilateral treaties with most Western jurisdictions for the mutual enforcement of court judgments, and federal law does not generally provide for the recognition and enforcement of foreign court judgments, although foreign court judgments are sometimes recognised and enforced by Russian courts on the basis of reciprocity, if courts of the country where the foreign judgment was rendered have previously enforced judgments issued by Russian courts. The existence of reciprocity must be established in each case at the time the recognition and enforcement of a foreign judgment is sought, and it is not possible to predict whether in the future a Russian court will recognise and enforce a judgment issued by a foreign court on the basis of reciprocity. Consequently, should a judgment be obtained from a foreign court, it may not be given direct effect in Russian courts. See *"Enforceability of Judgments."*

However, the Russian Federation is a party to the New York Convention on Recognition and Enforcement of Foreign Arbitral Awards of 10 June 1958. A foreign arbitral award obtained in a jurisdiction that is a party to the New York Convention should be recognised and enforced by a Russian court, subject to the qualifications provided for in the New York Convention and compliance with Russian rules of civil procedure and applicable Russian law. There is also a risk that Russian rules of civil procedure will be amended to introduce further grounds preventing foreign court judgments and arbitral awards from being recognised and enforced in the Russian Federation. In practice, reliance upon international treaties may meet with resistance or a lack of understanding on the part of Russian courts or other officials, thereby introducing delays and unpredictability into the process of enforcing any foreign judgment or any foreign arbitral award in the Russian Federation.

Risks Relating to the Russian Taxation System

- *Russian tax laws, regulations and practice are complex, uncertain and often not well developed and are subject to frequent changes, which could have an adverse effect on us.*

Generally, Russian companies pay taxes that are both substantial and numerous. These taxes include, among others, profit tax, value added tax, property tax and other taxes as well as contributions to social security funds (in effect since 1 January 2010, when the unified social tax was abolished). Russian oil companies may also be subject to substantial export duties and mineral extraction taxes.

Russian tax laws, regulations and court practice are subject to frequent change, varying interpretations and inconsistent and selective enforcement. Although the Russian authorities have taken steps in recent years to improve the country's tax climate, there remains the possibility that in the future we would be subject to higher taxes, or arbitrary or onerous taxes and penalties, or enforcement measures, despite our best efforts at compliance.

Since Russian federal, regional and local tax laws and regulations are subject to change and some of the sections of the Tax Code of the Russian Federation relating to the aforementioned taxes are comparatively new, interpretation of these regulations is often unclear or nonexistent. Also, differing interpretations of tax regulations exist both among and within government bodies at the federal, regional and local levels, creating uncertainties and inconsistent enforcement. Furthermore, taxpayers and the Russian tax authorities often interpret tax laws differently. In some instances Russian tax authorities have applied new interpretations of tax laws retroactively. There is no established precedent or consistent court practice in respect of these issues. In the absence of binding precedent, court rulings on tax or other related matters by different courts relating to the same or similar circumstances may also be inconsistent or contradictory. Taxpayers often have to resort to court proceedings to defend their position against the tax authorities. The tax authorities may be taking a more assertive position in their interpretation of the legislation and assessments. Furthermore, recently local tax officials have made several material tax claims against major Russian companies.

Generally, taxpayers are subject to tax audits for a period of three calendar years immediately preceding the year in which the decision to conduct the audit is taken. However such a limitation may be exceeded in case the taxpayer files an adjusted tax declaration that relates to earlier periods. This limitation relates also to the fact that

generally the tax authorities are prohibited from carrying out repeat on-site tax audits in respect of the same taxes for a tax period which has already been audited. Nevertheless in some cases the fact that a tax period has been reviewed by the tax authorities does not prevent further review of that tax period, or any tax declaration applicable to that tax period, from further review. Repeated on-site tax audit can be conducted by the same tax authority that carried out the initial on-site tax audit (i) in connection with the restructuring or liquidation of a taxpayer, or (ii) after it receives from the taxpayer adjusted tax declaration based on which the amount of tax is reduced.

The statute of limitations for the commission of a tax offence is also limited to three years from the date on which it was committed or from the date following the end of the tax period during which the tax offence was committed (depending on the nature of the tax offence). Nevertheless, based on current wording of the tax law there may be cases where the tax offence statute of limitations may be extended beyond three years limitations if the actions of the taxpayer create insurmountable obstacles for the tax audit. Because the term “insurmountable obstacles” is not specifically defined in Russian law, the tax authorities may attempt to interpret this term broadly, effectively linking any difficulty experienced in the course of their tax audit with obstruction by the taxpayer and use that as a basis to seek tax adjustments and penalties beyond the three year term. Therefore, the statute of limitations is not entirely effective.

Tax audits or inspections may result in additional costs to us, in particular if the relevant tax authorities conclude that we did not satisfy its tax obligations in any given year. Such audits or inspections may also impose additional burdens on us by diverting the attention of management resources.

In its decision dated 26 July 2001, the Constitutional Court introduced the concept of “a taxpayer acting in a bad faith” without clearly stipulating the criteria for it. Similarly, this concept is not defined in Russian tax law. Nonetheless, this concept has been used by the tax authorities to deny, for instance, the taxpayer’s right to rely on the letter of the tax law. The tax authorities and courts often exercise significant discretion in interpreting this concept in a manner that is unfavorable to taxpayers.

In October 2006, the Plenum of the Supreme Arbitrazh Court of the Russian Federation (the “**Supreme Arbitrazh Court**”) issued a ruling concerning judicial practice with respect to unjustified tax benefits. In this context, a tax benefit means a reduction in the amount of a tax liability resulting, in particular, from a reduction of the tax base, the receipt of a tax deduction or tax concession or the application of a lower tax rate, and the receipt of a right to a refund (offset) or reimbursement of tax. The ruling provides that where the true economic intent of operations is inconsistent with the manner in which they have been taken into account for tax purposes, a tax benefit may be deemed to be unjustified and disallowed. The same conclusion may apply when an operation lacks a reasonable economic or business rationale. As a result, a tax benefit cannot be regarded as a business objective in its own right. On the other hand, the fact that the same economic result might have been obtained with a lesser tax benefit accruing to the taxpayer does not constitute grounds for declaring a tax benefit to be unjustified. Moreover, there are no rules and little practice for distinguishing between lawful tax optimisation and tax avoidance or evasion. The tax authorities have actively sought to apply this concept when challenging tax positions taken by taxpayers in court, and are anticipated to expand this trend in the future. Although the intention of this ruling was to combat tax law abuses, in practice the tax authorities have started applying the “unjustified tax benefit” concept in a broader sense than may have been intended by the Supreme Arbitrazh Court. To date, in the majority of cases where this concept has been applied, the courts have ruled in favour of taxpayers, but it is unclear whether the courts will follow these precedents in the future.

In addition, in March 2012 the Russian Federal Tax Service prepared and proposed for consideration to the Russian Ministry of Finance and the Russian Ministry of Economic Development draft law which envisages certain amendments to the Tax Code of the Russian Federation adopted by the Russian government on 24 February 2010. The amendments to the Tax Code of the Russian Federation are aimed to discourage transactions with offshore jurisdictions which are in the proposed draft referred to as “controlled foreign company rules.” In particular, the draft law stipulates that expenses incurred by the Russian taxpayers from their operations with the foreign companies located in offshore jurisdictions (the list of which is envisaged by the Russian Ministry of Finance) should be treated as non-deductible expenses for the Russian profits tax purposes; simultaneously the amount of such expenses should be treated as taxable income for the Russian profits tax purposes. The other initiative is a draft Resolution of the Russian government which envisages introduction of the beneficial ownership concept to the Russian model double tax treaty as well as establishes a prevailing principle of the above mentioned domestic rules over the provisions of double tax treaties. Such amendments, prima facie, should not affect the application of double tax treaties in the Russian Federation as currently enacted. It is currently uncertain if and when these initiatives may be introduced, as well as how they would be interpreted and applied by the tax authorities and/ or courts in practice and what effect it may have on taxpayers.

We operate in various jurisdictions and includes companies incorporated outside of the Russian Federation. Though the Russian tax laws provide rules on taxation of foreign companies in the Russian Federation or operations of Russian companies abroad they are insufficiently detailed. It is possible that with the evolution of these rules or changes in the approach of the Russian tax authorities, we could be subject to additional taxation in the Russian Federation in respect of our operations outside of the Russian Federation.

Russian tax legislation in effect on the date of this Prospectus does not contain a concept of corporate tax residency. Russian companies are taxed on their worldwide income whilst foreign entities are taxed in the Russian Federation on income attributable to a permanent establishment and on Russian source income. The Russian government in its Main Directions of Russian Tax Policy for 2008-2010 has proposed the introduction of a concept of tax residency for legal entities to the domestic tax law. According to the proposals, a legal entity would be deemed a Russian tax resident based on the place of its effective management and control and/or based on the residence of its shareholders. No assurance can be currently given as to whether and when these amendments will be enacted, their exact nature, their potential interpretation by the tax authorities and the possible impact on us. We may not rule out that as a result of the introduction of these changes certain of our companies might be deemed to be Russian tax residents, subject to all applicable Russian taxes.

The above conditions create tax risks in the Russian Federation that are more significant than the tax risks typically found in countries with more developed taxation, legislative and judicial systems. These tax risks impose additional burdens and costs on our operations, including management resources, and complicate our tax planning and related business decisions, potentially exposing us to significant fines, penalties and enforcement measures, which could materially adversely affect our business, results of operations, financial condition or prospects.

Furthermore, Russian tax legislation is consistently becoming more sophisticated. It is possible that new revenue raising measures could be introduced. Although it is unclear how any new measures would operate, the introduction of such measures may affect our overall tax efficiency and may result in significant additional taxes becoming payable. We cannot offer prospective investors any assurance that additional tax exposures will not arise. Additional tax exposures could have a material adverse effect on our business, results of operations, financial condition or prospects.

- *The Russian thin capitalisation rules allow different interpretations, which may affect our business, results of operations, financial condition or prospects.*

Russian tax legislation includes thin capitalisation rules which limit the amount of interest that can be deducted by Russian companies of Sistema for corporate income tax purposes on “controlled” debts. The controlled debt is defined as loans and other indebtedness attracted by the Russian company from: (i) a foreign entity (foreign parent) which owns, directly or indirectly, more than 20% of the Russian company’s share capital; (ii) a Russian company affiliated to such foreign parent; (iii) that is guaranteed or otherwise secured by such foreign parent or its Russian affiliates. The deductibility of interest is restricted to the extent that the foreign controlled debt exceeds net assets by more than 3 times. Interest on excess debt is non-deductible and treated as a dividend subject to withholding tax.

Our Russian entities may be affected by the Russian Federation’s thin capitalisation rules if at any time they receive loans from or have loans guaranteed by a foreign shareholder owning directly or indirectly over 20% of the shares in their charter capital or from Russian affiliated companies of such foreign shareholder, or even from any party, where such loan is guaranteed by our Russian entity, which is affiliated with such foreign shareholder.

Currently, the practical implementation of these rules by the tax authorities is controversial due to different clarifications issued by the regulatory authorities especially regarding guarantees issued with respect to loans provided by third parties. The court practice on this matter is also controversial but the recent court precedents indicate that the authorities are seeking to apply thin capitalisation rules to cases that are not formally subject to such restrictions applying a substance over form principle.

In its decision of 15 November 2011, the Presidium of the Supreme Arbitrazh Court ruled in favour of the Russian tax authorities and stated that the Russian thin capitalisation rules shall prevail over the provisions of the double tax treaties. In particular, in the mentioned decision the Presidium of the Supreme Arbitrazh Court stated that the non-discrimination clause of the double tax treaty does not contradict the Russian thin capitalisation rules and, as such, these rules should be applied to the Russian taxpayer in order to determine the amount of interest expenses on controlled debt which could be treated as tax deductible for the Russian profits tax purposes. It should be mentioned that historically in the similar cases the Russian courts in its majority ruled in favour of the Russian taxpayers.

- *Russian transfer pricing legislation may require pricing adjustments and impose additional tax liabilities with respect to controlled transactions.*

The new transfer pricing rules became effective from 1 January 2012. Compared to the previous Russian transfer pricing rules, the new rules are more technically elaborate and, to a certain extent, better aligned with the international transfer pricing principles developed by the Organisation for Economic Co-operation and Development.

The list of the “controlled” transactions under the new transfer pricing legislation includes transactions with related parties and certain types of cross-border transactions. The new transfer pricing rules may have a potential impact on our tax costs arising from the pricing mechanism applied in “controlled” transactions, in particular, transactions with related parties located in and outside of the Russian Federation. The tax authorities will have right to accrue additional tax liabilities if the prices under the “controlled” transactions differ from those which would have been used by independent counterparties under similar conditions. However, it is still unclear what effect the new transfer pricing rules may have on taxpayers, including our Russian entities.

It is not always possible to determine market prices for crude oil in the Russian Federation, mainly due to the significant intragroup turnover of the vertically integrated oil companies that dominate the market. Substantially all crude oil in the Russian Federation is produced by vertically integrated oil companies, such as Bashneft. As a result, most transactions are conducted between affiliated entities within vertically integrated groups. Thus, there is no effective benchmark domestic market price for crude oil in the Russian Federation. The price of crude oil that is produced, but not refined or exported by one of the vertically integrated oil companies, is generally determined on a transaction-by-transaction basis against the background of world market prices, but with no direct reference or correlation. At any time, there may be significant price differences between regions for similar quality crude oil as a result of the competitive and economic conditions in those regions. Due to the uncertainties in the interpretation of transfer pricing legislation, the tax authorities may take a view as to what constitutes an appropriate market price that differs from our view.

Accordingly, due to the uncertainties in the interpretation of transfer pricing legislation, no assurance can be given that the tax authorities will not challenge the level of prices applied by us and make adjustments, which could affect our tax position. Unless such tax adjustments are successfully contested in court, the resulting increase in tax due could have a material adverse effect on our business, results of operations, financial condition or prospects.

Risks Relating to the Issuer, the Notes and the Trading Market

- *Sistema JSFC is a holding company and its subsidiaries conduct substantially all of its operations and directly own all of its assets (other than the shares of Sistema JSFC’s direct subsidiaries), and our obligation to make payments on the Loan are effectively subordinated to all the liabilities of Sistema JSFC’s subsidiaries.*

Sistema JSFC is a holding company and its primary assets consist of shares in its subsidiaries and cash in its bank accounts. Sistema JSFC has no revenue generating operations of its own, and therefore its cash flow and ability to service its indebtedness, including the Loan, will depend entirely on the operating performance and financial condition of its operating subsidiaries and the receipt by it of funds from such subsidiaries in the form of dividends, interest payments on intercompany loans or otherwise. Its subsidiaries are separate and distinct legal entities and have no obligation to pay any amounts due on the Loan or to provide the Issuer or Sistema JSFC with funds for the payment obligations under the Loan or the Notes. In the event of a bankruptcy, liquidation or reorganisation of a subsidiary, holders of that subsidiary’s indebtedness, and trade and other creditors of that subsidiary, will have a claim to the assets of the subsidiary that is prior to our interest in those assets (except to the extent that we are recognised as a creditor through intercompany claims or loans). Accordingly, in the event that any subsidiary becomes insolvent, liquidates or otherwise reorganises, our creditors (including, indirectly, the holders of the Notes) will have no right to proceed against the assets of such subsidiary and the creditors of such subsidiary, including trade creditors of such subsidiary, will generally be entitled to payment in full from the sale or other disposal of the assets of such subsidiary before Sistema JSFC, as direct or indirect shareholder, will be entitled to receive and distribution from such subsidiary. Therefore, in most circumstances, our obligations under the Loan will effectively rank junior to all liabilities of Sistema JSFC’s subsidiaries, including trade payables and the liquidation value of preferred stock of these subsidiaries. As of 31 December 2011, Sistema JSFC had total outstanding consolidated debt of \$16,409.9 million. Although the terms of the Loan require us to maintain a Net Leverage Ratio (as defined in the Loan Agreement) at the level of 3.5 to 1 or lower, thereby operating to restrict our ability to incur future indebtedness, we may incur substantial additional indebtedness.

In addition, Sistema JSFC's subsidiaries may be subject to contractual or other restrictions that would prevent them from paying dividends or otherwise distributing cash to us. There can be no assurance that the assets of any of its subsidiaries will be sufficient to repay their indebtedness and other liabilities or that any subsidiary's assets will be available to make distributions to Sistema JSFC that would be available to satisfy our payment obligations under the terms of the Loan.

- *The terms of the Loan provide significant flexibility for us to incur substantial additional secured and unsecured indebtedness.*

The terms of the Loan in certain circumstances restrict our ability to create security over our assets to secure indebtedness that we may incur as described in the "Loan Agreement" but this restriction is subject to certain carve-outs, including any liens existing on the Issue Date and additional liens comprising up to 20 per cent. of our consolidated total assets as stated in our most recent audited or unaudited interim balance sheet, as the case may be, prepared in accordance with Accounting Standards (as defined in the Loan Agreement). Holders of our secured indebtedness will have claims that rank senior to any claim that the Trustee may have in respect of the Issuer's rights under or in respect of the Loan Agreement. In the event of any distribution of our assets in any foreclosure, dissolution, winding-up, liquidation, reorganisation or other bankruptcy proceedings, holders of secured indebtedness will have prior claim to those of our assets that constitute their collateral. Any claim the Trustee may have in respect of the Issuer's rights under or in respect of the Loan Agreement will participate ratably with all holders of our unsecured indebtedness that is deemed to be of the same class as the Loan, and potentially with all our other general creditors, based on the respective amounts owed to each creditor, in our remaining assets. As at 31 December 2011 we and our subsidiaries granted security over equipment with carrying value of \$241.9 million to secure certain of our indebtedness.

Although the terms of the Loan require us to maintain a Net Leverage Ratio (as defined in the Loan Agreement) at the level of 3.5 to 1 or lower, thereby operating to restrict our ability to incur future indebtedness, we may incur substantial additional indebtedness. To the extent that any debt is incurred by any of Sistema JSFC's subsidiaries, our obligations under the Loan will effectively rank junior to all liabilities of Sistema JSFC's subsidiaries. See "*—Sistema JSFC is a holding company and its subsidiaries conduct substantially all of its operations and directly own all of its assets (other than the shares of Sistema's direct subsidiaries), and our obligation to make payments on the Loan are effectively subordinated to all the liabilities of Sistema JSFC's subsidiaries.*" Sistema JSFC is a holding company, and its primary assets consist of shares in its subsidiaries. The terms of the Loan do not restrict us from selling or otherwise disposing of our stakes in any or all of Sistema JSFC's subsidiaries although they impose certain requirements on such sales or disposals. At the same time the Loan Agreement impose no restrictions on how we apply the consideration that we receive following the sale of some or all of our stake in any of such subsidiaries. The terms of the Loan do not limit or otherwise restrict our ability to pay dividends in respect of our ordinary shares or limit our ability to make investments in joint ventures or other entities that we do not control. The making of such investments and the payment of such dividends may reduce funds that would otherwise be available to us to make payments in respect of our obligations under the Loan.

- *The Loan may not be capable of being accelerated if the indebtedness of certain of Sistema JSFC's subsidiaries is accelerated or such subsidiaries become insolvent.*

Sistema JSFC is a holding company, and its only significant assets are shares in its subsidiaries. Other than while the Investment Grade Status (as defined in the Loan Agreement) continues, the terms of the Loan permit the declaration of an Event of Default if Capital Markets Indebtedness of a Core Subsidiary is accelerated or if certain bankruptcy and insolvency events occur with respect to a Core Subsidiary. See "*The Loan Agreement—Events of Default,*"

"Capital Markets Indebtedness" is defined to mean any Indebtedness of a person which: (a)(i) is in the form of or represented by any bond, note, debenture stock, loan stock, certificate or other debt instrument issued by such person which is listed or quoted on any stock exchange outside of the Russian Federation or (ii) is in the form of a loan to such person which is financed by the issuance of any of the foregoing forms of debt in (a)(i) above, where such issuance is by a special purpose company or a bank or any other entity and the rights to payment of the holders of such forms of debt are limited to payments actually made by such person pursuant to such loan; and (b) in the case of the debt referred to in (a)(i) above or the debt financing a loan referred to in (a)(ii) above, was initially issued and distributed (as to more than 50 per cent. of the original principal amount of such debt) outside the Russian Federation. See "*The Loan Agreement—Definitions and Interpretation.*"

"Core Subsidiary" is defined to mean any Subsidiary (excluding OJSC "MTS Bank") (a) whose sales, as shown by its latest financial statements (consolidated with its Subsidiaries), are at least 35 per cent. of the consolidated

sales of the Group, as shown by the Sistema JSFC's latest consolidated financial statements (excluding the contribution of the sales of OJSC "MTS Bank"); or (b) whose total assets, as shown by its latest financial statements (consolidated with its Subsidiaries), are at least 35 per cent. of the consolidated total assets of the Group (excluding the contribution of the assets of OJSC "MTS Bank"), as shown by the Sistema JSFC's latest consolidated financial statements; provided that if a Core Subsidiary transfers any of its assets to another Core Subsidiary which would result in such Core Subsidiary ceasing to be a Core Subsidiary, such Subsidiary and such other Subsidiary shall both be tested under this definition on a consolidated basis until such times as they are not Core Subsidiaries on a consolidated basis. See "*The Loan Agreement—Definitions and Interpretation.*"

Although at the date of this Prospectus, MTS and Bashneft would each fall within the definition of "Core Subsidiary" and, thus, the relevant Events of Default under the Loan may apply in respect of their Capital Markets Indebtedness, neither of these subsidiaries, or any other subsidiaries of Sistema JSFC, may be Core Subsidiaries during the term of the Notes. Moreover, any default with respect to, or acceleration of, indebtedness of a Core Subsidiary that is not Capital Markets Indebtedness would not constitute an Event of Default under the Loan. The effect of this could be to result in a delay in the ability of the holders of the Notes to cause the Trustee to accelerate the Loan upon certain events, which could result in a significant reduction in the value of Sistema JSFC's assets or in its ability to gain access to cash, thereby materially reducing the amount of any possible recoveries by the holders of the Notes should such events occur. See "*—Sistema JSFC is a holding company and its subsidiaries conduct substantially all of its operations and directly own all of its assets (other than the shares of Sistema's direct subsidiaries), and our obligation to make payments on the Loan are effectively subordinated to all the liabilities of Sistema JSFC's subsidiaries.*"

- *Failure by Sistema JSFC or any of its subsidiaries to pay final judgements will not in itself constitute an Event of Default under the Loan, and therefore any such failure would not entitle holders of the Notes to cause the Trustee to accelerate the Loan.*

Failure by Sistema JSFC or any of its subsidiaries to pay a final judgment against it will not in itself constitute an Event of Default under the Loan Agreement. The enforcement of any such judgment could involve the attachment or seizure by a judicial body or judgment creditor of assets of Sistema JSFC or such subsidiary, or the imposition of a judicial lien in respect of any such assets. Any such event could impair the ability of Sistema JSFC or such subsidiary to realise cash or other value from any such assets and, accordingly, could materially impair the ability of Sistema JSFC to make payments in respect of the Loan, but such events would not entitle the holders of the Notes to cause the Trustee to accelerate the Loan.

- *The Issuer is a special purpose vehicle and payments under the Notes are limited to the amount of certain payments received under the Loan Agreement.*

The Issuer is a special purpose vehicle ("SPV") with no business other than issuing notes and advancing loans under the Loan Agreement and has no assets other than such loans. The Issuer is only obliged to make payments under the Notes to the Noteholders in an amount equal to, and in the same currency as, sums of principal, interest and additional amounts (if any) actually received by or for the account of the Issuer pursuant to the Loan Agreement. Consequently, if we fail to meet our payment obligations under the Loan Agreement in full, this will result in the Noteholders receiving less than the scheduled amount of principal, interest and additional amounts (if any) on the relevant due date.

- *No direct recourse of the Noteholders to us.*

Except as otherwise expressly provided in the "Terms and Conditions of the Notes" and in the Trust Deed, the Noteholders will not have any proprietary or other direct interest in the Issuer's rights under or in respect of the Loan Agreement. Subject to the terms of the Trust Deed, no Noteholder will have any entitlement to enforce any of the provisions of Loan Agreement or have direct recourse to us except through action by the Trustee through an action by the Trustee pursuant to the rights granted to the Trustee in the Trust Deed. Under the Trust Deed and the Conditions, the Trustee shall not be required to take proceedings to enforce payment under the Loan Agreement unless it has been indemnified and/or secured and/or pre-funded by the Noteholders to its satisfaction. In addition, neither the Issuer nor the Trustee is required to monitor our financial performance. See "*Terms and Conditions of the Notes.*"

- *No existing market/market volatility.*

There is no existing market for the Notes. Application has been made to the Irish Stock Exchange for the Notes to be admitted to the official list and trading on the Market. However, there can be no assurance that an active trading market for the Notes will develop or, if one does develop, that it will be maintained. If an active trading

market for the Notes does not develop or is not maintained, the market price and liquidity of the Notes may be adversely affected. The market for securities issued by Russian issuers is influenced by economic and market conditions in other emerging markets. In view of the recent unprecedented market volatility and overall market downturn in connection with the global financial crisis, there can be no assurance that such market volatility will not persist or recur, or that such volatility will not adversely affect the price of the Notes.

- *Payments on the Loan may be subject to Russian withholding tax.*

In general, interest payments on borrowed funds made by a Russian legal entity to a non-Russian legal entity or organisation having no registered presence and/or no permanent establishment in the Russian Federation are subject to Russian withholding tax at the rate of 20% and 30% for individuals that are not Russian residents for tax purposes, unless such withholding is reduced or eliminated pursuant to the terms of an applicable double tax treaty. We believe that payments of interest and some other amounts, as the case may be, on the Loan to the Issuer should not be subject to Russian withholding tax under the terms of the Convention between Grand Duchy of Luxembourg and the Russian Federation for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income and capital signed on 28 June 1993 (the “**Russian Federation-Luxembourg double tax treaty**”).

A new protocol to the Convention was signed in 2011. The protocol introduces certain changes to the provisions of the Convention. Such changes include inter alia a limitation of benefits of a resident of one contracting state if the main purpose or one of the main purposes of the establishment and existence of such resident was receipt of treaty benefits; further exchange of information procedures are extended. The protocol also provides that income falling under the “other income” category may be subject to Russian withholding tax. Once the protocol is ratified and becomes effective, it may have an impact on future payments under the Loan Agreement inter alia on payments other than interest income and principal.

Therefore, there can be no assurance that the double tax treaty relief mentioned above will be available in practice or will continue to be available throughout the term of the Loan since the application of tax benefits under the double tax treaty could be influenced by the change in the position of the Russian tax authorities to look beyond the mere form of the transaction while assessing the availability of treaty benefits. This position was reflected in a recent letter of the Ministry of Finance of the Russian Federation No. 03-08-13/1, dated 30 December 2011 (the “**Tax Letter**”), which expresses a view that the noteholders are the beneficial owners of interest payable by a Russian bank on the proceeds of a Eurobond offering that were placed as a deposit with the Russian bank by the issuer of the notes (being a special purpose vehicle established by the Russian bank). Although the transaction commented on in the Tax Letter is different from the structure contemplated by this Prospectus, it is possible that once the Tax Letter is circulated within the Federal Tax Service, it would be relied upon by the Russian tax authorities in order to challenge taxpayers who are the borrowers in eurobond structures.

On 27 January 2012, the Ministry of Finance issued a press-release confirming the opinion reflected in the Tax Letter. However, the Ministry of Finance also confirmed that it is considering introducing changes to the Tax Code of the Russian Federation that will exempt Russian companies borrowing in eurobond structures from withholding tax agent functions with respect to interest income paid to foreign SPV, at least in cases where bondholders are tax residents in countries that have entered into a double tax treaty with the Russian Federation. This draft law is envisaged to have retrospective effect to exempt interest payments made prior to 1 January 2013 and is likely to be submitted to the State Duma for consideration in the upcoming spring legislative session. As for Russian companies borrowing in eurobond structures prior 1 January 2012, the amendments to the budget legislation providing non-interest instalment of tax commitments are to be considered in the near future. At this stage it is not possible to predict whether such a draft law would be enacted, what its effect would be (if enacted) and how it would impact the Notes and the Loan. Also at this stage it is not possible to predict whether the position of the Ministry of Finance as set out in the Tax Letter would be upheld by courts in similar cases. Therefore it is possible that interest payments on the relevant Loan made to the Issuer may not be able to benefit from relief from the Russian withholding tax under the terms of the Russian Federation-Luxembourg double tax treaty and, even if previously available, such relief may not continue to be available throughout the term of the Loan.

Furthermore, a draft law envisaging the introduction of the concept of “actual recipient of income” to the Tax Code of the Russian Federation became available in December 2009. Although the draft law neither uses the term “beneficial owner” nor defines the term “actual recipient of income” (which is used in the Russian versions of double taxation treaties), it is likely that the intent of the proposed amendments is to introduce a concept of beneficial ownership in the Russian tax legislation and to combat the abuse of double taxation treaties where the beneficiary of income resides in a jurisdiction which has not concluded a double taxation treaty with the Russian

Federation. This draft law, if enacted as currently drafted, would increase the existing uncertainty and inconsistency in the application of double tax treaties in the Russian Federation. It may result in the inability for foreign entities to claim benefits under a double taxation treaty through structures which historically were subject to double taxation treaty protection in the Russian Federation. It is currently uncertain if and when this draft law may be introduced, as well as how it would be interpreted and applied by the tax authorities and/or courts in practice and what effect it may have on taxpayers, including us. Further, in August 2011 the Russian government also proposed in its Main Directions of Russian Tax Policy for 2012 and planned for 2013-2014 legislative changes concerning an anti-avoidance mechanism with respect to double tax treaty benefits in cases where ultimate beneficiaries of income do not reside in the relevant double tax treaty country. The introduction of such concept may result in the inability of foreign entities to claim benefits under double tax treaties through structures which historically were subject to double tax treaty protection in the Russian Federation.

If any payments under the Loan are subject to any Russian or Luxembourg withholding tax, Sistema JSFC will be obliged to increase the amounts payable as may be necessary to ensure that the recipient receives a net amount equally to the amount it would have received in the absence of such withholding taxes. In addition, payments in respect of the Notes will, except in certain limited circumstances, be made without deduction or withholding for or on account of Luxembourg taxes except as required by law. Based on professional advice, we believe that payments in respect of the Notes will only be subject to deduction or withholding for or on account of Luxembourg taxes as described in *"Taxation—Luxembourg."* In the event of such a deduction or withholding, the Issuer will only be required to increase payments to the extent that it receives corresponding amounts from Sistema JSFC under the Loan Agreement. While the Loan Agreement provides for Sistema JSFC to pay such corresponding amounts in these circumstances, there are some doubts as to whether a tax gross up clause such as that contained in the Loan Agreement is enforceable under Russian law. Due to the limited recourse nature of the Notes, if Sistema JSFC fails to pay any such gross-up amounts, the amount payable by the Issuer under the Notes will be correspondingly reduced. Any failure by Sistema JSFC to increase such payments would constitute an Event of Default under the Loan Agreement. In certain circumstances (including following enforcement of the security upon the occurrence of a Relevant Event as defined in the Trust Deed), in the event that Sistema JSFC is obliged to increase the amounts payable, it may prepay the principal amount of the Loan together with accrued interest and/or additional amounts payable (if any) thereon, and all outstanding Notes would be redeemed by the Issuer (to the extent that it has actually received the relevant funds from Sistema JSFC).

The Issuer will grant security over certain of its rights in the Loan Agreement to the Trustee on respect of its obligations under the Notes. The security under the Trust Deed will become enforceable upon the occurrence of an Event of Default or a Relevant Event, as defined in the Loan Agreement and the Trust Deed. In these circumstances, payments under the Loan Agreement (other than in respect of Reserved Rights) would be required to be made to, or to the order of, the Trustee. Under Russian tax law, payments of interest and other payments made by Sistema JSFC to the Trustee will in general be subject to Russian income tax withholding at a rate of 20% (or potentially 30% in respect of non-resident individual Noteholders). It is not expected that the Trustee will, or will be able to, claim a withholding tax exemption under any double tax treaty under such circumstances. In addition, while it may be possible for some Noteholders who may be eligible for an exemption from, or a reduction in, Russian withholding tax under double tax treaties to claim a refund of tax withheld, there would be considerable practical difficulties in obtaining any such refund.

As indicated above, it is currently unclear whether the provisions obliging Sistema JSFC to gross-up payments will be enforceable in the Russian Federation. If, in the case of litigation in the Russian Federation, a Russian court does not rule in favour of the Issuer or the Trustee and Noteholders, there is a risk that the tax gross-up for withholding tax will not take place and that payments made by Sistema JSFC under the Loan Agreement will be reduced by Russian income tax withheld by Sistema JSFC at a rate of 20% (or potentially 30% in respect of individual Noteholders), or such other rate as may be in force at the time of payment. See *"Taxation—Russian Taxation."*

- *Tax might be withheld on disposals of the Notes in the Russian Federation, reducing their value.*

If a non-resident Noteholder that is a legal entity or organisation, which in each case is not organised under Russian law and which holds and disposes of the Notes otherwise than through a permanent establishment in the Russian Federation, sells the Notes and received proceeds from a source within the Russian Federation, there is a risk that any part of the payment that represents accrued interest may be subject to a 20% Russian withholding tax (even if a disposal is performed at a loss). The foreign Noteholder may be entitled to a reduction of such Russian withholding tax under an applicable double tax treaty subject to compliance with the treaty clearance formalities.

Where proceeds from disposition of the Notes are received from a source within the Russian Federation by an individual who is not Russian resident for tax purposes, there is a risk that Russian withholding tax would be charged at a rate of 30% on gross proceeds from such disposal of the Notes less any available cost deduction. Although such tax may be reduced or eliminated under an applicable tax treaty subject to compliance with the treaty clearance formalities, in practice individuals would not be able to obtain advance treaty relief on receipt of proceeds from a source within the Russian Federation, whilst obtaining a refund of the taxes withheld can be extremely difficult, if not impossible. Furthermore, even though the Tax Code of the Russian Federation requires only a Russian professional asset manager or broker, or another person (including a foreign company with a permanent establishment or any registered presence in the Russian Federation or an individual entrepreneur located in the Russian Federation) acting in a similar capacity to withhold the tax from payment to an individual associated with disposition of securities, there is no guarantee that other Russian companies or foreign companies with a registered presence in the Russian Federation or an individual entrepreneur located in the Russian Federation would not seek to withhold the tax. The imposition or possibility of imposition of this withholding tax could adversely affect the value of the Notes. See “*Taxation.*”

- *Sistema and the Issuer could incur material compliance costs relating to FATCA, and payments on the Loan or the Notes may be subject to U.S. withholding tax under FATCA.*

The FATCA rules were enacted in 2010 to prevent U.S. tax evasion by requiring foreign banks and investment funds to provide information to the IRS about U.S. customers and investors. This is achieved through a comprehensive information reporting regime that requires foreign financial institutions (such as Sistema and the Issuer) to conduct diligence on their account holders and investors to determine whether their accounts are “U.S. accounts,” and either provide detailed information about these U.S. accounts to the IRS or suffer a 30% withholding tax on certain payments. The U.S. Treasury Department has not yet released final regulations clarifying the statutory language of FATCA, so the scope and application of FATCA is uncertain at this time. It is possible that FATCA could operate to impose U.S. withholding tax on (i) beginning in 2014, payments to Sistema and the Issuer in respect of U.S. source income, including interest and dividends, (ii) beginning in 2015, payments to Sistema and the Issuer of gross proceeds from the disposition of any property which can produce U.S. source interest or dividends, and (iii) beginning no earlier than 2017, certain “pass-thru payments” to Sistema and the Issuer, as well as certain “pass-thru” payments from the Issuer to certain Noteholders. It is also possible that Sistema and the Issuer could incur material costs in implementing information-gathering systems to comply with FATCA. Given the lack of final regulations or other binding guidance, it is impossible for Sistema to evaluate the potential effect of FATCA at this time.

- *Definitive Certificates will be available only in certain denominations.*

The minimum denomination of issued Notes will be \$200,000 (or its equivalent in other currencies at the date of issue). However, for so long as any of the Notes are represented by one or more Global Certificates, and Euroclear and Clearstream, Luxembourg so permit, the Notes shall be tradable in minimum nominal amounts of \$200,000 (or its equivalent in other currencies) and integral multiples of \$1,000 (or an equivalent in other currencies, as specified in the Terms and Conditions of the Notes) thereafter. In the event that any Global Certificate is exchanged for Definitive Certificates, such Definitive Certificates shall be printed and issued in denominations of \$200,000 only (or its equivalent in other currencies at the date such Global Certificate is exchanged for Definitive Certificates). Accordingly, if Definitive Certificates are required to be issued, Noteholders who hold Notes in Euroclear or Clearstream, Luxembourg in amounts that are not integral multiples of \$200,000 (or its equivalent in other currencies) may need to purchase or sell, on or before the relevant Exchange Date (as defined in “*Summary of the Provisions Relating to the Notes in Global Form—Exchange for Definitive Certificates—Exchange*”), a principal amount of Notes such that their holding is an integral multiple of \$200,000 (or its equivalent in other currencies).

- *An investment in the Notes may be subject to ERISA restrictions.*

The issued Notes may be regarded for purposes of the ERISA, as equity interests in a separate entity whose sole asset is the Loan. Accordingly, the Notes should not be acquired by any “benefit plan investor” within the meaning of Section 3(42) of ERISA (“**Benefit Plan Investor**”). Each purchaser and/or holder of Notes and each transferee therefore will be deemed to have made representations that it is not a Benefit Plan Investor. Potential purchasers should read the sections entitled “Certain U.S. Employee Benefit Plan Considerations” and “Transfer Restrictions.”

- *Our credit ratings may not reflect all risks of an investment in the Notes.*

Our credit rating may not reflect the potential impact of all risks related to the structure and other factors on any trading market for, or trading value of, the Notes. In addition, real or anticipated changes in our credit ratings will

generally affect any trading market for, or trading value of, the Notes. A credit rating is not a recommendation to buy, sell or hold securities and may be revised or withdrawn by the rating agency at any time. There is no assurance that a credit rating will remain for any given period of time or that a credit rating will not be lowered or withdrawn by the relevant rating agency if, in its judgment, circumstances so warrant. The impact of other activities that we undertake, including changes in its dividend rate and, particularly, increases in its debt levels could also result in future declines in its credit ratings. In the event that a credit rating assigned to us or the Notes is subsequently lowered for any reason, no person or entity is obliged to provide any additional support or credit enhancement with respect to the Notes, and the market value of the Notes is likely to be adversely affected.

In general, European regulated investors are restricted under the CRA Regulation from using credit ratings for regulatory purposes, unless such ratings are issued by a credit rating agency established in the EU and registered under the CRA Regulation (and such registration has not been withdrawn or suspended), subject to transitional provisions that apply in certain circumstances whilst the registration application is pending. Such general restriction will also apply in the case of credit ratings issued by non-EU credit rating agencies, unless the relevant credit ratings are endorsed by an EU-registered credit rating agency or the relevant non-EU rating agency is certified in accordance with the CRA Regulation (and such endorsement action or certification, as the case may be, has not been withdrawn or suspended). The list of registered and certified rating agencies published by the European Securities and Markets Authority (“ESMA”) on its web site in accordance with the CRA Regulation is not conclusive evidence of the status of the relevant rating agency including in such list, as there may be delays between certain supervisory measures being taken against a relevant rating agency and the publication of the updated ESMA list.

- *The Notes may only be transferred in accordance with the procedures of the depositaries in which the Notes are deposited.*

Except in limited circumstances, the Notes will be issued only in global form with interests therein held through the facilities of Euroclear, Clearstream, Luxembourg and/or DTC. Ownership of beneficial interests in the Notes is shown on, and the transfer of that ownership is effected only through, records maintained by the Euroclear, Clearstream, Luxembourg and/or DTC or their nominees and the records of their participants. The laws of some jurisdictions may require that certain purchasers of securities take physical delivery of such securities in definitive form. These laws may impair the ability to transfer beneficial interests in the Notes. Because Euroclear, Clearstream, Luxembourg and/or DTC can only act on behalf of their participants, which, in turn, act on behalf of owners of beneficial interests held through such participants and certain banks, the ability of a person having a beneficial interest in the Note to pledge or transfer such interest to persons or entities that do not participate in the Euroclear, Clearstream, Luxembourg and/or DTC may be impaired.

- *Legal investment considerations may restrict certain investments.*

The investment activities of certain investors are subject to investment laws and regulations, or to the review by, or regulation of, certain authorities. Each potential investor should consult its legal advisers to determine whether and to what extent (i) the Notes are legal investments to it; (ii) the Notes can be used as collateral for various types of borrowings; and (iii) other restrictions apply to its purchase or pledge of any Notes. Financial institutions should consult their legal advisers or the appropriate regulators to determine the appropriate treatment of the Notes under any applicable risk based capital or similar rules.

USE OF PROCEEDS

The gross proceeds from the Notes will be used by the Issuer for the sole purpose of financing the Loan to Sistema JSFC. The proceeds of the Loan, less any commissions or expenses payable by Sistema JSFC in connection with the Notes and the Loan, will be used by Sistema JSFC for general corporate purposes. See *“Management’s Discussion and Analysis of Financial Condition and Results of Operations—Liquidity and Capital Resources.”*

CAPITALISATION

The following table sets forth the consolidated capitalisation of Sistema as at 31 December 2011 on an historical basis, and as adjusted to give effect to the offering. This information should be read in conjunction with “Use of Proceeds,” “Management’s Discussion and Analysis of Financial Condition and Results of Operations,” “Selected Consolidated Financial Data” and the U.S. GAAP Financial Statements, and related notes thereto, included elsewhere in this Prospectus. See “*Management’s Discussion and Analysis of Financial Condition and Results of Operations— Capital Resources*” and our U.S. GAAP Financial Statements included elsewhere in this Prospectus.

	As at 31 December 2011	
	Historical	As adjusted
	<i>(\$ in thousands)</i>	
Short-term debt		
Short-term loans payable	299,610	299,610
Current portion of long-term debt	4,097,076	4,097,076
Total short-term debt	4,396,686	4,396,686
Long-term debt		
Loans from banks and financial institutions	10,326,198	10,326,198
Notes and corporate bonds	5,356,583	5,856,583
Capital leases	227,647	227,647
Loans from related parties	54,931	54,931
Vendor financing	133,705	133,705
Other borrowings	11,209	11,209
Total long-term debt (less current portion of long-term debt)	12,013,197	12,513,197
Total debt	16,409,883	16,909,883
Shareholders’ equity		
Share capital	30,057	30,057
Treasury stock	(467,198)	(467,198)
Additional paid in capital	2,575,601	2,575,601
Retained earnings	6,418,649	6,418,649
Accumulated other comprehensive loss	(518,354)	(518,354)
Non-redeemable noncontrolling interests in equity of subsidiaries	5,667,208	5,667,208
Total shareholders’ equity	13,705,963	13,705,963

Except as disclosed in “Management’s Discussion and Analysis of Financial Condition and Results of Operations—Recent Developments,” there has been no material change in Sistema’s capitalisation since 31 December 2011.

SELECTED CONSOLIDATED FINANCIAL DATA

The table below sets forth our historical financial information as at and for the years ended 31 December 2009, 2010 and 2011. This information has been extracted without material adjustment from the U.S. GAAP Financial Statements except as provided in the footnotes below. Historical information as at 31 December 2009 has been Extracted from our U.S. GAAP historical financial statements, which are not presented herein. The selected financial data should be read in conjunction with “Management’s Discussion and Analysis of Financial Condition and Results of Operations” and our U.S. GAAP Financial Statements included elsewhere in this Prospectus. Our U.S. GAAP Financial Statements have been prepared in accordance with U.S. GAAP since 1998. Although our results are presented in U.S. dollars, you should not construe those translations as a representation that those amounts could be converted from one currency to another at any particular rate or at all. The rouble generally is not convertible outside the Russian Federation. A market exists within the Russian Federation for the conversion of roubles into other currencies, but the limited availability of other currencies may tend to inflate their values relative to the rouble.

	Years ended 31 December					
	2009	% of total revenues	2010	% of total revenues	2011	% of total revenues
	(\$ in thousands, except percentages)					
Sales	17,425,502	96.2	26,222,373	97.8	32,452,236	98.4
Revenues from banking activities	697,227	3.8	588,946	2.2	529,012	1.6
Total Revenues	18,122,729	100.0	26,811,319	100.0	32,981,248	100.0
Cost of sales, exclusive of depreciation, depletion and amortisation shown separately below	(7,084,969)	(39.1)	(10,716,816)	(40.0)	(13,021,173)	(39.5)
Cost related to banking activities, exclusive of depreciation and amortisation shown separately below	(540,263)	(3.0)	(374,036)	(1.4)	(310,332)	(0.9)
Selling, general and administrative expenses	(3,028,891)	(16.7)	(3,747,805)	(14.0)	(3,936,588)	(11.9)
Depreciation, depletion and amortisation	(2,434,733)	(13.4)	(2,862,754)	(10.7)	(3,281,629)	(9.9)
Transportation costs	(159,001)	(0.9)	(535,391)	(2.0)	(789,785)	(2.4)
Provision for doubtful accounts	(246,981)	(1.4)	(161,519)	(0.6)	(135,967)	(0.4)
Loss from impairment and provisions of other assets	(717,516)	(4.0)	(313,381)	(1.2)	(1,031,262)	(3.1)
Taxes other than income tax	(1,607,243)	(8.9)	(4,106,338)	(15.3)	(6,257,642)	(19.0)
Other operating expenses, net	(436,371)	(2.4)	(260,271)	(1.0)	(458,852)	(1.4)
Equity in results of affiliates	(12,758)	(0.1)	92,235	0.3	120,929	0.4
Gain on acquisition	2,782,835	15.4	—	—	—	—
Gain upon adoption of equity method	—	—	477,400	1.8	—	—
(Loss)/gain on disposal of interests in subsidiaries and affiliates	(383,978)	(2.1)	—	—	62,514	0.2
Operating income	4,252,860	23.5	4,302,643	16.1	3,941,461	12.0
Interest income	191,203	1.1	131,534	0.5	176,584	0.5
Change in fair value of derivative instruments	(35,200)	(0.2)	(2,062)	(0.0)	(2,268)	(0.0)
Interest expense	(1,246,356)	(6.9)	(1,597,244)	(6.0)	(1,742,690)	(5.3)
Foreign currency transactions (losses)/gains	(94,053)	(0.5)	26,151	0.1	(326,415)	(1.0)
Income from continuing operations before income tax	3,068,454	16.9	2,861,022	10.7	2,046,672	6.2
Income tax expense	(743,895)	(4.1)	(1,065,480)	(4.0)	(1,088,546)	(3.3)
Equity in net income of energy companies in the Republic of Bashkortostan	4,400	0.0	—	—	—	—
Income from continuing operations	2,328,959	12.9	1,795,542	6.7	958,126	2.9
Income/(loss) from discontinued operations ⁽¹⁾	(16,679)	(0.1)	(2,999)	(0.0)	71,233	0.2
(Loss)/gain on disposal of discontinued operations ⁽²⁾	(26,194)	(0.1)	324,656	1.2	161,817	0.5
Net income	2,286,086	12.6	2,117,199	7.9	1,191,176	3.6
Noncontrolling interest	(642,645)	(3.5)	(1,198,502)	(4.5)	(973,174)	(3.0)
Net income attributable to Sistema JSFC . .	1,643,441	9.1	918,697	3.4	218,002	0.6

	Years ended 31 December		
	2009	2010	2011
	(\$ in thousands)		
Cash flows			
Net cash provided by operating activities	3,684,569	4,056,752	5,571,408
Net cash used in investing activities	(6,298,273)	(4,839,344)	(5,185,884)
Net cash provided by/(used in) financing activities	5,207,891	(6,878)	(481,938)
Consolidated balance sheet data (end of period)			
Cash and cash equivalents of continuing operations ⁽³⁾	5,351,761	4,554,372	4,239,032
Short-term investments	575,966	879,680	763,631
Total assets	42,011,040	44,166,048	43,902,021
Total debt (long-term and short-term) ⁽⁴⁾	15,445,221	15,384,001	16,409,883
Total liabilities	27,918,784	29,850,172	29,472,239
Total shareholders' equity	14,009,995	14,208,533	13,705,963
Non-U.S. GAAP measure			
OIBDA ⁽⁵⁾	6,687,593	7,165,397	7,223,090

- (1) Net of income tax effect of \$2.78 million in 2009, \$23.5 million in 2010 and \$26.2 million in 2011.
- (2) Net of income tax effect of \$39.5 million in 2011. Income tax effect was nil in 2009 and 2010.
- (3) Includes cash from banking activity in the amount of \$1,936,456 thousand, \$2,308,488 thousand and \$1,315,075 thousand in 2009, 2010 and 2011, respectively.
- (4) Includes short-term loans payable, long-term debt, net of current portion and current portion of long-term debt.
- (5) OIBDA represents operating income before depreciation, depletion and amortisation. OIBDA is not a measure of financial performance under U.S. GAAP. You should not consider it an alternative to net income as a measure of operating performance or to cash flows from operating activities as a measure of liquidity. Our calculation of OIBDA may be different from the calculation used by other companies and therefore comparability may be limited. We believe that OIBDA provides useful information to investors because it is an indicator of the strength and performance of our ongoing business operations, including our ability to fund discretionary spending such as capital expenditures, acquisitions of subsidiaries and other investments and our ability to incur and service debt. While depreciation, depletion and amortisation are considered operating costs under U.S. GAAP, these expenses primarily represent non-cash current period allocation of costs associated with long-lived assets acquired or constructed in prior periods.

The following table presents a reconciliation of OIBDA to operating income for the periods indicated:

	For the year ended		
	2009	2010	2011
	(\$ in thousands)		
Operating income	4,252,860	4,302,643	3,941,461
Depreciation, depletion and amortisation	2,434,733	2,862,754	3,281,629
OIBDA	6,687,593	7,165,397	7,223,090

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following is a discussion of our financial condition and results of operations as at and for the years ended 31 December 2009, 2010 and 2011 and of the material factors that we believe are likely to affect our consolidated financial condition. You should read this section together with our audited consolidated financial statements as at and for the years ended 31 December 2009, 2010 and 2011, including the notes to those financial statements. In addition, this discussion contains forward-looking statements that involve risks and uncertainties. Our actual results may differ materially from those discussed in forward-looking statements as a result of various factors. Our reporting currency is the U.S. dollar, and our consolidated financial statements have been prepared in accordance with U.S. GAAP.

Overview

We are the largest publicly-traded diversified investment company in the Russian Federation and the CIS in terms of market capitalisation, managing companies that collectively serve over 100 million customers. We are focused on delivering long-term growth to our shareholders through returns on our diversified portfolio of investments and identifying new and profitable investment opportunities. Our investment portfolio is currently largely composed of stakes in Russian businesses operating in a variety of sectors, including telecommunications, oil, utilities, consumer, high tech and others.

We were founded in 1993 by Vladimir Evtushenkov and his close associates as an operating holding company and developed through the 1990s and early 2000s through various acquisitions and the creation of several successful strategic partnerships. We completed an IPO in February 2005, when we completed a standard listing of our GDRs on the London Stock Exchange. Our ordinary shares are listed on the MICEX-RTS Stock Exchange and on the Moscow Stock Exchange.

Since our founding, we primarily operated in the wireless communications, fixed line telecommunications, technology, insurance, real estate, media, banking, retail and travel sectors. In March 2009, we added the oil sector to our operations by acquiring a controlling interest in JSOC Bashneft and related companies. In October 2009, we sold our fixed line telecommunications operations to our wireless communication subsidiary, MTS OJSC, creating a leading supplier of integrated telecommunications solutions in the Russian Federation and the CIS.

In October 2010, we adopted a new strategy providing for our transition from an operating holding company to an investment company. In April 2011, in line with this strategy and to better allow us to identify and evaluate new investment opportunities and to manage our existing investments, we announced a new organisational and management structure which divides our investments into Core Assets and Developing Assets. See “*Business—Our businesses*” for more information on our management of, and strategy with respect to, our Core Assets and Developing Assets. We consider RussNeft, in which we hold a non-controlling 49.0% stake, to be one of our Developing Assets. See “*—Acquisitions, Divestitures and Key Corporate Restructurings—Acquisitions—Acquisition of non-controlling stake in RussNeft.*”

Consolidated revenues, OIBDA and net income attributable to Sistema JSFC for the year ended 31 December 2011 were \$32,981.2 million, \$7,223.1 million and \$218.0 million, respectively. For the year ended 31 December 2011, MTS and Bashneft, two of our Core Assets, accounted for 88.6% of our consolidated revenues and RTI, MTS Bank and SSTL, three of our Developing Assets, accounted for 6.5% of our consolidated revenues. In 2011, MTS and Bashneft recorded an aggregate operating income of \$5,672.7 million and RTI, MTS Bank and SSTL recorded an aggregate operating loss of \$1,169.2 million.

We require substantial funds to make new investments and support our Developing Assets in their early stages. Bashneft and MTS also require substantial funds to support their operations, but they are largely self-sufficient in terms of funding. Our cash outlays for capital expenditures in the years ended 31 December 2009, 2010 and 2011 were \$3,434.4 million, \$4,179.6 million and \$4,132.1 million, respectively. We have historically financed our cash requirements through cash flows, including dividends from subsidiaries, and borrowings. The proceeds from long-term borrowings for the years ended 31 December 2009, 2010 and 2011 amounted to \$11,639.0 million, \$5,459.4 million and \$6,421.0 million, respectively. As at 31 December 2011, we had indebtedness of \$16,409.9 million, including capital lease obligations, and our interest expense for 2011 was \$1,742.7 million, net of amounts capitalised.

Our portfolio companies also require substantial funds for capital expenditures. The table below sets forth capital expenditures under each of our reporting segments (except for Corporate Division) and for our Other category for the periods indicated:

<u>Subsidiary</u>	<u>Year Ended 31 December</u>		
	<u>2009</u>	<u>2010</u>	<u>2011</u>
	(\$ in millions)		
MTS	2,208.0	2,647.1	2,584.5
Bashneft	403.5 ⁽¹⁾	1,088.8	877.4
RTI	125.7	91.2	127.2
MTS Bank	25.9	19.2	34.4
SSTL	210.1	169.0	178.2
Other ⁽²⁾	574.3	105.3	321.7

Notes

- (1) This figure represents capital expenditures for the year ended 31 December 2009. Capital expenditures equalled \$289.7 million from 1 April 2009 to 31 December 2009, the period during which Bashneft's results were consolidated into our accounts.
- (2) Other includes Bashkirenergo, Sistema Mass Media, Intourist, Medsi Group, Binnopharm and NIS.

The following table illustrates our ownership interests in our principal consolidated subsidiaries as at 31 December 2011.

<u>Subsidiary</u>	<u>Industry</u>	<u>Beneficial ownership⁽¹⁾</u>	<u>Voting interest⁽²⁾</u>
MTS	Telecommunications	53%	53%
Bashneft ⁽³⁾	Oil	69%	86%
RTI	High Technology	85%	85%
MTS Bank	Banking	99%	99%
SSTL	Telecommunications	57%	57%
<u>Other</u>			
Bashkirenergo ⁽⁴⁾	Energy	39%	50%
Sistema Mass Media	Media	75%	75%
Detsky Mir	Retail	75%	75%
Intourist	Travel services	66%	66%
Meds Group	Private Healthcare	100%	100%
Binnopharm	Pharmaceuticals	100%	100%
NIS ⁽⁵⁾	High Technology	51%	51%

- (1) Represents the percentage of ownership interests of the relevant entity that are beneficially owned by Sistema JSFC, directly or indirectly, based on its proportionate ownership of the relevant entity through its consolidated subsidiaries. Sistema JSFC's ownership interests in the subsidiaries presented above are calculated based on shares owned by us as well as shares owned by certain companies affiliated but not owned by us, which we are required to consolidate under U.S. GAAP as variable interest entities in which we are deemed to be the primary beneficiary.
- (2) Represents the percentage of ownership interests of the relevant entity that Sistema JSFC or any of its consolidated subsidiaries has the power to vote.
- (3) Bashneft has two classes of shares: ordinary shares, which are voting shares, and preferred shares, which are non-voting shares. Our voting interest in Bashneft is greater than our beneficial ownership because we own a greater share of Bashneft's overall ordinary shares than we do of Bashneft's ordinary and preferred shares combined.
- (4) Bashkirenergo has two classes of shares: ordinary shares, which are voting shares, and preferred shares, which are non-voting shares. Our voting interest in Bashkirenergo is greater than our beneficial ownership because we own a greater share of Bashkirenergo's overall ordinary shares than we do of Bashkirenergo's ordinary and preferred shares combined.
- (5) In February 2012, we increased our stake in NIS to 70%. See "*—Recent Developments.*"

Segment Reporting

In April 2011, we approved a new organisational and management structure, which classifies our assets into two business units based on their level of maturity: Core Assets and Developing Assets. This change in structure has caused the composition of our reportable segments to change. We currently have six reportable segments,

namely, MTS and Bashneft, which form part of the Core Assets; RTI, MTS Bank and SSTL, which form part of the Developing Assets; and the Corporate Division. Information about our other operating segments that are not reportable due to their materiality is combined and disclosed in the Other category. The Other category includes Bashkirenergo, Sistema Mass Media, Detsky Mir, Intourist, Medsi Group, Binnopharm and NIS.

To measure performance of these segments, we examine certain segment financial information, including net sales to external customers, intersegment sales and operating income. A significant share of total revenues is derived from the MTS and Bashneft segments. In 2009, 2010 and 2011, MTS accounted for 54.5%, 42.1% and 37.4%, respectively, and Bashneft accounted for 26.8%, 43.7% and 50.2%, respectively, of our total revenues. See “—*Segment Financial Results Overview*,” below, for further discussion on our segments.

Recent Developments

In January 2012, Sistema JSFC granted approximately 1% of our charter capital to certain members of our Management and Board of Directors within the framework of our Long-Term Motivation Programme (the “**Motivation Programme**”), approved in September 2010. See “—*Liquidity and Capital Resources—Stock Option Plans*” and “—*Management—Compensation—Incentive Schemes—Long-term incentive scheme*.”

In January 2012, JSOC Bashneft made a drawdown of RUB 10 billion under the revolving credit facility agreement entered into with Sberbank dated 15 October 2010. See “—*Liquidity and Capital Resources—Capital Resources—Description of material loan agreements—Bashneft—Credit facility agreements with Sberbank*.”

In January 2012, we announced that we are in discussions with NVision Group Managing Company LLC about a potential transaction between RTI and CJSC NVision Group, one of the largest information and communication technology companies in the Russian Federation.

In January and March 2012, Sistema JSFC made drawdowns under the facility agreement entered into with the Royal Bank of Scotland N.V. dated 29 December 2011 in the aggregate amount of \$267.4 million. See “—*Liquidity and Capital Resources—Capital Resources—Description of material loan agreements—SSTL—Facility agreement with the Royal Bank of Scotland N.V.*”

In February 2012, Sistema JSFC increased our stake in NIS from 51% to 70% through the acquisition of an additional issuance of NIS shares in exchange for the contribution of a 51% stake in M2M Telematics LLC to the charter capital of NIS.

On 17 February 2012, Bashneft JSOC issued 10,000,000 non-convertible rouble-denominated bonds at par value of RUB 1,000, maturing in 2022. The bonds have a coupon rate of 9.0% per annum until February 15, at which point subsequent coupon rates are to be determined and bondholders have the right to redeem the bonds at par value. As a result of this bond issuance, the other borrowings as described herein under “—Recent Developments” and the appreciation of the rouble against the U.S. dollar, the amount of our total debt (long-term and short-term) in U.S. dollar terms as of 31 March 2012 has increased compared with the amount of our total debt in U.S. dollar terms as of 31 December 2011.

In March 2012, RTI made a voluntary offer to acquire up to a 36.9% stake in JSC SITRONICS (“**SITRONICS**”), representing all of the shares in SITRONICS that RTI currently does not own, at a cash price of RUB 0.55 (\$0.02 at RUB/\$ exchange rate on 31 March 2012) per common share. Should the entire 36.9% stake be acquired, total cash consideration would equal RUB 1,939 million (\$66.1 million). The offer is expected to remain open until 22 May 2012.

On 30 March 2012, Sistema JSFC entered into a facility agreement with Raiffeisen Bank International AG allowing for borrowings of up to INR 10.3 billion (approximately \$202.4 million). See “—*Liquidity and Capital Resources—Capital Resources—Description of material loan agreements—SSTL—Facility agreement with Raiffeisen Bank International AG*.”

In the first quarter of 2012, Medsi Group commenced a transaction with the State Unitary Enterprise Medical Centre under the Administration of the Mayor of Moscow and the Moscow Government (“**SUE**”), a large group of healthcare institutions in Moscow. Within the framework of the transaction, Medsi Group has initiated an additional share issuance via closed subscription in favour of two parties—SUE and an investment vehicle, through which investment funds are expected to make investments into Medsi Group. SUE is expected to pay for the shares issued to it with property, which currently has a market value of approximately RUB 6.043 billion. In

exchange for this property, SUE is expected to receive a 25.02% stake in the integrated company. According to current plans, SUE is to become a shareholder of Medsi Group upon completion of the transfer of the designated healthcare assets, which is expected to occur by the end of 2012. The investment vehicle is currently expected to purchase a 24.98% stake in Medsi Group via the additional share issuance in exchange for RUB 6.035 billion in cash. Should the legal entity participate in the issuance, Sistema JSFC expects to retain a 50% stake in and control of the combined entity. Should the legal entity not participate in the issuance, Sistema JSFC will likely retain up to a 74.98% stake in the combined entity. The combined entity is expected to operate under the Medsi Group name.

In April 2012, the shareholders of JSOC Bashneft and certain of its subsidiaries formally approved the reorganisation of Bashneft's corporate structure through the merger of certain of JSOC Bashneft subsidiaries into JSOC Bashneft. See "*Business—Business Description—Core Assets—Bashneft—Organisational Structure*" and "*—Acquisitions, Divestitures and Key Corporate Restructurings—Divestitures & Key Corporate Restructurings—Energy—Bashneft.*"

In April 2012, Sistema, together with RZ Agro Ltd., announced they are establishing an agricultural joint venture RZ Agro Holding Ltd. (the "**RZ Agro**") to be located in the Rostov region of the Russian Federation. Sistema is expected to contribute to the joint venture two grains and oilseed farms with a total acreage of 46,000 hectares, and RZ Agro Ltd. is expected to contribute farmland comprising 41,500 hectares. Completion of the transaction is subject to the satisfaction of certain conditions, including the receipt of FAS approval and execution of additional agreements, and is expected to occur in the second quarter of 2012. Upon completion of certain conditions in 2013, Sistema is expected to own 50% in RZ Agro.

Key Factors Affecting Our Results of Operations

We believe that the following factors significantly affected our results of operations for the years ended 31 December 2009, 2010 and 2011 and will have a significant impact on our results of operations in the future.

Because Bashneft and MTS accounted for 88.6% of consolidated revenues in the year ended 31 December 2011, significant factors that affect their results of operations are likely to have an impact on our results of operations.

General Factors

Russian and CIS Macroeconomic Conditions and Trends

The following table sets out key economic indicators of the Russian Federation and for the periods indicated:

Macroeconomic indicator	Year Ended 31 December		
	2009	2010	2011
Real GDP (decline)/growth (% , period-on-period)	(7.8)	4.3	4.3
Inflation			
Consumer price inflation (%)	8.8	8.8	6.1
Producer price inflation (%)	13.9	16.7	12.0
Exchange rates			
Period-end exchange rate (RUB/\$)	30.24	30.48	32.20
Average exchange rate (RUB/\$)	31.72	30.37	29.38
Nominal rouble (depreciation) appreciation against U.S. dollar (based on period-end rates)	(2.9)	(0.8)	(5.6)
Real rouble appreciation (depreciation) against U.S. dollar	(12.2)	9.7	8.8
Real disposable income growth (% , period-on-period)	3.1	5.1	0.8

Source: Rosstat.

The macroeconomic condition of the Russian economy substantially affects our results of operations. A fall in GDP, for example, would likely lead to a decline in demand for the products our subsidiaries offer, including telecommunications products and services and refined oil products. A fall in GDP may also lead to a decline in the prices of the products our subsidiaries sell. A rise in GDP, on the other hand, would likely have a positive impact on our results of operations. In addition, a decline in real disposable income may negatively impact our results of operations, should it cause a decline in demand for the key retail products our subsidiaries sell.

Inflation and exchange rate movements have a particular impact on our results of operations.

Inflation

Historically, the Russian economy has been characterised by high rates of inflation, though these rates have declined in relative terms over the past several years. While a significant part of our costs are denominated in U.S. dollars or are closely tied to the U.S. dollar, such as the price of crude oil purchases at Bashneft, a significant share of our costs, including salaries and utility costs, are sensitive to rises in the general price level in the Russian Federation. An increase in inflation, therefore, would increase our costs and thereby exert downward pressure on our profit margin and may also negatively impact domestic demand for the products of our subsidiaries. To the extent the increase in costs from higher inflation is not offset by an increase in sales, our results of operations would be negatively affected.

MTS' financial position and results of operations have been influenced by inflation in the various countries in which it conducts business, particularly the Russian Federation, where consumer price inflation equalled 8.8% in each of 2009 and 2010 and 6.1% in 2011. In Ukraine, Uzbekistan and Armenia, where MTS also has operations, consumer price inflation totaled 8.0%, 7.6% and 7.7%, respectively, in the year ended 31 December 2011. These rates of inflation contributed to an increase in cost of sales, exclusive of depreciation, depletion and amortisation, of \$2,304.4 million, or 21.5%, in 2011 compared to 2010 and of \$3,631.8 million, or 51.3%, in 2010 compared to 2009. We expect that inflation-driven increases in costs would put pressure on MTS' margins. While MTS could seek to raise its tariffs to compensate for such increase in costs, competitive pressures may not permit increases that are sufficient to preserve operating margins. See *"Risk Factors—Risks Relating to Our Business and Industry—General Risks—We encounter competition from other companies in all areas of operations."*

Bashneft's financial position and results of operations have also been affected by inflation levels in the Russian Federation, in particular, the impact of inflation on real exchange rate levels. See *"—Exchange rate movements,"* below. In addition, because Bashneft is engaged in a capital-intensive industry, and thus relies on the successful implementation of large-scale projects requiring significant capital expenditures, we expect that inflation in the Russian Federation would have a negative impact on the costs associated with such capital expenditures. In the event of a significant increase in prices in the Russian Federation, Bashneft may be limited in its ability to increase sales prices due to competitive pressures as well as certain other factors, such as potential government-imposed price ceilings.

Exchange rate movements

Most of our revenues from operations are denominated in roubles, and a significant part of our capital expenditures and borrowing costs, including at MTS and Bashneft, are denominated in foreign currencies, including the U.S. dollar, the euro and, with respect to SSTL, the Indian rupee, or tightly linked to the U.S. dollar.

The depreciation of the rouble against the U.S. dollar or the euro would likely have an overall negative effect on our financial position and results of operations. With respect to our financial position, rouble depreciation would lead to an increase in the rouble equivalent of our borrowings and other liabilities that are denominated in U.S. dollars or euros, and would subject our investments in rouble-denominated monetary assets to the risk of loss in U.S. dollar terms. For example, the rouble depreciated in nominal terms by 5.6% during 2011, increasing the cost of servicing our rouble-denominated debt, which amounted to \$7,001.7 million (based on the exchange rate of RUB/\$ exchange rate of 32.20, in effect on 31 December 2011). As at 31 December 2011, our borrowings denominated in foreign currencies equaled \$4,658.0 million. Rouble depreciation may also make it more difficult to timely fund cash payments on debt denominated in foreign currencies. The negative impact of rouble depreciation on our financial position would be partially offset, however, by an increase in the rouble equivalent of our monetary assets denominated in foreign currencies, such as the U.S. dollar or euro. Depreciation of the rouble against the U.S. dollar would also increase our costs denominated in roubles, both in absolute terms and relative to rouble-denominated revenues. See *"Risk Factors—Risks Relating to the Russian Federation—Economic Risks—Depreciation of the rouble against the U.S. dollar and euro could increase our costs and reduce our revenues, or make it more difficult for us to comply with financial ratios and to repay our debts."*

While we could seek to raise our prices and tariffs to compensate for the increase in costs resulting from depreciation of the rouble, competitive pressures may not permit increases that are sufficient to preserve our operating margins. In addition, because the U.S. dollar is our reporting currency and the rouble is our predominant functional currency, a decline in the rouble against the U.S. dollar will result in a decrease in revenues in U.S. dollar terms in our consolidated financial statements.

We carry out a variety of measures to hedge against currency fluctuations, and, in particular, the depreciation of the rouble against the U.S dollar or euro.

We from time to time enter into cross-currency interest rate swap agreements and foreign currency option agreements. In 2009, for example, we entered into several cross-currency interest rate swap agreements, which fix in advance exchange rates at which future swaps of both principal and interest payments from rouble-denominated amounts to U.S.-dollar and euro-denominated amounts may take place. The foreign currency option agreements that we have entered into grant us a combination of put and call option rights to acquire foreign currencies at different rates. As at 31 December 2011, the total fair value of our currency option agreements was \$0.9 million. See “—Market Risk—Interest Rate Risk.”

Capital expenditures and the implementation of large-scale investment projects

We require substantial funds to support our operations and implement large-scale investment projects at our subsidiaries. Our portfolio companies require capital expenditures for various reasons. MTS, for example, requires capital expenditures primarily to continue the installation and build-out of its 3G, broadband Internet and fixed line networks, and to maintain its market share. Bashneft, on the other hand, generally requires capital expenditures to modernise its facilities and improve its results of operations. MTS and Bashneft are largely self-sufficient in funding, but our other portfolio companies which are less mature, particularly SSTL, require funding from Sistema JSFC. Our results of operations, therefore, are impacted by our ability to raise adequate levels of debt financing and successfully complete capital investment projects in a timely manner and within budget.

In 2009, 2010 and 2011, our cash outlays for capital expenditures were \$3,434.4 million, \$4,179.6 million and \$4,132.1 million, respectively. From 2009 through 2011, we financed our cash requirements through a combination of operating cash flows and borrowings. In particular, we have used cash flows received through dividends from MTS and Bashneft to finance capital expenditures in our other subsidiaries.

The table below sets forth capital expenditures at each of our reporting segments (except for Corporate Division) and for our Other category for the periods indicated:

<u>Subsidiary</u>	<u>Year Ended 31 December</u>		
	<u>2009</u>	<u>2010</u>	<u>2011</u>
	<i>(\$ in millions)</i>		
MTS	2,208.0	2,647.1	2,584.5
Bashneft	403.5 ⁽¹⁾	1,088.8	877.4
RTI	125.7	91.2	127.2
MTS Bank	25.9	19.2	34.4
SSTL	210.1	169.0	178.2
Other	574.3	105.3	321.7

(1) This figure represents capital expenditures for the year ended 31 December 2009. Capital expenditures equalled \$289.7 million from 1 April 2009 to 31 December 2009, which corresponds with the period consolidated into our accounts.

We expect our capital expenditure to remain at a level in 2012 similar to 2011, and also do not expect a material difference for funding our operations in 2013 and 2014. MTS expects to spend approximately \$2.5 billion (calculated using the exchange rate as at 31 December 2011) in 2012. Bashneft expects to spend \$1.0 billion-\$1.2 billion in 2012. Actual capital expenditures may vary depending on the availability of financing, demand, currency volatility and other factors, including, with regard to Sistema JSFC, the availability of dividends from subsidiaries.

Certain of our subsidiaries, such as Bashneft and MTS, operate in capital-intensive industries, and their results of operations depend significantly on their ability to successfully carry out large-scale investment projects. This includes the ability to select and prioritise those large-scale investment projects which are most likely to increase margins and the ability to plan and implement such projects, including attracting the significant funding necessary to ensure their completion.

For example, in 2011, MTS capital expenditures amounted to approximately 21% of its total revenues. A significant share of these funds were spent on the expansion of MTS’ 3G network in the Russian Federation, which now includes approximately 23,000 3G base stations. SSTL also relies on capital expenditures to finance its continued expansion of its coverage in the Indian mobile telecommunications market.

Bashneft's results of operations are expected to depend on the successful development of the Trebs and Titov oil fields on a timely basis and within budget. According to Bashneft's current estimates, production at Trebs and Titov is expected to begin in 2013, and peak production is expected to take place from 2018 through 2023. To develop these fields, Bashneft and LUKOIL agreed to establish a joint venture, in which Bashneft's share is 74.9% and LUKOIL's share is 25.1%. Upon creation of the joint venture, we began to account for Bashneft-Polus under the equity method because we concluded that, although we have a 74.9% stake in the company, the shareholders agreement grants substantive participating rights in Bashneft-Polus to LUKOIL. Bashneft and LUKOIL are expected to finance development of the oil fields in proportion with their respective stakes in the joint venture. In 2011, approximately RUB 5.3 billion were spent on development of the Trebs and Titov fields (including the acquisition of 29 exploratory wells from LUKOIL), and Bashneft expects capital expenditures on the fields to amount to approximately RUB 9-10 billion in 2012. According to current estimates, capital expenditures for the overall project are expected to reach \$6 billion. Nevertheless, these figures are subject to change, based on, among other factors, exchange rate movements, revisions to costs and design specifications and the availability of financing. The project is expected to be funded principally through a combination of debt financing and excess cash flows from Bashneft's and LUKOIL's operations. See "*Business—Material Litigation*" for a discussion of a shareholder claims challenging the licence to explore and develop the Trebs and Titov fields.

Acquisitions

During the period under review, we made several acquisitions that had a significant impact on our results of operations and financial condition, the most significant of which in terms of purchase price was our purchase in April 2009 of a controlling stake in various oil and energy companies in Bashkortostan. Because of the number of significant transactions completed between 1 January 2009 and 31 December 2011, period-to-period comparisons of our results of operations need to be considered in light of the impact of such transactions. See "*—Acquisitions, Divestitures and Key Corporate Restructurings—Acquisitions.*"

Acquisitions are expected to continue to be a core element of our growth strategy, which is based on seeking opportunities to create value for our portfolio. The ability to carry out large-scale acquisitions successfully and on a timely basis is in large part dependent on choosing the appropriate companies to acquire, securing the necessary financing and properly integrating the acquired company into our portfolio. In selecting our acquisitions, we rely on various financial metrics including TSR, which is compared against internal hurdle rates for specific industries and investment types when making an acquisition.

Having selected a potential value-enhancing acquisition, we often require substantial funding sources to complete the transaction. In 2009, 2010 and 2011, we spent \$1,729.1 million, \$364.5 million and \$375.2 million, respectively, on purchases of businesses, net of cash acquired. Historically, we have relied on a combination of operating cash flows, dividends from subsidiaries and external funding to finance our acquisitions. We expect to continue relying on these sources for future acquisitions, and, in particular, expect to seek external funding sources only for large-scale acquisitions. Therefore, our ability to make acquisitions depends on factors that affect the overall performance of our subsidiaries and conditions on the lending market, including the condition of the global and Russian economies and market interest rates. See "*—Market Risks—Interest Rate Risk.*"

Our results of operations are also dependent on properly integrating a newly acquired company into our portfolio. We seek to influence our portfolio companies primarily through board representation, with operational decisions taken by the management teams of each portfolio company. In certain circumstances, we may also assist our portfolio companies, in particular Developing Assets, in relation to overall strategy, partnerships, risk management, corporate governance and internal controls, third party financing, management selection and identifying and implementing synergies with other portfolio companies.

Factors Affecting MTS' Results of Operations

In addition to general economic conditions, inflationary trends and currency and interest rate fluctuations discussed above, factors significantly affecting the results of operations of MTS are set forth below.

Acquisitions

MTS' results of operations for the periods presented are significantly affected by acquisitions. See "*—Acquisitions, Divestitures and Key Corporate Restructurings—Acquisitions*" below for a discussion of those MTS acquisitions which are material to Sistema. In 2009, 2010 and 2011, MTS spent \$1,688.1 million, \$588.6 million and \$890.5 million, respectively, on acquisitions.

During the period under review, MTS' most significant acquisitions in terms of purchase price were its purchase of stakes in Comstar UTS and MGTS, as well as its purchase in December 2010 of Sistema Telecom LLC ("**Sistema Telecom**"), the holder of the MTS trademark, for \$379.0 million.

In October 2009, MTS purchased a 50.9% stake in Comstar, a provider of fixed line communication services in the Russian Federation, Ukraine and Armenia, from Sistema JSFC for RUB 39.15 billion (\$1,322.3 million). MTS subsequently increased its ownership stake in Comstar to 62.0% (or 64.0% excluding treasury shares) in December 2009 and to 71.0% (or 73.3% excluding treasury shares) in September 2010 through a voluntary tender offer. On 23 December 2010, the extraordinary general shareholders meetings of Comstar and MTS approved a merger of Comstar and MTS, which was completed on 1 April 2011. On 10 March 2011, MTS completed a share buyback as part of the reorganisation of MTS involving a merger with Comstar, Dagtelecom and Evrotel. Specifically, a total of 8,000 MTS ordinary shares representing 0.0004% of MTS' issued share capital were repurchased for RUB 1.96 million. The buyback price was set at RUB 245.19 per one MTS ordinary share. In addition, a total of 22,483,791 Comstar ordinary shares representing 5.4% of Comstar issued share capital were repurchased for RUB 4.8 billion. The buyback price was set at RUB 212.85 per one Comstar ordinary share. The remaining 98,853,996 Comstar ordinary shares were converted into treasury shares and 73,087,006 newly-issued MTS ordinary shares at an exchange ratio of 0.825 MTS ordinary shares for each Comstar ordinary share. MTS has since resold the 8,000 ordinary shares it had repurchased as part of the buy-back, having sold the remaining 2,340 ordinary shares in March 2012.

In December 2011, MTS purchased a 29% stake in MGTS, a fixed line operation, as part of its acquisition of a 100% stake in CJSC Sistema-Inventure, which directly owned 29% of the ordinary shares of MGTS. The purchase price for the 29% stake in MGTS was \$667.8 million (of which \$331.5 million represented assumed debt).

Competition and Market Penetration

MTS faces significant competition in the mobile and fixed line telecommunications services market.

The wireless telecommunications services market is particularly competitive in the Russian Federation and Ukraine, where mobile penetration exceeds 100% (based on number of SIM cards). While customer growth has been, and expected to continue being, a principal source of revenue growth, increasing competition and market saturation will likely cause the increase in subscribers to continue to slow in comparison to MTS' historical growth rates. As a result, MTS will need to continue developing new competitive services, including value-added, 3G, Internet, Blackberry services, integrated telecommunications services and others, as well as consider vertical integration opportunities through the development or acquisition of dealers in order to generate new sources of revenue in addition to standard voice services.

MTS' ability to secure new revenue sources is dependent on several factors, including its ability to identify attractive opportunities in markets that will grow, to manage the operations of acquired or newly established businesses and to secure key licences in important growth areas. MTS' strategy currently contemplates the acquisition of additional operations within the CIS in both the mobile and fixed broadband segments.

MTS' future results of operations are likely to be affected by its ability to develop its network, including its 3G network, as well as by its ability to enter the market for 4G wireless services. In September 2011, the Russian government announced its intention to auction frequencies for LTE use on a national level in 2012. Currently, Scartel (Yota brand) has two ranges of LTE frequencies each in the 2.5-2.7 GHz band. Four sets of additional frequencies in the 791-862 MHz band are expected to be sold at auction in 2012, the winners of which will also receive frequencies in the 2.5-2.7 GHz band. The remaining frequencies that are to be sold during the auction comprise 40 MHz of the 2.5-2.7 GHz band. According to recent news reports, MegaFon, one of MTS' principal wireless competitors in the Russian Federation, is negotiating a possible acquisition of Scartel, which, were it to take place, may present MegaFon with significant short-term competitive advantages both in terms of frequency resources and LTE network development costs.

Tariff regulation

MGTS, a Moscow public switched telephone network ("**PSTN**") fixed line subsidiary of MTS, is considered to be a company holding a dominant position as well as a natural monopoly in the Moscow telecommunications market under Russian antimonopoly regulations. Consequently, the FTS regulates MGTS' tariffs for most services provided to its PSTN subscribers, including installation fees, monthly subscription fees (for subscribers to the unlimited tariff plan) and local call charges (for subscribers who do not use the unlimited tariff plan).

In addition, the Federal Law on Communications also provides for the special regulation of telecommunications operators occupying a “substantial position,” *i.e.*, operators which together with their affiliates have, in the Russian Federation generally or in a geographically defined specific numerical zone, 25% or more of installed capacity or capacity to carry out transmission of not less than 25% of traffic. Comstar and MGTS were added to the register of telecommunications operators occupying a substantial position in 2005 and 2006, respectively. Accordingly, the interconnect tariffs established by Comstar, prior to its merger with MTS, and MGTS are also subject to regulation by the Federal Agency on Communications. Although MTS has not been formally recognised as a telecommunications operator occupying a substantial position on the market, we believe that interconnect tariffs previously approved by the Federal Agency on Communications for Comstar also apply to MTS following the merger completed on 1 April 2011.

MGTS’ tariffs for both residential and corporate customers have generally increased between 2009 and 2011, contributing to an increase in profits and we believe the tariffs currently set by the FTS and the Federal Agency on Communications are sufficient to compensate MTS for the costs of providing its services. We expect that an increase in tariffs at a faster rate than an increase in costs would have a positive impact on MTS’ results of operations, while lower tariffs or higher costs without a corresponding increase in tariffs would likely have a negative effect on MTS’ results.

Seasonality

MTS’ results of operations are impacted by certain seasonal trends. Generally, revenue is higher during the second and third quarter due to increased mobile use by subscribers who travel in the summer from urban areas to more rural areas where fixed line penetration is relatively low, as well as an increase in roaming revenues and guest roaming revenues during these quarters. Quarterly trends can also be influenced by a number of factors, including new marketing campaigns and promotions, and may not be consistent from year to year. Furthermore, MTS’ results of operations may be impacted by unexpected adverse weather conditions. In 2010, for example, MTS was significantly and adversely affected by a sustained heat wave in Moscow and severe wildfires in the surrounding regions. Many of MTS’ subscribers left Moscow, which resulted in a substantial decline in the volume in calls made, and, in turn, MTS’ revenues in the fixed line segment in the third quarter of 2010.

Factors Affecting Bashneft’s Results of Operations

Crude oil and oil product prices, together with refining costs

The principal factor affecting Bashneft’s results of operations are the prices for crude oil and oil products, both in the international market and in the Russian Federation, together with its refining costs in the Russian Federation.

Crude oil and oil product prices are affected by external factors over which Bashneft has no control, such as global economic conditions, demand fluctuations, global and domestic supply, global inventory levels, weather, government regulation and price controls and competing fuel prices. Export and domestic prices for crude oil and oil products have been highly volatile, depending, among other things, on the balance between supply and demand, the economic environment, conditions in commodities and financial markets and worldwide production levels.

A decline in the price of crude oil has both a positive and negative effect on Bashneft’s results of operations. A lower price for crude oil may lead to a lower cost of purchased crude oil, gas and oil products, and to lower mineral extraction taxes and customs duties and therefore potentially an increase in profits from the sale of oil products. At the same time, a lower price for crude oil means that Bashneft would generate lower revenues from the sale of crude oil. During the period under review, crude oil prices have increased. Although operating income declined in 2010 compared to 2009, revenues from crude oil and oil products’ sales increased at a faster rate than cost of sales, a large component of which consists of crude oil purchases, and taxes other than income tax, which are linked to the price of crude oil. The increase in crude oil prices in 2011 compared to 2010 led to an increase in Bashneft’s operating income, despite being partially offset by an increase in the cost of sales and taxes other than income tax.

Bashneft’s results of operations are also influenced by its refining costs, including feedstock and energy costs. In 2009, 2010 and 2011, Bashneft accrued approximately \$933 million, \$2,882 million and \$3,994 million, respectively, in expenses on crude oil, gas and petroleum products. While we believe Bashneft’s refining costs are higher than many of its competitors, we believe this is largely the result of the relatively more complex basket of oil products Bashneft produces and the complexity of its refineries. Due, in part, to the introduction of an energy saving programme, Bashneft has significantly lowered its per tonne refining costs from the beginning of 2009 through 2011.

Bashneft’s ability to lower its refining costs depends critically on its ability to produce an optimal slate of products and to efficiently adjust sales flows between domestic and export markets. For this reason, Bashneft has

prioritised those projects that will lead to an increase in refining depth and light product yield, and intends to produce only Euro-5 compliant products by 2015. See “*Business—Business Description—Core Assets—Bashneft—Refining and Petrochemicals.*”

International crude oil and oil products prices

The prices at which Bashneft sells crude oil and oil products are subject to significant fluctuations.

The average price for Brent crude oil was \$61.5 per barrel in 2009, \$79.5 per barrel in 2010 and \$111.3 per barrel in 2011. The increase in crude oil prices contributed to the overall increase in total crude oil sales revenues in 2010 compared to 2009 and in 2011 compared to 2010.

The following table shows the average prices for crude oil and oil products exports for 2009, 2010 and 2011, respectively.

	Average for the year ended 31 December		
	2009	2010	2011
Crude oil and oil products			
Brent crude, \$/barrel	61.5	79.5	111.3
Urals crude, \$/barrel	61.0	78.3	109.1
Fuel oil, \$/tonne ⁽¹⁾	344.0	440.8	607.2
Diesel fuel, \$/tonne ⁽²⁾	518.9	671.8	933.8
Naphtha, \$/tonne ⁽³⁾	531.2	710.9	929.2
Vacuum gasoil, \$/tonne ⁽⁴⁾	—	546.3	769.0

Source: *Platts*

- (1) Average FOB Rotterdam/CIF NWE
- (2) Average FOB Rotterdam/CIF NWE
- (3) Average FOB Rotterdam/CIF NWE
- (4) FOB NWE

Domestic crude oil and oil products sales

Substantially all crude oil produced in the Russian Federation is produced by vertically integrated oil companies, such as Bashneft. As a result, most transactions are between affiliated entities within vertically integrated groups. Thus, there is no concept of a benchmark domestic market price for crude oil. The price of crude oil that is produced but not refined or exported by one of the vertically integrated oil companies is generally determined on a transaction-by-transaction basis against a background of world market prices, but with no direct reference or correlation. At any time there may exist significant price differences between regions for similar quality crude oil as a result of the competition and economic conditions in those regions.

Domestic prices for oil products are determined to some extent by world market prices, but they are also directly affected by local demand and competition.

The following table shows the average and prices for domestic sales of crude oil and oil products (including excise taxes, but exclusive of value-added tax (“VAT”)) for 2009, 2010 and 2011, respectively.

	Average for the year ended 31 December		
	2009	2010	2011
Russian market (U.S.\$/tonne)			
Crude oil	182.5	222.2	304.4
Fuel oil	207.9	252.1	299.5
Diesel fuel (summer gasoil)	398.0	469.5	670.0
Diesel fuel (winter gasoil)	452.2	544.1	741.6
Jet fuel	427.0	490.4	701.8
High-octane gasoline	579.8	685.1	821.5
Low-octane gasoline	500.0	569.0	753.0

Source: *Kortes/Argus*

Taxation

Bashneft is subject to significant customs duties on the export of crude oil and oil products and to a broad range of taxes imposed at the federal, regional and local levels, and the taxes to which it is subject have had a significant effect on Bashneft's results of operations. Bashneft's revenues are presented net of value added tax. Russian tax legislation is and has been subject to varying interpretations and frequent changes. See "*Risk Factors—Risks Relating to the Russian Federation and Other Emerging Markets—Risks Relating to the Russian Taxation System—Russian tax laws, regulations and practice are complex, uncertain and often not well developed and are subject to frequent changes, which could have an adverse effect on us.*"

In addition to income tax and value added tax, Bashneft is also subject to:

- mineral extraction tax;
- export duties on crude oil;
- export duties on oil products;
- excise taxes on oil products;
- social taxes;
- property tax; and
- other taxes and levies.

These taxes (excluding income tax and value added tax) have had a significant effect on Bashneft's results of operations and represented 31.1%, 33.7% and 36.7% of Bashneft's total revenues in the years ended 31 December 2009, 2010 and 2011, respectively.

The table below presents a summary of the most significant duties and taxes to which Bashneft is subject during the periods indicated:

<u>Tax</u>	<u>Year Ended 31 December</u>		
	<u>2009</u>	<u>2010</u>	<u>2011⁽¹⁾</u>
Mineral extraction tax (roubles per tonne)			
Crude oil	2,299	3,074	4,455
Export duty (\$ per tonne)			
Crude oil	179	274	409
Light and medium distillates	133	197	274
Fuel oil	72	106	208
Excise taxes (roubles per tonne)⁽²⁾			
High octane gasoline	3,629	3,992	—
Low octane gasoline	2,657	2,923	—
Naphtha	3,900	4,290	—
Diesel fuel	1,080	1,188	—
Lubricants	2,951	3,246	—

(1) Effective 1 January 2011, excise taxes are differentiated based on fuel quality standards. See "*Excise taxes,*" below.

(2) Excise taxes are paid by sellers of refined products to end customers, while producers and intermediary re-sellers accrue excise tax and subsequently recover it subject to certain conditions set by Russian legislation.

Mineral extraction tax

The mineral extraction tax payable on crude oil increased by 33.7% from RUB 2,299 per tonne in 2009 to RUB 3,074 per tonne in 2010. In 2011, the mineral extraction tax payable increased to RUB 4,455 per tonne, a 44.9% increase compared to 2010.

The base rate of the mineral extraction tax is currently RUB 446 per tonne extracted. The rate is set on a monthly basis, and it is adjusted depending on the international market price of Urals blend and the rouble-U.S. dollar exchange rate and multiplied by a coefficient characterising the depletion of the relevant oil field. The coefficient is equal to 1.0 for oil fields with a depletion rate below 80%, defined as the ratio of cumulative production to initial extractable reserves of categories ABC1+C2 according to the State Balance of Reserves of Mineral Resources.

As at 31 December 2011, four of Bashneft's fields had a depletion rate of over 80%. As a result, on average, in 2009-2011, Bashneft's actual mineral extraction tax expenses were approximately 20-25% lower than the base tax rate, resulting in savings of approximately \$300-400 million per year.

The table below sets forth the base tax mineral extraction tax rate and actual mineral extraction tax expenses for the periods indicated:

<u>Mineral extraction tax</u>	<u>Year Ended 31 December</u>		
	<u>2009</u>	<u>2010</u>	<u>2011</u>
Base mineral extraction tax rates (\$/barrel)	10.3	13.9	20.8
Actual mineral extraction tax expenses (\$/barrel)	7.9	10.7	16.1

Export duties on crude oil

The crude oil export duty rate is revised monthly on the basis of the crude oil price in the immediately preceding month. The government determines the export duty rate, which is dependent on the average Urals price for the monitoring period, according to the following table. Effective 1 October 2011, the maximum marginal export duty rate for crude oil exports was lowered from 65% to 60% as part of the 60-66-90 Scheme, discussed below.

<u>Quoted Urals price (P), \$ per tonne</u>	<u>Maximum Export Duty Rate</u>
0 – 109.50	0%
109.50 – 146.00	35% * (P – 109.50)
146.00 – 182.50	\$12.78 + 45% * (P – 146.00)
>182.50	\$29.20 + 60% * (P – 182.50)

The average export duty on crude oil increased by 52.6% in 2010, compared to 2009, and by 49.3% in 2011, compared to 2010. The increase was associated with the increase of average Urals prices by 28.3% in 2010, compared to 2009, and by 39.3% in 2011, compared to 2010.

Total crude oil export duties paid by Bashneft in 2009, 2010 and 2011 amounted to \$329 million, \$876 million and \$1,466 million, respectively.

Export duties on oil products

Export duties on oil products are set by the Russian government on a monthly basis pursuant to a formula that takes into account several factors, including the price of crude oil and the domestic demand for oil products. An increase in the price of crude oil will generally lead to a corresponding increase in export duties on oil products, while a decrease in the crude oil price will generally lead to a corresponding decrease in export duties on oil products.

Export duties payable on oil products increased in 2010 compared to 2009 and 2011 compared to 2010, due to the recovery in domestic demand for oil products as well as to the increase in the international crude oil price.

In the years ended 31 December 2009, 2010 and 2011, Bashneft's export duties on oil products amounted to \$270 million, \$1,205 million and \$1,791 million, respectively.

60-66-90 Scheme

The Russian government has introduced the 60-66-90 Scheme for calculating the marginal export duty rates on crude oil and oil products. Beginning 1 October 2011, export duties on oil products, except gasoline, have been equalised at 66% of the crude oil export duty, which was achieved, in part, through the increase of marginal export duty rates on heavy oil products from 46.7% of the crude oil export duty. The export duty on gasoline has remained unchanged at 90% of the crude oil export duty. Effective 1 January 2012, the maximum marginal rate for crude oil export duties was lowered from 65% to 60% of the crude oil export duty.

The 60-66-90 Scheme is designed, in part, to stimulate investment in upstream assets. It is also expected to incentivise downstream oil companies to increase refining depth in order to export a greater share of light oil products. Because the plan has raised export duty rates on heavy oil products from their previous level of 46.7% of the crude oil export duty, it is expected that it will be less profitable than has historically been the case to produce heavy oil products, such as fuel oil.

Based on an exchange rate of RUB 30.27 per U.S. dollar and a price of \$90 per barrel of Urals oil, Bashneft currently estimates that it will lose approximately \$150 million annually as a result of the 60-66-90 Scheme. Nevertheless, in November 2011, the Russian government approved certain tax concessions for Bashneft designed to partially offset the impact of the 60-66-90 Scheme, which are expected to amount to approximately RUB 10 billion over the next five years. No decision has been formally taken as to the form of the tax concessions.

Excise taxes

Excise taxes on oil products are set by the Russian government. Excise taxes only apply to domestic sales and, because they are paid by the customer, represent an indirect tax on Bashneft's operations. An increase in excise tax rates generally exerts downward pressure on the domestic demand for, and, in turn, domestic price of, oil products. In 2010 compared to 2009, excise tax rates increased for each of Bashneft's principal oil products by 10%.

Prior to 1 January 2011, excise taxes on oil products were set based on the type of oil product and on its octane level. Beginning 1 January 2011, excise taxes are set based on fuel quality standards, with higher tax rates applying to lower quality fuel.

The table below sets forth excise tax levels for 2011-2014 as currently stipulated under Russian law.

	<u>2011</u>	<u>1 January – 30 June, 2012</u>	<u>1 July – 31 December 2012</u>	<u>2013</u>	<u>2014</u>
	<i>(roubles per tonne)</i>				
Gasoline					
Not corresponding to Euro 3,4 or 5	5,995	7,725	8,225	10,100	11,110
Corresponding to Euro 3	5,672	7,382	7,882	9,750	10,725
Corresponding to Euro 4	5,143	6,822	6,822	8,560	9,416
Corresponding to Euro 5	5,143	6,822	5,143	5,143	5,657
Naphtha	6,089	7,824	7,824	9,617	10,579
Diesel Fuel					
Not corresponding to Euro 3, 4 or 5	2,753	4,098	4,300	5,860	6,446
Corresponding to Euro 3	2,485	3,814	4,300	5,860	6,446
Corresponding to Euro 4	2,247	3,562	3,562	4,934	5,427
Corresponding to Euro 5	2,247	3,562	2,962	4,334	4,767
Lubricants	4,681	6,072	6,072	7,509	8,260

As indicated in the table above, excise taxes are expected to increase in the future for each of Bashneft's principal oil products, although excise tax rates are expected to be lower for products of relatively higher quality.

In the years ended 31 December 2010 and 2011, excise taxes totaled \$672 million and \$974 million, respectively. Excise taxes are included in the price of Bashneft's oil products. Bashneft, in turn, is responsible for transferring an amount equal to the excise taxes to the Russian government.

Transportation of Crude Oil and Oil Products in the Russian Federation

The main Russian crude oil production regions are remote from the main crude oil and oil products markets. Therefore, access of crude oil production companies to the markets is dependent on the extent of diversification of transport infrastructure and access to it. As a result, transportation costs are an important factor affecting Bashneft's results of operations. Increases in prices of transportation services charged by our third party providers can lead to an increase in our transportation costs and negatively affect our margins. In addition, an increase in the proportion of export sales can lead to an increase in our transportation costs. For example, transportation costs increased by \$252.6 million, or 47.2%, in 2011 relative to 2010, driven, in part, by exports accounting for a relatively greater share of Bashneft's overall sales. Transportation costs also increased in 2010 relative to 2009 partially as a result of an increase in the volume of crude oil export sales. See "*Risk Factors—Risks Relating to Our Oil and Energy Business—Bashneft and Bashkirenergo are dependent upon the services provided by, and the assets and infrastructure of third parties.*"

Transportation of crude oil produced in the Russian Federation to refineries and export destinations is performed primarily through the trunk oil pipeline system of state-owned Transneft. Access to the Transeft crude oil export

pipeline network is allocated quarterly, based on recent volumes produced and delivered through the pipeline and proposed export destinations. The crude oil transported by Transneft is Urals blend—a mix of crude oils of various qualities.

Transportation of oil products in the Russian Federation is performed by a combination of railway, pipeline and motor vehicle. The Russian railway infrastructure is owned and operated by the state-owned OJSC Russian Railways, (the “**Russian Railways**”) and the oil products pipeline network is owned and operated by the Transneft subsidiary OAO AK Transnefteprodukt (“**Transnefteprodukt**”). Bashneft relies on railway and pipeline to transport most of its oil products to wholesale domestic consumers and trading companies for onward export and on railway and motor vehicle to transport oil products to its growing network of gas stations.

As the activities of Russian Railways and Transnefteprodukt fall under the scope of natural monopolies, the fundamentals of their tariff policies are set by the FTS. The tariffs are dependent on transport destination, delivery volume, distance of transportation and several other factors. Changes in the tariff rates depend on inflation forecasts, the investment needs of owners of the transport infrastructure, other macroeconomic factors and compensation of economically reasonable expenses incurred by the transport natural monopolies. Tariff rates are revised by the FTS at least annually.

Acquisitions, Divestitures and Key Corporate Restructurings

Between 1 January 2009 and 31 December 2011, we completed a number of acquisitions and divestitures, several of which have had a significant impact on our results of operations and financial condition, as well as a number of corporate restructurings. We consolidate revenues and expenses of newly acquired entities from the date we acquire a controlling interest in such entities.

Due to the number of significant transactions completed between 1 January 2009 and 31 December 2011, period-to-period comparisons of our results of operations need to be considered in light of the impact of such transactions.

Acquisitions

Acquisitions of businesses from third parties are accounted for using the purchase method. Upon acquisition, the assets and liabilities of an acquired entity are measured at their fair value as at the date of acquisition.

In the years ended 31 December 2009, 2010 and 2011, we spent \$1,729.1 million, \$364.5 million and \$375.2 million, respectively, on acquisitions of controlling stakes in businesses from third parties, net of cash acquired.

In addition, in the years ended 31 December 2009, 2010 and 2011, we spent \$194.2 million, \$787.4 million and \$261.3 million, respectively, on acquisitions of non-controlling stakes in existing subsidiaries.

Below is a list of our major acquisitions of controlling stakes in businesses from third parties during the years ended 31 December 2009, 2010 and 2011.

See Note 3 of the U.S. GAAP Financial Statements for further description of these acquisitions and those which are less significant to our business. For a discussion of acquisitions made after 31 December 2011, see “—Recent Developments,” above.

<u>Company</u>	<u>Principal activity</u>	<u>Date of acquisition⁽¹⁾</u>	<u>Stake in acquired entity following acquisition</u>	<u>Acquiring entity</u>	<u>Purchase price⁽²⁾</u> (\$ in millions)
Year ended 31 December 2009					
Telefon.ru	Mobile retailer	February 2009	100.0%	MTS	60.0
Oil and energy companies in Bashkortostan, <i>including</i> ⁽³⁾	Oil and gas production and energy	April 2009		Sistema	2,000.0
JSOC Bashneft			76.5%		
OAO Ufaneftekhim (“Ufaneftekhim”)			65.8%		
OJSC Novoil (“Novoil”)			87.2%		
OAO Ufaorgsintez (“Ufaorgsintez”)			73.0%		
OAO Ufa Oil Refinery (“Ufa Oil Refinery”)			78.5%		
OJSC Bashkirnefteprodukt (“Bashkirnefteprodukt”)			73.3%		
Eurotel	Fixed line services	December 2009	100.0	MTS	90.0
Year ended 31 December 2010					
Sky Link ⁽⁴⁾	Mobile telephony	April 2010	100.0%	Sistema	168.5
Multiregion	Broadband/cable TV provider	July 2010	100.0%	MTS	123.6
Year ended 31 December 2011					
JSC Orenburgnefteprodukt (“Orenburgnefteprodukt”)	Wholesale and retail of oil products	April 2011	94.0%	Bashneft	119.3
OOO BN-Nefteprodukt ⁽⁵⁾ (“BN-Nefteprodukt”)	Wholesale and retail of oil products	July 2011	100.0%	Bashneft	101.7
TVT	Fixed line and internet services	October 2011	100.0%	MTS	162.5

(1) We consolidate revenues and expenses of newly acquired entities from the date we acquire a controlling interest in such entities.

(2) Excluding acquisition-related costs.

(3) As a result of our purchase of these oil and energy companies in Bashkortostan, we acquired a controlling stake in Bashkirenergo, since, at the time of our acquisition, Bashneft, Ufaneftekhim, Novoil and Ufa Oil Refinery owned an aggregate stake of 50.2% in Bashkirenergo.

(4) This 100% stake in Sky Link was recorded as an asset held for sale because of a November 2009 non-binding memorandum of understanding between us and Svyazinvest, according to which the parties would enter into a series of transactions, including our sale of this 100% in Sky Link to Svyazinvest. See “Note 3 of the U.S. GAAP Financial Statements.”

(5) In July 2010, Bashneft acquired a 49.99% stake in OOO ASPEC (“ASPEC”), a company engaged in wholesale and retail of oil products, real estate development and automotive retail business, for \$123 million. In July 2011, ASPEC was reorganised into two entities: ASPEC and BN-Nefteprodukt. As a result, Bashneft received 100.0% of BN-Nefteprodukt, which assumed ownership over ASPEC’s oil products trading company, and withdrew as a shareholder of ASPEC.

Acquisition of non-controlling stake in RussNeft

In April 2010, we acquired a non-controlling 49.0% stake in RussNeft, an oil and gas company, for a total cash consideration of \$20 million. The investment is accounted for using the equity method. As a result of the final measurement of the equity interest in RussNeft and the ongoing operational losses, we recognised a loss of \$20 million in the year ended 31 December 2010, bringing the carrying value of our investment in RussNeft to

nil in our U.S. GAAP Financial Statements. Nothing has been recognised in 2011 for this investment as the net assets of RussNeft were still negative. See Note 15 of the U.S. GAAP Financial Statements. RussNeft is one of our Developing Assets.

RussNeft is one of the Russian Federation's largest oil companies in terms of production and reserves. In December 2010, RussNeft restructured over \$6.3 billion of debt owed to Sberbank and Glencore, a leading global trading firm, reducing its debt burden to \$5.1 billion as at 31 December 2011. As a result of this restructuring, the average interest rate of RussNeft's debt was reduced to 9% and the maturity of its debt was extended to 2020. As at 31 December 2011, our stake in RussNeft was pledged as a guarantee of payment under certain RussNeft borrowings.

Divestitures & Key Corporate Restructurings

Telecommunications

MTT

In March 2009, we sold 50.0% of voting shares in MTT, a long-distance fixed line operator, for \$54.0 million, recognising a loss of \$19.4 million.

Comstar

In October 2009, Sistema JSFC sold its 50.9% stake in Comstar, held directly and through its wholly-owned subsidiaries, to MTS for approximately \$1.32 billion. The transaction was accounted for directly in equity and resulted in an increase in non-controlling interests of \$154.6 million.

In December 2009, through a series of transactions, a group of investment funds exchanged their joint 14.2% stake in MGTS for a 1.6% stake in MTS, previously held in treasury, and a cash payment of \$7.3 million. Simultaneously, MTS received an 11.1% stake in Comstar from MGTS Finance S.A, a wholly-owned subsidiary of MGTS. As a result of these transactions, our effective ownership in MTS decreased from 55.7% to 54.8% and our effective ownership in Comstar increased from 33.1% to 35.1%.

On 1 April 2011, we completed the merger of Comstar into MTS. Qualifying holders of Comstar ordinary shares received 0.825 MTS ordinary shares for each Comstar ordinary share. As a result of this transaction, a total of 98,853,996 Comstar shares were converted into treasury shares and 73,087,006 newly-issued ordinary shares of MTS.

As a result of these transactions, Comstar no longer exists as a separate legal entity, having been fully merged into MTS.

Svyazinvest

In November 2009, we and Svyazinvest signed a non-binding memorandum of understanding under which both parties agreed to enter into a series of transactions that would result in the following actions: (i) Disposal of our interest in Svyazinvest to a state-controlled enterprise; (ii) non-cash settlement of certain of our indebtedness to Sberbank by Svyazinvest; (iii) an increase in our ownership in Sky Link from 50% to 100%; (iv) our disposal of this 100% of our investment in Sky Link to Svyazinvest; and (v) the sale to us of 28% of MGTS' common stock held by Svyazinvest.

In July 2010, we and Svyazinvest signed an exchange agreement, whereby we and Svyazinvest agreed to the exchange of stakes in MGTS and Sky Link. In particular, Svyazinvest agreed to transfer 28% of the ordinary shares in MGTS (23.3% of the share capital of MGTS) to us in exchange for our effective 100% stake in Sky Link and a cash payment of RUB 450 million to cover the difference in value between MGTS and Sky Link shares. The new shareholders in Sky Link also agreed to settle Sky Link's obligations to us in the amount of approximately \$307.4 million. As a result of this transaction, we recognised a gain on disposal of discontinued operations in the amount of \$324.7 million. In 2010, Comstar sold its 17.3% +1 stake in Svyazinvest and Comstar subsidiary MGTS Finance sold its 7.7% stake in Svyazinvest to Rostelecom, the proceeds from which were used to repay the Sberbank loan to Comstar.

As a result of these transactions, we no longer hold any interest in Svyazinvest.

Sistema Telecom

In December 2010, Sistema JSFC sold a 100.0% stake in Sistema Telecom to MTS for RUB 11.6 billion (approximately \$379.0 million as at 27 December 2010). Sistema Telecom's key assets include certain MTS, Comstar and MGTS trademarks, certain promissory notes issued by MTS in the amount of RUB 2 billion (approximately \$65.5 million) and a 45% stake in TS-Retail.

SSTL

In March 2011, Rosimushchestvo acquired a 17.1% stake in SSTL through a secondary share issuance of SSTL equity shares. Rosimushchestvo paid the rupee equivalent of \$600 million for the stake in December 2010, and our stake in SSTL decreased to 56.7%. SSTL is using the proceeds of this issuance to further strengthen its position in wireless broadband services, to expand its mono-brand retail network in existing telecommunications circles and to launch in new circles

As part of this transaction, we entered into a put and call option agreement, under which the Russian government has the right to sell its stake in SSTL back to us between March 2016 and March 2017 for the higher of \$777 million or the market value as determined by an independent valuator.

See “—Commitments and Contingencies—Obligations under derivative contracts—Russian government put option in SSTL,” “Risk Factors—Risks Relating to Our Business and Industry—General Risks—The licences and permits that we require for our business may be invalidated, suspended or may not be issued or renewed, or may contain onerous terms and conditions that restrict our ability to conduct our operations or could result in substantial compliance costs or administrative penalties” and “Risk Factors—Risks Relating to Our Business and Industry—General Risks—As a result of litigation proceedings involving SSTL, certain financing arrangements of SSTL and Sistema JSFC may well currently be capable of being accelerated. In addition, pursuant to a put and call option agreement exercisable between March 2016 and March 2017, we may be required to repurchase the stake in SSTL held by the Russian government. If the Russian government were to exercise its put option over its stake in SSTL, there can be no assurance that such exercise would not have a material adverse effect on our financial condition.”

Real estate

In a series of transactions between April and October 2009, we sold a 51.8% stake in Sistema-Hals, a real estate development company, to VTB Bank for a nominal price of RUB 60, thereby reducing our stake in Sistema-Hals from 80% to 28.2%. We recognised a loss of \$364.9 million on the disposal. In December 2010, we disposed of our remaining stake in Sistema-Hals for a total cash consideration of \$70 million.

Retail

In December 2010, Detsky Mir increased its share capital through a private placement of additional shares to Sberbank. The new shares, which represented a 25% + 1 stake of Detsky Mir post-issuance, were purchased for approximately RUB 3.4 billion (\$111.6 million as at 31 December 2010). One of the objectives of this transaction was to grow the value of the Detsky Mir business with the ultimate aim of attracting a strategic investor or achieving a similar event in the next several years. If this aim is not achieved within three years from the date of the sale, and subject to certain other conditions, Sberbank has the right to sell its stake in Detsky Mir back to us. See “Business—Business Description—Developing Assets—Detsky Mir.”

In July 2011, Intourist sold a 50.1% stake in ITC, its wholly-owned tour operating and retail subsidiary, to Thomas Cook plc for a total consideration of \$45 million, consisting of a cash payment of \$10 million and shares in Thomas Cook plc in the amount of \$35 million. As a result of this transaction, we recognised a gain in the amount of \$47.8 million.

Energy

Bashkirenergo

In September 2011, we complete the sale of 100% of the electricity retail company ESKB, formerly a subsidiary of Bashkirenergo, to RusHydro for total cash consideration of RUB 5.7 billion. As a result of this transaction, we recognised a gain on disposal of discontinued operations of \$149.5 million.

In accordance with legislation applicable to the Russian electricity market, starting from 1 January 2011, it is prohibited for an entity (or a group of entities) to operate as an integrated business model that includes the

generation and transmission of electricity. In response to these regulations, Bashkirenergo obtained approval from the FAS in October 2010 to perform a reorganisation of Bashkirenergo in the form of a spin-off of its electricity transmission activities. However, the reorganisation plan was not approved by the shareholders at an extraordinary general shareholders' meeting that took place in December 2010. Consequently, Bashkirenergo has continued to operate its generation and transmission businesses as an integrated business model after 1 January 2011. In March 2012, Bashkirenergo approved the reorganisation of its generation, distribution and transmission businesses with the result that its power and heat generation assets and heat distribution assets are to be controlled by one company, Bashenergoaktiv, and its power transmission and distribution assets are to be controlled by another company, BESK. On 12 May 2012, we entered into an agreement with INTER RAO UES in respect of the proposed reorganisation of Bashkirenergo where we have given certain warranties, indemnities and other undertakings to INTER RAO UES. As a result of this reorganisation, we expect to receive a combination of cash and promissory notes from INTER RAO UES. Subject to the approval of shareholders of Sistema and of Bashkirenergo and certain other conditions, including receipt of necessary government approvals and the execution of additional ancillary agreements, the reorganisation is expected to be completed in the fourth quarter of 2012 or first quarter of 2013. Following the reorganisation, we expect to hold a 75% stake in the power transmission and distribution company, BESK, and no stake in Bashenergoaktiv. Although Bashkirenergo's reorganisation has not yet been approved by FAS, FAS has approved the purchase of Bashenergoaktiv by INTER RAO UES. See *"Business—Business Description—Core Assets—Bashkirenergo"* and *"Risk Factors—Risks Relating to Our Oil and Energy Business—Bashneft and Bashkirenergo have been involved in corporate reorganisations, which may adversely affect their business, results of operations, financial condition or prospects."*

Bashneft

In order to create a vertically-integrated oil group, we have undertaken a number of restructuring initiatives with respect to the Bashneft Group. In December 2009, Sistema JSFC sold to Bashneft controlling stakes in the following companies: (i) a 47.2% stake in Ufaneftekhim; (ii) a 61.6% stake in Novoil; (iii) a 51.5% stake in Ufaorgsintez; and (iv) a 55.6% stake in Ufa Oil Refinery. In January 2010, JSFC Sistema transferred its stake in Bashkirnefteprodukt to Bashneft. These transactions were accounted for directly in equity and resulted in the increase in non-controlling interests of \$328 million in respect of the December 2009 transactions and \$53.0 million in respect of the January 2010 transaction.

In order to improve operating efficiency and transparency, Bashneft has commenced the reorganisation of its corporate structure through the merger of the Ufa Oil Refinery, Novoil, Ufaneftekhim, Bashkirnefteprodukt and Orenburgnefteprodukt (the **"Merger Subsidiaries"**) into JSOC Bashneft. The merger procedure contemplates two steps: (i) the conversion of ordinary and preferred shares in the Merger Subsidiaries into ordinary and preferred shares, respectively, in JSOC Bashneft, at the conversion ratios determined by the boards of directors of JSOC Bashneft and the Merger Subsidiaries; and (ii) a cash buyback by JSOC Bashneft and the Merger Subsidiaries of the shares of those shareholders who did not vote or who voted against the merger. In March 2012, each of the boards approved the proposed terms of the consolidation, including the conversion ratios, and, at the end of April, the shareholder meetings of JSOC Bashneft and each of the Merger Subsidiaries approved the merger. The share buyback is scheduled to be completed in July 2012, and the share conversion is expected to be completed by the end of 2012. At that point, the Merger Subsidiaries will cease to exist as separate legal entities.

Technology

We and Bank of Moscow formed RTI in February 2011. We received 84.6% of RTI in exchange for our 97% stake in RTI Concern and RUB 2.88 billion (approximately \$97 million) in cash. Bank of Moscow contributed RUB 3 billion (approximately \$100 million) in cash in exchange for a 15.4% stake in RTI.

In July 2011, we completed our sale of a 63% stake in SITRONICS to RTI for \$0.9228 per GDR. In March 2012, RTI made a voluntary cash offer to acquire the remaining 36.9% stake in SITRONICS for RUB 0.55 per share. The voluntary offer remains open until 22 May 2012. Should the offer be accepted in full, RTI intends to delist SITRONICS' shares from MICEX-RTS and SITRONICS' GDRs from the London Stock Exchange.

For further description of our acquisitions, divestitures and key corporate restructurings, please see Notes 3, 4 and 5 of the U.S. GAAP Financial Statements.

Consolidated Financial Results Overview

The following table sets forth a summary of our financial results for the years ended 31 December 2009, 2010 and 2011. This financial information should be read in conjunction with our U.S. GAAP Financial Statements.

	Years ended 31 December					
	2009	% of total revenues	2010	% of total revenues	2011	% of total revenues
	<i>(\$ in thousands, except percentages)</i>					
Sales	17,425,502	96.2	26,222,373	97.8	32,452,236	98.4
Revenues from banking activities	697,227	3.8	588,946	2.2	529,012	1.6
Total revenues	18,122,729	100.0	26,811,319	100.0	32,981,248	100.0
Cost of sales, exclusive of depreciation, depletion and amortisation shown separately below	(7,084,969)	(39.1)	(10,716,816)	(40.0)	(13,021,173)	(39.5)
Cost related to banking activities, exclusive of depreciation and amortisation shown separately below	(540,263)	(3.0)	(374,036)	(1.4)	(310,332)	(0.9)
Selling, general and administrative expenses	(3,028,891)	(16.7)	(3,747,805)	(14.0)	(3,936,588)	(11.9)
Depreciation, depletion and amortisation	(2,434,733)	(13.4)	(2,862,754)	(10.7)	(3,281,629)	(9.9)
Transportation costs	(159,001)	(0.9)	(535,391)	(2.0)	(789,785)	(2.4)
Provision for doubtful accounts	(246,981)	(1.4)	(161,519)	(0.6)	(135,967)	(0.4)
Loss from impairment and provisions of other assets	(717,516)	(4.0)	(313,381)	(1.2)	(1,031,262)	(3.1)
Taxes other than income tax	(1,607,243)	(8.9)	(4,106,338)	(15.3)	(6,257,642)	(19.0)
Other operating expenses, net	(436,371)	(2.4)	(260,271)	(1.0)	(458,852)	(1.4)
Equity in results of affiliates	(12,758)	(0.1)	92,235	0.3	120,929	0.4
Gain on acquisition	2,782,835	15.4	—	—	—	—
Gain upon adoption of equity method	—	—	477,400	1.8	—	—
(Loss)/gain on disposal of interests in subsidiaries and affiliates	(383,978)	(2.1)	—	—	62,514	0.2
Operating income	4,252,860	23.5	4,302,643	16.0	3,941,461	12.0
Interest income	191,203	1.1	131,534	0.5	176,584	0.5
Change in fair value of derivative instruments	(35,200)	(0.2)	(2,062)	(0.0)	(2,268)	(0.0)
Interest expense	(1,246,356)	(6.9)	(1,597,244)	(6.0)	(1,742,690)	(5.3)
Foreign currency transaction (losses)/gains	(94,053)	(0.5)	26,151	0.1	(326,415)	(1.0)
Income from continuing operations before income tax	3,068,454	17.0	2,861,022	10.7	2,046,672	6.2
Income tax expense	(743,895)	(4.1)	(1,065,480)	(4.0)	(1,088,546)	(3.3)
Equity in net income of energy companies in the Republic of Bashkortostan	4,400	0.0	—	—	—	—
Income from continuing operations	2,328,959	12.9	1,795,542	6.7	958,126	2.9
(Loss)/income from discontinued operations ⁽¹⁾	(16,679)	(0.1)	(2,999)	(0.0)	71,233	0.2
(Loss)/gain from disposal of discontinued operations ⁽²⁾	(26,194)	(0.1)	324,656	1.2	161,817	0.5
Net income	2,286,086	12.6	2,117,199	7.9	1,191,176	3.6
Noncontrolling interest	(642,645)	(3.5)	(1,198,502)	(4.5)	(973,174)	(3.0)
Net income attributable to Sistema JSFC	1,643,441	9.1	918,697	3.4	218,002	0.6
OIBDA ⁽³⁾	6,687,593	36.9	7,165,397	26.7	7,223,090	21.9

(1) Net of income tax effect of \$2.8 million in 2009, \$23.5 million in 2010 and \$26.2 million in 2011.

(2) Net of income tax effect of \$39.5 million in 2011. Income tax effect was nil in 2009 and 2010.

(3) OIBDA represents operating income before depreciation, depletion and amortisation. OIBDA is not a measure of financial performance under U.S. GAAP. You should not consider it an alternative to net income as a measure of operating performance or to cash flows from operating activities as a measure of liquidity. Our calculation of OIBDA may be different from the calculation used by other companies and therefore comparability may be limited. We believe that OIBDA provides useful information to investors because it is an indicator of the strength and performance of our ongoing business operations, including our ability to fund discretionary spending such as capital expenditures, acquisitions of subsidiaries and other investments and our ability to incur and service debt. While depreciation, depletion and amortisation are considered operating costs under U.S. GAAP, these expenses primarily represent non-cash current period allocation of costs associated with long-lived assets acquired or constructed in prior periods.

The following table presents a reconciliation of OIBDA to operating income for the periods indicated:

	For the year ended		
	2009	2010	2011
	(\$ in thousands)		
Operating income	4,252,860	4,302,643	3,941,461
Depreciation, depletion and amortisation	2,434,733	2,862,754	3,281,629
OIBDA	<u>6,687,593</u>	<u>7,165,397</u>	<u>7,223,090</u>

The following tables set forth a summary of revenues and operating income by reportable segment for the years ended 31 December 2009, 2010 and 2011. In April 2011, we approved a new organisational and management structure, which classifies our assets into two business units based on their level of maturity: Core Assets and Developing Assets. This change in structure has caused the composition of our reportable segments to change. We currently have six reportable segments, namely, MTS and Bashneft, which form part of the Core Assets; RTI, MTS Bank and SSTL, which form part of the Developing Assets; and the Corporate Division. Information about our other operating segments that are not reportable due to their materiality is combined and disclosed in the Other category. The other category includes Bashkirenergo, Sistema Mass Media, Detsky Mir, Intourist, Medsi Group, Binnopharm and NIS. Prior period segment data has been restated to reflect these changes.

In our comparison of period-to-period results of operations, to analyse changes, developments and trends in revenues by reference to individual segment revenues, we present our revenues on an aggregated basis, that is, revenues after elimination of intra-segment (between entities in the same segment) transactions, but before intersegment (between entities in different segments) eliminations. Amounts attributable to individual companies, where appropriate, are shown prior to both intra-segment and inter-segment eliminations.

Revenues by segment:

	Year ended 31 December					
	2009	% of total revenues	2010	% of total revenues	2011	% of total revenues
	(\$ in thousands, except percentages)					
MTS	9,867,253	54.4	11,299,056	42.1	12,318,688	37.4
Bashneft	4,849,529	26.8	11,706,740	43.7	16,549,086	50.2
SSTL	36,374	0.2	114,615	0.4	262,264	0.8
MTS Bank	713,844	3.9	613,745	2.3	560,906	1.7
RTI	1,403,176	7.7	1,631,816	6.1	2,093,039	6.3
Other ⁽¹⁾	1,626,520	9.0	1,902,546	7.1	1,974,977	6.0
Corporate	32,870	0.2	63,312	0.2	64,549	0.2
Aggregated revenue	18,529,566	102.2	27,331,830	101.9	33,823,509	102.6
Eliminations ⁽²⁾	(406,837)	(2.2)	(520,511)	(1.9)	(842,261)	(2.6)
Total	<u>18,122,729</u>	<u>100.0</u>	<u>26,811,319</u>	<u>100.0</u>	<u>32,981,248</u>	<u>100.0</u>

(1) Other includes Bashkirenergo, Sistema Mass-Media, Detsky Mir, Intourist, Medsi Group, Binnopharm and NIS.

(2) Eliminations of intersegment sales.

Operating income/(loss) by segment:

	Year ended 31 December					
	2009	% of total operating income	2010	% of total operating income	2011	% of total operating income
	(\$ in thousands, except percentages)					
MTS	2,282,523	53.7	2,744,107	63.8	2,893,938	73.4
Bashneft	3,349,839	78.8	2,301,342	53.5	2,778,789	70.5
SSTL	(250,791)	(5.9)	(410,789)	(9.5)	(1,196,084)	(30.3)
MTS Bank	(83,514)	(2.0)	21,329	0.5	(23,510)	(0.6)
RTI	(10,997)	(0.3)	81,551	1.9	50,382	1.3
Other ⁽¹⁾	(508,974)	(12.0)	85,304	2.0	(129,373)	(3.3)
Corporate	670,911	15.8	(288,791)	(6.7)	(228,712)	(5.8)
Aggregated operating income	5,448,997	128.1	4,534,053	105.4	4,145,430	105.2
Eliminations ⁽²⁾	(1,196,137)	(28.1)	(231,410)	(5.4)	(203,969)	(5.2)
Total	4,252,860	100.0	4,302,643	100.0	3,941,461	100.0

(1) Other includes Bashkirenergo, Sistema Mass-Media, Detsky Mir, Intourist, Medsi Group, Binnopharm and NIS.

(2) Eliminations of intersegment operating income.

Explanation of Key Items in Statements of Operations*Sales*

Our sales are derived mainly from the revenues generated by MTS and Bashneft. In 2009, 2010 and 2011, before intersegment eliminations, revenues of MTS accounted for 54.4%, 42.1% and 37.4%, respectively, of our consolidated sales, and revenues of Bashneft accounted for 26.8%, 43.7% and 50.2%, respectively, of consolidated sales. See “—Critical accounting policies,” for a discussion of our revenue recognition policies.

Revenues from banking activities

Revenues from banking activities consist of revenues from banking services of MTS Bank.

Cost of sales, exclusive of depreciation, depletion and amortisation

Our cost of sales is primarily incurred at MTS and Bashneft. In 2009, 2010 and 2011, cost of sales at MTS and Bashneft accounted for 69.4%, 77.5% and 80.0%, respectively, of our overall cost of sales.

Cost of sales at MTS and Bashneft are those costs that are incurred directly in the sale and production of MTS’ and Bashneft’s principal products and services. For MTS, they mainly consist of cost of services, such as interconnect and line rental charges and roaming expenses, and the cost of handsets and accessories. For Bashneft, they mainly consist of the cost of purchased crude oil, gas and oil products, repairs and maintenance and certain other operating expenses.

Cost of sales also includes a share of rental expenses under operating leases. See Note 27 of the U.S. GAAP Financial Statements.

Selling, general and administrative expenses

Selling, general and administrative expenses are primarily incurred at MTS and Bashneft. In 2009, 2010 and 2011, selling, general and administrative expenses at MTS accounted for 59.0%, 55.6% and 53.4%, respectively, of our overall selling, general and administrative expenses. Bashneft accounted for 12.9%, 12.4% and 11.2% of our overall selling, general and administrative expenses in 2009, 2010 and 2011, respectively. Selling, general and administrative expenses are significantly higher at MTS than at Bashneft because of the nature of the telecom business, which requires greater expenditures on marketing and advertising.

A substantial share of selling, general and administrative expenses consists of marketing and advertising costs. Other components of selling, general and administrative expenses include employee salaries and bonuses, social contributions payable to state funds and sundry office expenses.

Selling, general and administrative expenses also include a share of rental expenses under operating leases. See Note 27 of the U.S. GAAP Financial Statements.

Depreciation, depletion and amortisation

Most of our depreciation, depletion and amortisation expenses are incurred at MTS and Bashneft. In 2009, 2010 and 2011, depreciation and amortisation at MTS accounted for 73.0%, 69.9% and 69.9%, respectively, of our overall depreciation, depletion and amortisation expenses. Bashneft accounted for 17.1%, 20.7% and 18.6%, respectively, of our depreciation, depletion and amortisation expenses in 2009, 2010 and 2011. Depreciation costs during the period under review were higher at MTS than at Bashneft due to historically higher capital expenditures at MTS.

Depreciation, depletion and amortisation expenses primarily consist of expenses related to the depreciation of property, plant and equipment, the depletion of crude oil reserves and the amortisation of intangible assets.

Transportation costs

Transportation costs represent all expenses incurred in the transportation of crude oil and oil products via the Transneft pipeline network, by railway by road transport to filling stations or other transportation means. Transportation costs also include shipping and handling costs.

Taxes other than income taxes

Taxes other than income taxes comprise excise and mineral extraction taxes and export duties, which relate to Bashneft, and property tax. See “—*Key Factors Affecting Our Results of Operations—Factors Affecting Bashneft’s Results of Operations—Taxation.*”

Other operating expenses, net

Other operating expenses, net, consist of miscellaneous expenses that are not included in other expense lines in our U.S. GAAP Financial Statements.

Operating income

Operating income is revenues less operating costs, plus equity in the results of affiliates (excluding equity in the net income of energy companies in the Republic of Bashkortostan before the acquisition of a controlling stake), gain on acquisition, gain upon adoption of equity method and the gain/(loss) on the disposal of interests in subsidiaries and affiliates.

Interest expense

Interest expenses consist primarily of interest expense on loans and borrowings.

Foreign currency transaction (losses)/gains

Management has determined that the functional currency of most of our subsidiaries is the currency of the country where they principally operate, with the exception of certain subsidiaries whose functional currency is the U.S. dollar due to the pervasive use of the U.S. dollar in their operations or whose functional currency is the currency of its parent company if the entity is a device or shell company for holding investments or obligations.

Foreign currency transaction (losses)/gains result from a change in exchange rates between the functional currency and the currency in which a foreign currency transaction is denominated.

Income tax expense

Income tax expense comprises current and deferred income tax. During the periods under review, the corporate income tax rate in the Russian Federation was 20% and the income tax rate on dividends paid within the Russian Federation was 9%. Our foreign subsidiaries pay income tax in their respective jurisdictions. The income tax rate in India, Ukraine and the Czech Republic was 25%, 25% and 26%, respectively, during the reporting period.

Deferred income tax reflects the tax effect of all significant differences between the tax bases of assets and liabilities and their amounts as reported in the U.S. GAAP Financial Statements. Deferred tax assets and liabilities are measured using the enacted tax laws and rates applicable in the periods when the differences are expected to affect taxable income. See Note 2 of our U.S. GAAP Financial Statements for a summary of our income tax policies.

Year Ended 31 December 2011 Compared to the Year Ended 31 December 2010

Sales

Our sales increased by \$6,229.9 million, or 23.8%, from \$26,222.4 million in the year ended 31 December 2010 to \$32,452.2 million in the year ended 31 December 2011.

The growth in overall sales was attributable primarily to the growth in revenues at Bashneft and MTS. Revenues at Bashneft grew by \$4,842.3 million, or 41.4%, and revenues at MTS grew by \$1,019.6 million, or 9.0%. Revenues at RTI and SSTL also grew, while revenues of MTS Bank declined. Revenues at RTI grew by \$461.2 million, or 28.3%, and revenues at SSTL grew by \$147.6 million, or 128.8%. Revenues in our Other category grew by \$72.4 million, or 3.8%. See “—*Revenues from banking activities*,” below, for a discussion of MTS Bank revenues.

Bashneft, which we acquired in April 2009, is, together with MTS, one of our two largest revenue contributors. In the years ended 31 December 2010 and 2011, Bashneft’s share of our consolidated revenues was 43.7% and 50.2%, respectively. Bashneft’s revenues grew by \$4,842.3 million, or 41.4%, from \$11,706.7 million in 2010 to \$16,549.1 million in 2011 mainly due to revenue growth in the sale of crude oil and oil products, which, in turn, was both price and volume driven. See “—*Segment Financial Results Overview—Bashneft*,” below, for further discussion of Bashneft’s results of operations.

MTS is the other of our two largest revenue contributors. In the years ended 31 December 2010 and 2011, MTS’ share of our consolidated revenues was 42.1% and 37.4%, respectively. MTS’ share of our consolidated revenues declined in 2011 mainly because of significant growth in our other primary revenue generator, Bashneft. MTS’ revenues grew by \$1,019.6 million, or 9.0%, from \$11,299.1 million in 2010 to \$12,318.7 million in 2011 as a result of several factors, including increased usage of value-added services, which was mainly attributable to MTS’ active promotion of these services, increased mobile Internet penetration, active 3G network expansion and the consequent improvement of the quality of value-added services. See “—*Segment Financial Results Overview—MTS*,” below, for further discussion of MTS’ results of operations.

Revenues at RTI increased by \$461.2 million or 28.3%, from \$1,631.8 million in the year ended 31 December 2010 to \$2,093.0 million in the year ended 31 December 2011 mainly as a result of a significant increase in sales in the systems integration and microelectronics solutions units and the completion of an increased number of government defence contracts. See “—*Segment Financial Results Overview—RTI*,” below, for further discussion of RTI’s results of operations.

Revenues at SSTL grew by \$147.6 million, or 128.8%, from \$114.6 million in the year ended 31 December 2010 to \$262.3 million in the year ended 31 December 2011 due to growth in subscriber base and non-voice revenues from both mobile and data value-added services. See “—*Segment Financial Results Overview—SSTL*,” below, for further discussion of SSTL’s results of operations and “*Risk Factors—Risks Relating to Our Business and Industry—General Risks—As a result of litigation proceedings involving SSTL, certain financing arrangements of SSTL and Sistema JSFC may well currently be capable of being accelerated. In addition, pursuant to a put option agreement, we may be required to repurchase the stake in SSTL held by the Russian government. If the Russian government were to exercise its put option over its stake in SSTL, there can be no assurance that such exercise would not have a material adverse effect on our financial condition.*”

Revenues in our Other category increased by \$72.4 million, or 3.8%, from \$1,902.5 million in the year ended 31 December 2010 to \$1,975.0 million in the year ended 31 December 2011, mainly due to growth in revenues at Detsky Mir, Medsi Group, Sistema Mass Media and Binnopharm. Revenues at Detsky-Mir grew by \$124.8 million, or 18.9%; at Medsi Group by \$42.5 million, or 27.2%; at Sistema Mass Media by \$7.5 million, or 7.9%; and at Binnopharm by \$6.4 million, or 19.9%. A five-fold increase in revenues at NIS, where total revenues exceeded \$100.0 million in 2011, contributed to the overall revenue growth of the other segment. In 2011 compared to 2010, revenues at Intourist declined by \$241.6 million, or 46.6%, and revenues at Bashkirenergo declined by \$4.1 million, or 1.0%. See “—*Segment Financial Results Overview—Other*,” below, for further discussion of the results of operations of the Other category.

Revenues from banking activities

Revenues from banking activities declined by \$59.9 million, or 10.2%, from \$588.9 million in the year ended 31 December 2010 to \$529.0 million in the year ended 31 December 2011 mainly due to a reduction in average interest rates. Revenues from banking activities accounted for 2.2% of total revenues in 2010 and 1.6% of total revenues in 2011. See “—Segment Financial Results Overview—MTS Bank,” below, for further discussion of results of operations at MTS Bank.

Total revenues

For the reasons set forth above, total revenues increased by \$6,169.9 million, or 23.0%, from \$26,811.3 million in the year ended 31 December 2010 to \$32,981.2 million in the year ended 31 December 2011.

Cost of sales, exclusive of depreciation, depletion and amortisation

Cost of sales, exclusive of depreciation, depletion and amortisation, increased by \$2,304.4 million, or 21.5%, from \$10,716.8 million in the year ended 31 December 2010 to \$13,021.2 million in the year ended 31 December 2011. The increase in the cost of sales was primarily due to higher cost of sales at MTS and Bashneft. Cost of sales at MTS increased mainly due to the expansion of MTS’ retail operations, which generally have lower margins than communications service operations. Cost of sales at Bashneft increased largely due to an increase in the cost of purchased crude oil, gas and petroleum products and production and operating expenses. See “—Segment Financial Results Overview—MTS” and “—Segment Financial Results Overview—Bashneft.”

In the years ended 31 December 2010 and 2011, cost of sales also included \$182.4 million and \$232.0 million, respectively, of rental expenses under operating leases. See Note 27 of the U.S. GAAP Financial Statements.

Cost related to banking activities, exclusive of depreciation and amortisation

Cost related to banking activities, exclusive of depreciation and amortisation, decreased by \$63.7 million, or 17.0%, from \$374.0 million in the year ended 31 December 2010 to \$310.3 million in the year ended 31 December 2011 mainly due to the extension of better quality loans in 2011 compared to 2010. Higher quality loans are generally associated with lower costs than loans of relatively worse quality.

Selling, general and administrative expenses

Selling, general and administrative expenses increased by \$188.8 million, or 5.0%, from \$3,747.8 million in the year ended 31 December 2010 to \$3,936.6 million in the year ended 31 December 2011 mainly due to higher expenses at MTS and Bashneft, and, in particular, due to an increase in expenses related to marketing and advertising, employee salaries and bonuses, social contributions payable to state funds and sundry office expenses.

In the years ended 31 December 2010 and 2011, a share of selling, general and administrative expenses consisted of rental expenses under operating leases. See Note 27 of the U.S. GAAP Financial Statements.

Depreciation, depletion and amortisation

Depreciation, depletion and amortisation increased by \$418.9 million, or 14.6%, from \$2,862.8 million in the year ended 31 December 2010 to \$3,281.6 million in the year ended 31 December 2011 mainly due to an increase in our depreciable assets, including the increased asset base at MTS. See “—Segment Financial Results Overview—MTS,” below, for further discussion of depreciation and amortisation at MTS.

Transportation costs

Transportation costs increased by \$254.4 million, or 47.5%, from \$535.4 million in the year ended 31 December 2010 to \$789.8 million in the year ended 31 December 2011 due to an increase in transportation costs at Bashneft. Transportation costs at Bashneft increased primarily because of a 12.1% increase in export sales volumes of crude oil, a 17.7% increase in export sales volumes of oil products, and a rise in transport tariffs. Export sales are generally associated with higher transportation costs than domestic sales, primarily due to relatively longer travel distances for exports. See “—Segment Financial Results Overview—Bashneft,” below, for further discussion of transportation costs at Bashneft.

Provision for doubtful accounts

Provision for doubtful accounts decreased by \$25.6 million, or 15.8%, from \$161.5 million in the year ended 31 December 2010 to \$136.0 million in the year ended 31 December 2011 mainly due a general improvement in the economic conditions of the markets where our subsidiaries operate.

Loss from impairment and provisions of other assets

Loss from impairment and provisions of assets increased by \$717.9 million from \$313.4 million in the year ended 31 December 2010 to \$1,031.3 million in the year ended 31 December 2011. In the year ended 31 December 2010, we recorded an impairment loss of \$137.8 million in connection with the suspension of MTS' licences in Turkmenistan. In the year ended 31 December 2011, we recorded an impairment loss of \$694.7 million in connection with the suspension of certain of SSTL's operating licences in India.

See Note 11 of the U.S. GAAP Financial Statements, "*Risk Factors—Risks Relating to Our Business and Industry—General Risks—As a result of litigation proceedings involving SSTL, certain financing arrangements of SSTL and Sistema JSFC may well currently be capable of being accelerated. In addition, pursuant to a put option agreement, we may be required to repurchase the stake in SSTL held by the Russian government. If the Russian government were to exercise its put option over its stake in SSTL, there can be no assurance that such exercise would not have a material adverse effect on our financial condition*" and "*Business—Material Litigation*" for a discussion of the suspension of SSTL's operating licences in India.

Taxes other than income tax

Taxes other than income tax increased by \$2,151.3 million, or 52.4%, from \$4,106.3 million in the year ended 31 December 2010 to \$6,257.6 million in the year ended 31 December 2011 mainly due to an increase in export duties, excise taxes and the mineral extraction tax at Bashneft.

Export duties on crude oil increased from \$876.0 million in 2010 to \$1,466.0 million in 2011 due to a 12.1% increase in export sales volumes and a 49.3% increase in the export duty rate. The increase in the export duty rate was mainly due to the increase in oil prices. Export duties on oil products increased from \$586.0 million in 2010 to \$1,791 million in 2011 due to a 17.7% increase in export sales volumes and a 39.1% increase in the export duty rate on light and medium distillates and a 96.2% increase in the export duty rate on fuel oil.

Excise taxes increased from \$672 million in 2010 to \$974 million in 2011 due to an increase in the excise tax rates for all of Bashneft's principal oil products. The increase was partially offset by an 8.4% decrease in domestic sales volumes of oil products.

The mineral extraction tax increased from \$1,108.3 million in 2010 to \$1,754.0 million in 2011 due to an increase in the tax rate from \$10.7/barrel in 2010 to \$16.1/barrel in 2011 and a 6.8% increase in the volume of crude oil production.

See "*—Segment Financial Results Overview—Bashneft*" and "*—Key Factors Affecting Our Results of Operations—Factors Affecting Bashneft's Results of Operations—Taxation*," for further discussion.

Other operating expenses, net

Other operating expenses, net, increased by \$198.6 million, or 76.3%, from \$260.3 million in the year ended 31 December 2010 to \$458.9 million in the year ended 31 December 2011.

Equity in results of affiliates

In the year ended 31 December 2010, we recorded income of \$92.2 million in our equity in the results of affiliates, which mainly reflected the increase in profitability at OAO Belkamneft ("**Belkamneft**").

In the year ended 31 December 2011, we recorded income of \$120.9 million in our equity in the results of affiliates mainly because of higher profitability at Belkamneft.

Gain upon adoption of equity method

In the year ended 31 December 2010, we recognised a \$477.4 million gain on the acquisition of significant influence over Belkamneft following the purchase of a 49.0% stake in its parent company RussNeft.

Gain/(loss) on disposal of interest in subsidiaries and affiliates

In the year ended 31 December 2011, we recognised a gain on the disposal of interests in subsidiaries and affiliates in the amount of \$62.5 million. \$47.8 million of this gain was due to Intourist's sale in July 2011 of a 50.1% stake in ITC, its tour operating and retail subsidiary, to Thomas Cook for total consideration of \$45 million.

Operating income

For the reasons set forth above, our operating income decreased by \$361.2 million, or 8.4%, from \$4,302.6 million in the year ended 31 December 2010 to \$3,941.5 million in the year ended 31 December 2011.

Our consolidated operating income margin was 16.0% for the year ended 31 December 2010 and 12.0% for the year ended 31 December 2011. In both years, MTS and Bashneft were the main contributors to our operating income.

Interest income

Interest income increased by \$45.1 million, or 34.2%, from \$131.5 million in the year ended 31 December 2010 to \$176.6 million in the year ended 31 December 2011 due mainly to the increase of our interest-bearing investment assets.

Change in fair value of derivative instruments

In the years ended 31 December 2010 and 2011, we recorded losses of \$2.1 million and \$2.3 million, respectively, reflecting an increase in the fair value of the put option held by the Russian Corporation of Nanotechnologies (“**RUSNANO**”) to sell its shares in the SITRONICS-Nano joint venture to Sistema. See “—Commitments and Contingencies—Obligations under Derivative Contracts—SITRONICS-Nano.”

Interest expense

Interest expense increased by \$145.4 million, or 9.1%, from \$1,597.2 million in the year ended 31 December 2010 to \$1,742.7 million in the year ended 31 December 2011. This increase in interest expense was mainly due to non-recurring expenses, including penalties, associated with our early repayment of certain indebtedness in 2011.

Foreign currency transaction (losses)/gains

In the year ended 31 December 2010, we recorded a foreign currency transaction gain of \$26.2 million, which was mainly due to the appreciation of the rouble against the U.S. dollar in 2010. Appreciation of the rouble led to the reduction in rouble terms of U.S. dollar-denominated liabilities. The reduction in rouble terms of our liabilities is reflected as a gain upon translation into our presentational currency, the U.S. dollar.

In the year ended 31 December 2011, we recorded a foreign currency transaction loss of \$326.4 million, which was mainly due to the depreciation of the rouble against the U.S. dollar in 2011.

See “—Key Factors Affecting Our Results of Operations—General Factors—Russian and CIS Macroeconomic Conditions and Trends.”

Income from continuing operations before income tax

For the reasons set forth above, income from continuing operations before income tax decreased by \$814.4 million, or 28.5%, from \$2,861.0 million in the year ended 31 December 2010 to \$2,046.7 million in the year ended 31 December 2011.

Income tax expense

Income tax expense increased by \$23.1 million, or 2.2%, from \$1,065.5 million in the year ended 31 December 2010 to \$1,088.5 million in the year ended 31 December 2011, due to an increase in current income tax payments and a decrease in deferred income tax benefits.

The following table sets forth our income tax expense for the years ended 31 December 2010 and 2011:

	For the year ended 31 December			
	2010		2011	
	<i>(\$ in thousands, except percentages)</i>			
Current provision	1,089,577	102.3%	1,103,480	101.4%
Deferred income tax benefit	(24,097)	(2.3)%	(14,934)	(1.4)%
Total income tax expense	1,065,480	100.0%	1,088,546	100.0%

Our effective tax rate was 37.2% in 2010 and 53.2% in 2011. The increase in our effective tax rate in 2011 compared to 2010 was mainly due to certain non-recurring events in 2011 that were not tax deductible, such as the impairment loss of \$1,031.3 million in the year ended 31 December 2011, compared to the impairment loss of \$313.4 million in the year ended 31 December 2010. See “—Loss from impairment and provisions of other assets,” above, and Note 21 of the U.S. GAAP Financial Statements.

Income from continuing operations

For the reasons set forth above, our income from continuing operations decreased by \$837.4 million, or 46.6%, from \$1,795.5 million in the year ended 31 December 2010 to \$958.1 million in the year ended 31 December 2011.

Gain/(loss) from discontinued operations

In the year ended 31 December 2010, we recorded a loss from discontinued operations of \$3.0 million.

In the year ended 31 December 2011, we recorded a gain of \$71.2 million, which reflected gains attributable to Bashkirenergo’s power generation business.

Gain/(loss) on disposal of discontinued operations

In the year ended 31 December 2010, we recorded a gain of \$324.7 million in connection with the disposal of Sky Link in October 2010. See Note 3 of the U.S. GAAP Financial Statements.

In the year ended 31 December 2011, we recorded a gain of \$161.8 million in connection with the disposal of discontinued operations, including a gain of \$149.5 million in connection with the sale of a 100% interest in the electricity retail company, ESKB, a subsidiary of Bashkirenergo. See “—Acquisitions—Divestitures & Key Corporate Restructurings—Bashkirenergo” and Note 4 of the U.S. GAAP Financial Statements.

Net income

For the reasons set forth above, net income decreased by \$926.0 million, or 43.7%, from \$2,117.2 million in the year ended 31 December 2010 to \$1,191.2 million in the year ended 31 December 2011.

Non-controlling interest and net income attributable to Sistema JSFC

Non-controlling interests equalled \$1,198.5 million in the year ended 31 December 2010 and \$973.2 million in the year ended 31 December 2011.

Net income attributable to Sistema JSFC decreased by \$700.7 million, or 76.3%, from \$918.7 million in the year ended 31 December 2010 to \$218.0 million in the year ended 31 December 2011.

Year Ended 31 December 2010 Compared to the Year Ended 31 December 2009

Sales

Our sales increased by \$8,796.9 million, or 50.5%, from \$17,425.5 million in the year ended 31 December 2009 to \$26,222.4 million in the year ended 31 December 2010.

The growth in overall sales was attributable primarily to the growth in revenues at Bashneft and MTS. Revenues at Bashneft grew by \$6,857.2 million, or 141.4%, and revenues at MTS grew by \$1,431.8 million, or 14.5%. Revenues at RTI and SSTL also exhibited growth, while revenues of MTS Bank declined. Revenues at RTI grew

by \$228.6 million, or 16.3%, and revenues at SSTL grew by \$78.2 million, or 215.1%. Revenues in our Other category grew by \$276.0 million, or 17.0%. See “—Revenues from banking activities,” below, for a discussion of MTS Bank revenues.

In the years ended 31 December 2009 and 2010, Bashneft’s share of our consolidated revenues was 26.8% and 43.7%, respectively. Bashneft’s revenues grew by \$6,857.2 million, or 141.4%, from \$4,849.5 million in the year ended 31 December 2009 to \$11,706.7 million in the year ended 31 December 2010 as a result of several factors. The principal reason for the growth was the consolidation of 12 months of Bashneft revenues in 2010, compared to nine months in 2009, due to our purchase of Bashneft in April 2009. In addition, Bashneft recorded revenue growth as a result of an increase in export sales of crude oil and oil products and domestic sales of oil products, which, in turn, were both volume and price driven. See “—Segment Financial Results Overview—Bashneft,” below, for further discussion of Bashneft’s results of operations.

In the years ended 31 December 2009 and 2010, MTS’ share of our consolidated revenues was 54.4% and 42.1%, respectively. MTS’ share of our consolidated revenues declined in 2010 mainly because of significant growth in our other primary revenue generator, Bashneft. MTS’ revenues grew by \$1,431.8 million, or 14.5%, from \$9,867.3 million in the year ended 31 December 2009 to \$11,299.1 million in the year ended 31 December 2010 mainly due to growth in its subscriber base, increased usage of value-added services, increased traffic on its mobile networks, expansion of MTS’ retail business in the Russian Federation and appreciation of MTS’ functional currencies against the U.S. dollar. See “—Segment Financial Results Overview—MTS,” below, for further discussion of the drivers behind the sales growth at MTS.

Revenues at RTI increased by \$228.6 million, or 16.3%, from \$1,403.2 million in the year ended 31 December 2009 to \$1,631.8 million the year ended 31 December 2010 primarily as a result of the completion of several large defence contracts and increased government spending on defence. See “—Segment Financial Results Overview—RTI,” below, for further discussion of RTI’s results of operations.

Revenues at SSTL grew by \$78.2 million, or 215.1%, from \$36.4 million in the year ended 31 December 2009 to \$114.6 million in the year ended 31 December 2010 due to growth in its subscriber base. SSTL’s mobile subscriber base nearly tripled, reaching 8.5 million customers as at 31 December 2010, compared to 3.1 million customers as at 31 December 2009. Mobile broadband subscribers also increased from 430,000 customers as at 31 December 2010, compared to 7,000 customers as at 31 December 2009. SSTL’s roll-out of new networks in an additional five telecom circles, bringing its coverage to 15 circles, and its launch of high speed data services in 99 of India’s largest cities also contributed to the growth in year-on-year sales at SSTL. See “—Segment Financial Results Overview—SSTL,” below, for further financial discussion of SSTL’s results of operations.

Revenues in our Other category increased by \$276.0 million, or 17.0%, from \$1,626.5 million in the year ended 31 December 2009 to \$1,902.5 million the year ended 31 December 2010 due to growth in revenues at each of the businesses comprising the Other category, except for Binnopharm. Revenues at Bashkirenergo grew by \$86.2 million, or 30.2%; at Detsky Mir by \$76.6 million, or 13.1%; at Intourist by \$118.6 million, or 29.7%; at Medsi Group by \$30.6 million, or 24.3%; and at Sistema Mass Media by \$7.2 million, or 8.3%. Revenues at Binnopharm declined by \$23.6 million, or 42.3%, in 2010 compared to 2009. See “—Segment Financial Results Overview—Other,” below, for further discussion of the results of operations of our Other category.

Revenues from banking activities

Revenues from banking activities declined by \$108.3 million, or 15.5%, from \$697.2 million in the year ended 31 December 2009 to \$588.9 million in the year ended 31 December 2010 mainly due to a decline in the value of MTS Bank’s loan portfolio and to a decrease in interest income from retail and corporate lending operations. Revenues from banking activities accounted for 3.8% of total revenues in 2009 and 2.2% of total revenues in 2010.

Total revenues

For the reasons set forth above, total revenues increased by \$8,688.6 million, or 47.9%, from \$18,122.7 million in the year ended 31 December 2009 to \$26,811.3 million in the year ended 31 December 2010.

Cost of sales, exclusive of depreciation, depletion and amortisation

Cost of sales, exclusive of depreciation, depletion and amortisation, increased by \$3,631.8 million, or 51.3%, from \$7,085.0 million in the year ended 31 December 2009 to \$10,716.8 million in the year ended 31 December 2010. The increase in the cost of sales was primarily due to higher cost of sales at MTS and Bashneft, and

principally to the fact that, in 2009, we consolidated nine months of expenses at Bashneft, compared to 12 months of consolidated expenses at Bashneft in 2010. Cost of sales at Bashneft also increased as a result of an increase in the cost of purchased crude oil, gas and petroleum products and in production and operating expenses. See “—*Segment Financial Results Overview—Bashneft*.” Cost of sales at MTS increased in line with its revenue growth, and, in particular, as a result of an increase in the cost of services and cost of handsets and accessories. Cost of services grew mainly because of an increase in the number of subscribers, traffic volume, and utility and energy costs. See “—*Segment Financial Results Overview—MTS*.”

In the years ended 31 December 2009 and 2010, cost of sales also included \$168.7 million and \$182.4 million, respectively, of rental expenses under operating leases. See Note 27 of the U.S. GAAP Financial Statements.

Cost related to banking activities, exclusive of depreciation and amortisation

Cost related to banking activities, exclusive of depreciation and amortisation, decreased by \$166.2 million, or 30.8%, from \$540.3 million in the year ended 31 December 2009 to \$374.0 million in the year ended 31 December 2010 mainly due to a decrease in loans issued.

Selling, general and administrative expenses

Selling, general and administrative expenses increased by \$718.9 million, or 23.7%, from \$3,028.9 million in the year ended 31 December 2009 to \$3,747.8 million in the year ended 31 December 2010 mainly due to higher expenses at MTS and Bashneft, and, in particular, to the following: (i) the consolidation of 12 months of expenses at Bashneft in 2010 compared to nine months in 2009; (ii) an increase in marketing and advertising expenses at MTS; and (iii) an increase in expenses related to employee salaries and bonuses at MTS and Bashneft. See “—*Segment Financial Results Overview—MTS*,” below, for further discussion of marketing expenses at MTS.

In the years ended 31 December 2009 and 2010, a share of selling, general and administrative expenses consisted of rental expenses under operating leases. See Note 27 of the U.S. GAAP Financial Statements.

Depreciation, depletion and amortisation

Depreciation, depletion and amortisation increased by \$428.0 million, or 17.6%, from \$2,434.7 million in the year ended 31 December 2009 to \$2,862.8 million in the year ended 31 December 2010 mainly due to the consolidation of 12 months of Bashneft operations in 2010, compared to nine months in 2009 and the increased asset base at MTS, which, in turn, was the result of continued expansion of MTS’ network through build-outs. See “—*Segment Financial Results Overview—Bashneft*” and “—*Segment Financial Results Overview—MTS*,” below, for further discussion of depreciation at Bashneft and MTS, respectively.

Transportation costs

Transportation costs increased by \$376.4 million, or 236.7%, from \$159.0 million in the year ended 31 December 2009 to \$535.4 million in the year ended 31 December 2010 due to higher transportation costs associated with Bashneft, which, in turn, was mainly due to the consolidation of 12 months of results at Bashneft in 2010, compared to nine months of results in 2009.

In addition, transportation costs at Bashneft increased due to a 67.6% increase in the volume of crude oil export sales, a 190.3% increase in the volume of oil products exports, a 167.1% increase in the volume of domestic sales of oil products and a rise in transport tariffs. See “—*Segment Financial Results Overview—Bashneft*,” below, for further discussion of transportation costs at Bashneft.

Provision for doubtful accounts

Provision for doubtful accounts decreased by \$85.5 million, or 34.6%, from \$247.0 million in the year ended 31 December 2009 to \$161.5 million in the year ended 31 December 2010 mainly due a general improvement of the economic conditions in the markets where our subsidiaries operate.

Loss from impairment and provisions of other assets

Loss from impairment of provisions of assets decreased by \$404.1 million, or 56.3%, from \$717.5 million in the year ended 31 December 2009 to \$313.4 million in the year ended 31 December 2010.

In the year ended 31 December 2009, we recorded an impairment of \$349.4 million that reflected the difference between the carrying out and our best estimate of the fair value of our 25%+1 stake in Svyazinvest. See Note 11 of the U.S. GAAP Financial Statements.

In the year ended 31 December 2010, we recorded an impairment loss of \$137.8 million in connection with the suspension of MTS' licences in Turkmenistan.

Taxes other than income tax

Taxes other than income tax increased by \$2,499.1 million, or 155.5%, from \$1,607.2 million in the year ended 31 December 2009 to \$4,106.3 million in the year ended 31 December 2010 due mainly to higher taxes associated with operations at Bashneft, and, in particular, to the fact that, in 2009, we consolidated nine months of taxes other than income tax at Bashneft, compared with 12 months in 2010.

In addition, Bashneft's export duties increased in 2010 compared to 2009 due to an increase in volumes exported and an increase in the export duty. The excise tax increased due to an increase in excise tax rates and an increase in the domestic sales volumes of oil products. The mineral extraction tax increased in 2010 compared to 2009 due to both an increase in oil production volumes and a rise in the mineral extraction tax rate.

Export duties on crude oil increased from \$329.0 million in 2009 to \$876.0 million in 2010 due to a 67.6% increase in export sales volumes and a 53.1% increase in the export duty rate. Export duties on oil products increased from \$270 million in 2009 to \$1,205 million in 2010 due to a 190.3% increase in export sales volumes and a 48.1% increase in the export duty rate on light and medium distillates and a 47.2% increase in the export duty rate on fuel oil.

Excise taxes increased from \$193.5 million in 2009 to \$671.4 million in 2010 due to the 161.1% increase in domestic sales volumes of oil products and to an across-the-board increase of 10% in the excise tax rate.

The mineral extraction tax increased from \$687.0 million in 2009 to \$1,108.3 million in 2010 due to an increase in the tax rate from \$7.9/barrel in 2009 to \$10.7/barrel in 2010 and a 15.6% increase in the volume of crude oil production.

See “—Segment Financial Results Overview—Bashneft” and “—Key Factors Affecting Our Results of Operations—Factors Affecting Bashneft's Results of Operations—Taxation,” for further discussion.

Other operating expenses, net

Other operating expenses, net, decreased by 176.1 million, or 40.4%, from \$436.4 million in the year ended 31 December 2009 to \$260.3 million in the year ended 31 December 2010.

Equity in results of affiliates

In the year ended 31 December 2009, we recorded a loss of \$12.8 million in our equity in the results of affiliates, which reflected losses at Sky Link and Sistema-Hals. These losses were partially offset by income at MTS Belarus. See “—Year Ended 31 December 2011 Compared to the Year Ended 31 December 2010—Equity in results of affiliates,” for a discussion of gains in equity in results of affiliates in 2010.

Gain on acquisition

In the year ended 31 December 2009, we recognised a gain on acquisition of \$2,782.8 million, which arose in connection with our purchase in April 2009 of several stakes in various oil and energy companies in the Republic of Bashkortostan. The gain represents the value of the net assets acquired in the transaction, which amounted to \$5,766.4 million, less the carrying value of our existing investments in the companies and the amount of cash consideration paid.

Gain upon adoption of equity method

There was no gain upon adoption of equity method in the year ended 31 December 2009. See “—Year Ended 31 December 2011 Compared to the Year Ended 31 December 2010—Gain upon adoption of equity method,” for a discussion of gain upon adoption of equity method in 2010.

Gain/(loss) on disposal of interests in subsidiaries and affiliates

In the year ended 31 December 2009, we recognised a net loss of \$384.0 million in the disposal of interests in subsidiaries and affiliates. The net loss was mainly attributable to the sale of our controlling stake in Sistema-Hals, which resulted in the recognition of a \$364.9 million loss, and the sale of 50% of the voting shares in MTT, which resulted in the recognition of a \$19.4 million loss.

Operating income

For the reasons set forth above, our operating income increased by \$49.8 million, or 1.2%, from \$4,252.9 million in the year ended 31 December 2009 to \$4,302.6 million in the year ended 31 December 2010.

Our consolidated operating income margin equaled 23.5% for the year ended 31 December 2009 and 16.0% for the year ended 31 December 2010.

The gain from the acquisition of control over energy companies in the Republic of Bashkortostan contributed 15.4% to the operating income margin in the year ended 31 December 2009, which was a significant driver for the substantially higher operating income margin in 2009 compared to 2010.

Interest income

Interest income decreased by \$59.7 million, or 31.2%, from \$191.2 million in the year ended 31 December 2009 to \$131.5 million in the year ended 31 December 2010 due mainly to an overall decrease in market interest rates.

Change in fair value of derivative instruments

In the year ended 31 December 2009, we recognised a loss of \$35.2 million, which reflected an increase in the fair value of the call and put option on Comstar shares that we issued in connection with our acquisition of the 25% +1 stake in Svyazinvest. See “—Year Ended 31 December 2011 Compared to the Year Ended 31 December 2010—Change in fair value of derivative instruments” above, for a discussion of changes in the fair value of derivative instruments in 2010.

Interest expense

Interest expense increased by \$350.9 million, or 28.2%, from \$1,246.4 million in the year ended 31 December 2009 to \$1,597.2 million in the year ended 31 December 2010. This increase in interest expense was mainly due to an increase in indebtedness in 2010, including the share of debt denominated in roubles, which historically have had higher interest rates than our foreign currency denominated debt, and to appreciation of the rouble against the U.S. dollar in 2010.

Foreign currency transaction (losses)/gains

In the year ended 31 December 2009, we recorded a foreign currency transaction loss of \$94.1 million, which was mainly the result of the depreciation of the rouble against the U.S. dollar in 2009. See “—Year Ended 31 December 2011 Compared to the Year Ended 31 December 2010—Foreign currency transaction (losses)/gains,” above, for a discussion of foreign currency transaction gains in 2010.

See “—Key Factors Affecting Our Results of Operations—General Factors—Russian and CIS Macroeconomic Conditions and Trends.”

Income from continuing operations before income tax

For the reasons set forth above, income from continuing operations before income tax decreased by \$207.4 million, or 6.8%, from \$3,068.5 million in the year ended 31 December 2009 to \$2,861.0 million in the year ended 31 December 2010.

Income tax expense

Income tax expense increased by \$321.6 million, or 43.2%, from \$743.9 million in the year ended 31 December 2009 to \$1,065.5 million in the year ended 31 December 2010, mainly attributable to an increase in the current income tax payments of \$315.7 million, or 40.8%, from \$773.8 million in the year ended 31 December 2009 to \$1,089.6 million in the year ended 31 December 2010.

The following table sets forth our income tax expense for the years ended 31 December 2009 and 2010:

	For the year ended 31 December			
	2009		2010	
	(\$ in thousands, except percentages)			
Current provision	773,849	104.0%	1,089,577	102.3%
Deferred income tax benefit	(29,954)	(4.0)%	(24,097)	(2.3)%
Total income tax expense	743,895	100.0%	1,065,480	100.0%

Our current income tax expense increased mainly due to increased taxable income from Bashneft in 2010 compared to 2009, which, in turn, was due to the consolidation of 12 months of Bashneft results in 2010, compared to nine months in 2009, and to the increase in revenue growth at Bashneft in 2010 compared to 2009. See “—Segment Financial Results Overview—Bashneft—Year Ended 31 December 2010 Compared to the Year Ended 31 December 2009.”

Our effective tax rate was 24.2% in 2009 and 37.2% in 2010. The relatively lower effective tax rate in 2009 was substantially due to the non-taxable gain discussed above. See Note 21 of the U.S. GAAP Financial Statements.

Equity in net income of energy companies in the Republic of Bashkortostan

In the year ended 31 December 2009, we recorded income of \$4.4 million attributable to our equity position in the net income of the oil and energy companies we purchased in the Republic of Bashkortostan. See “*Business-Business Description—Core Assets—Bashneft.*”

Income from continuing operations

For the reasons set forth above, our income from continuing operations decreased by \$533.4 million, or 22.9%, from \$2,329.0 million in the year ended 31 December 2009 to \$1,795.5 million in the year ended 31 December 2010.

Income/(loss) from discontinued operations

In the year ended 31 December 2009, we recorded a loss from discontinued operations of \$16.7 million.

Gain/(loss) from disposal of discontinued operations

In the year ended 31 December 2009, we recorded a loss of \$26.2 million in connection with the disposal by SITRONICS of several distribution companies in April 2009. See “—Year Ended 31 December 2011 Compared to the Year Ended 31 December 2010—Gain/(loss) from disposal of discontinued operations,” above, for a discussion of gains recorded in 2010 from the disposal of discontinued operations.

Net income

For the reasons set forth above, net income decreased by \$168.9 million, or 7.4%, from \$2,286.1 million in the year ended 31 December 2009 to \$2,117.2 million in the year ended 31 December 2010.

Noncontrolling interest and net income attributable to Sistema JSFC

Noncontrolling interests equaled \$642.6 million in 2009 and \$1,198.5 million in 2010. The increase of noncontrolling interests in the net income of our subsidiaries in 2010 was mainly due to the consolidation of 12 months of results at Bashneft in 2010, compared to nine months of results in 2009, as well as to increased profitability at Bashneft.

Net income attributable to Sistema JSFC decreased by \$724.7 million, or 44.1%, from \$1,643.5 million in the year ended 31 December 2009 to \$918.7 million in the year ended 31 December 2010.

Segment Financial Results Overview

The following analysis concentrates on our reporting segments—MTS, Bashneft, RTI, MTS Bank and SSTL—and our Other category. Bashkirenergo, Detsky Mir, Intourist, Sistema Mass Media, Medsi Group, Binnopharm

and NIS and other businesses are included within the Other category. See “*Business—Business Description—Core Assets—Bashkirenergo*” and Note 4 of the U.S. GAAP Financial Statements for further discussion of Bashkirenergo’s restructuring and accounting treatment. Central corporate functions are reported separately.

Segment results are presented after elimination of intra-segment transactions, but prior to elimination of transactions between segments.

MTS

MTS is a leading telecommunications provider in the Russian Federation and the CIS, providing a wide range of mobile and fixed line voice and data telecommunications services, including transmission, broadband, pay-TV and various value added services, as well as selling equipment and accessories.

Capital expenditures at MTS totaled \$2,208.0 million, \$2,647.1 million and \$2,584.5 million, respectively, in 2009, 2010 and 2011 and were spent on network development in the Russian Federation and the other countries where MTS operates. We expect capital expenditures at MTS to equal approximately \$2.5 billion in 2012, subject to various factors including final approval.

For the years ended 31 December 2009, 2010 and 2011, MTS’ revenues accounted for 54.4%, 42.1% and 37.4%, respectively, of Sistema’s consolidated revenues.

Certain Operating Data

Below we provide certain operating data useful for evaluating MTS’ business and results. The data focuses primarily on MTS’ mobile operations, particularly in the Russian Federation and Ukraine, which comprise the most significant share of MTS’ revenue in the periods presented.

Mobile Subscriber Data

The following table shows MTS’ mobile subscribers by country as at the dates indicated:

	<u>At 31 December</u>		
	<u>2009</u>	<u>2010</u>	<u>2011</u>
	<i>(millions)</i>		
Subscribers⁽¹⁾			
The Russian Federation	69.3	71.4	70.0
Ukraine ⁽²⁾	17.6	18.2	19.5
Uzbekistan	7.1	8.8	9.3
Armenia	2.1	2.5	2.4
Turkmenistan ⁽³⁾	1.8	2.4	n/a
Total consolidated	<u>97.8</u>	<u>103.3</u>	<u>101.1</u>
MTS Belarus (unconsolidated)	4.6	4.7	4.9

(1) MTS defines a subscriber as an individual or organisation whose account shows chargeable activity within 61 days (or 183 days in the case of its pre-paid tariffs) or whose account does not have a negative balance for more than this period.

(2) Including CDMA (Code Division Multiple Access) subscribers starting 2011.

(3) MTS does not present subscribers for 2011 as its operations in Turkmenistan have been terminated

Mobile Churn Rate

MTS defines mobile churn as the total number of subscribers who cease to be a subscriber 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 its subscribers during that period. MTS views the subscriber churn as a measure of market competition and customer dynamics. The following table shows MTS’ Russian and Ukrainian subscriber churn for the periods indicated.

	<u>Year Ended 31 December</u>		
	<u>2009</u>	<u>2010</u>	<u>2011</u>
Subscriber Churn			
the Russian Federation	38.3%	45.9%	47.6%
Ukraine	40.0%	31.0%	30.7%

The churn rate is highly dependent on competition in MTS' licence areas and those subscribers who migrate as a result of such competition.

MTS' churn rate in the Russian Federation equaled 47.6% during the year ended 31 December 2011, up from 45.9% in the year ended 31 December 2010 and 38.3% in the year ended 31 December 2009. The increase in churn rate was mainly attributable to MTS' mobile subscribers becoming more price sensitive and more likely to switch tariffs and switch to operators with lower-price tariff plans and offers due to continued economic uncertainty. In addition, due to the financial distress experienced by several mobile retailers in the Russian Federation, many increased their sales efforts in 2011 relative to 2010 and 2010 relative to 2009 to stimulate revenue earned from subscription fees, which MTS management believes led to a decline in the loyalty of new subscribers.

MTS' churn rate in Ukraine remained stable at 31.0% and 30.7%, respectively, in the years ended 31 December 2010 and 2011. The churn rate remains high due to the competitive environment among mobile operators in Ukraine, which has significantly intensified in recent years.

MTS' churn rate in Ukraine decreased to 31% in the year ended 31 December 2010 from 40.0% in the year ended 31 December 2009, in the face of a very competitive environment among mobile operators in Ukraine. MTS was able to decrease the churn rate by adjusting its tariffs in response to changes in the market and economic environment and focusing on subscriber base management with an emphasis on improving the quality of subscriber acquisitions.

Mobile ARPU

MTS calculates mobile average monthly service revenue per subscriber by dividing its service revenues for a given period, including interconnect, guest roaming fees and connection fees, by the average number of its subscribers during that period and dividing by the number of months in that period.

The following table shows MTS' average monthly service revenue per Russian and Ukrainian subscriber based on this calculation methodology and average monthly minutes of use per Russian and Ukrainian subscriber for the periods indicated.

	Year Ended 31 December		
	2009	2010	2011
Average monthly service revenue per subscriber			
the Russian Federation	\$ 7.8	\$ 8.3	\$ 9.3
Ukraine	\$ 4.7	\$ 4.8	\$ 4.9
Average monthly minutes of use per subscriber			
the Russian Federation	213	234	269
Ukraine	462	535	580

The average monthly service revenue per subscriber in the Russian Federation increased insignificantly from \$7.8 in the year ended 31 December 2009 to \$8.3 in the year ended 31 December 2010. This increase was accompanied by the addition of 6.5 million net subscribers in 2009, who, given the maturity of the market, are largely lower-value subscribers, which is dilutive to operating indicators like ARPU. The average monthly service revenue per subscriber in the Russian Federation increased from \$8.3 in the year ended 31 December 2010 to \$9.3 in the year ended 31 December 2011. Notwithstanding the decline in subscriber base from 103.3 million subscribers in 2010 to 101.1 million subscribers in 2011 (which was mainly due to the suspension of operations in Turkmenistan), total monthly service revenues increased in 2011 compared to 2010. Revenues increased due to price increases, and an increase in the average monthly minutes of use per subscriber from 234 minutes in 2010 to 269 minutes in 2011, which were possible due to an overall increase in the disposable income of the general population. As a consequence of the increase in monthly service revenues and decline in subscriber base, ARPU increased in 2011 compared to 2010.

The average monthly service revenue per subscriber in Ukraine increased to \$4.9 in the year ended 31 December 2011, from \$4.8 in the year ended 31 December 2010 to \$4.7 in the year ended 31 December 2009, mainly due to the introduction of a wide range of attractive tariffs aimed at stimulating traffic, such as inexpensive intra-network rates, as well as the increased use by subscribers of tariffs that include a flat amount of minutes per month.

Results of Operations

The following table presents the results of operations for MTS for the periods under review:

	Year ended 31 December					
	2009	% of revenues	2010	% of revenues	2011	% of revenues
	(\$ in thousands, except percentages)					
Revenues ⁽¹⁾	9,867,253	100.0	11,299,056	100.0	12,318,688	100.0
Cost of sales, exclusive of depreciation and amortisation shown separately below	(3,130,721)	(31.7)	(3,857,166)	(34.1)	(4,547,348)	(36.9)
Selling, general and administrative expenses	(1,785,952)	(18.1)	(2,084,261)	(18.4)	(2,101,316)	(17.1)
Equity in net income of investees	60,313	0.6	70,649	0.6	49,443	0.4
Interest income	108,543	1.1	84,396	0.7	62,559	0.5
Interest expense	(577,139)	(5.8)	(777,288)	(6.9)	(656,898)	(5.3)
Depreciation and amortisation	(1,776,461)	(18.0)	(2,000,495)	(17.7)	(2,293,021)	(18.6)
Operating income	2,282,523	23.1	2,744,107	24.3	2,893,938	23.5
OIBDA ⁽²⁾	4,058,984	41.1	4,744,602	42.0	5,186,959	42.1

- (1) Includes net sales to external customers and intersegment sales. Intersegment sales accounted for \$6,329 thousand, \$3,805 thousand and \$6,187 thousand in the years ended 31 December 2009, 2010 and 2011, respectively.
- (2) OIBDA represents operating income before depreciation and amortisation. OIBDA is not a measure of financial performance under U.S. GAAP. You should not consider it an alternative to net income as a measure of operating performance or to cash flows from operating activities as a measure of liquidity. Our calculation of OIBDA may be different from the calculation used by other companies and therefore comparability may be limited. We believe that OIBDA provides useful information to investors because it is an indicator of the strength and performance of our ongoing business operations, including our ability to fund discretionary spending such as capital expenditures, acquisitions of subsidiaries and other investments and our ability to incur and service debt. While depreciation and amortisation are considered operating costs under U.S. GAAP, these expenses primarily represent non-cash current period allocation of costs associated with long-lived assets acquired or constructed in prior periods.

The following table presents a reconciliation of OIBDA to operating income for the periods indicated:

	For the year ended		
	2009	2010	2011
	(\$ in thousands)		
Operating income	2,282,523	2,744,107	2,893,938
Depreciation and amortisation	1,776,461	2,000,495	2,293,021
OIBDA	4,058,984	4,744,602	5,186,959

Year Ended 31 December 2011 Compared to the Year Ended 31 December 2010

Revenues

Revenues increased by \$1,019.6 million, or 9.0%, from \$11,299.1 million in the year ended 31 December 2010 to \$12,318.7 million in the year ended 31 December 2011. The growth in revenues in the year ended 31 December 2011 was mainly due to the increase in the usage of value-added services by MTS subscribers, which, in turn, was the result of MTS' active promotion of these services, the increase of mobile Internet penetration, active 3G network expansion and the consequent improvement of the quality of value-added services.

In the Russian Federation, revenues increased by \$1,217.4 million, or 12.9%, from \$9,414.9 million in the year ended 31 December 2010 to \$10,632.3 million in the year ended 31 December 2011. The increase in revenues was primarily the result of growth in value-added services, interconnect revenues, fixed revenues and sales of handsets and accessories. Revenues from value-added services grew mainly due to the increase in data traffic volumes attributable to the introduction of new marketing initiatives aimed at stimulating greater usage of value-added services among MTS' subscribers as well as to the overall improvement of quality of these services. Interconnect revenues increased due to the growth in the volume of traffic from MTS' competitors. Fixed

revenues grew primarily due to the continued growth in domestic and international long distance and “calling party pays” traffic volumes, growth in the broadband Internet business and regulatory price increases for residential and corporate voice services. MTS’ continued expansion of its monobrand retail chain in 2011 caused sales of handsets and accessories to increase.

In Ukraine, revenues increased by \$69.8 million, or 6.5%, from \$1,072.8 million in the year ended 31 December 2010 to \$1,142.6 million in the year ended 31 December 2011. Revenues increased primarily due to subscriber growth and an increase in usage of value-added services. MTS’ subscriber base in Ukraine increased from 18.2 million in 2010 to 19.5 million in 2011. The revenue growth from value added services was mainly due to the active promotion of these services among MTS subscribers.

Revenues from other countries decreased mainly due to MTS’ ceasing to provide mobile telecommunications services in Turkmenistan at the end of 2010.

Cost of sales, exclusive of depreciation and amortisation

Overall cost of sales, which includes cost of services and cost of handsets and accessories, exclusive of depreciation and amortisation, increased by \$690.2 million, or 17.9%, from \$3,857.2 million in the year ended 31 December 2010 to \$4,547.3 million in the year ended 31 December 2011. MTS’ overall cost of services and cost of handsets and accessories increased mainly due to the expansion of MTS’ retail operations, which generally have lower margins than communications service operations.

The cost of services and cost of handsets and accessories in the Russian Federation increased by \$602.3 million, or 23.4%, from \$2,571.5 million in the year ended 31 December 2010 to \$3,173.8 million in the year ended 31 December 2011. The increase was primarily due to the increase in outgoing traffic volumes, the cost of handsets and accessories and the cost of value-added services. Interconnect expenses increased mainly due to the growth in outgoing network traffic.

The cost of services and cost of handsets and accessories in the Ukraine segment increased by \$7.2 million, or 2.3%, from \$313.77 million in the year ended 31 December 2010 to \$320.9 million in the year ended 31 December 2011 primarily due to an increase in regular payments for radio frequencies and growth of electricity tariffs regulated by the government and was partially offset by a decrease in interconnect expenses, due, in turn, to the decrease in interconnect rates charged by Kyivstar.

The cost of services and cost of handsets and accessories in the other countries and business activities of MTS decreased due mainly to MTS’ discontinuation of mobile telecommunications services in Turkmenistan at the end of 2010.

Selling, general and administrative expenses

Selling, general and administrative expenses at MTS increased by \$17.1 million, or 0.8%, from \$2,084.3 million in the year ended 31 December 2010 to \$2,101.3 million in the year ended 31 December 2011. The increase was partly attributable to a general increase in expenses caused by the growth in MTS’ operations, growth in sales and marketing expenses and the appreciation of the functional currencies in countries in which MTS operates against the U.S. dollar. Sales and marketing expenses grew slightly on account of an increase in commissions payable to dealers, which, in turn, was mainly the result of dealers acquiring subscribers with a higher ARPU. Improvements in operational efficiencies partially offset this increase in selling, general and administrative expenses. For example, in order to reduce operating expenses, MTS’ contact centers were relocated in 2011 from regions where property ownership was expensive to other Russian regions where such costs are lower. MTS also consolidated its contact centers into three key locations in the Russian Federation.

Interest expense

Interest expense decreased by \$120.4 million, or 15.5%, from \$777.3 million in the year ended 31 December 2010 to \$656.9 million in the year ended 31 December 2011 as a result of several factors. The amortisation of MTS’ debt issuance costs were lower in 2011 than in 2010. This was due to the voluntary repayment before the due date of approximately \$1.4 billion of MTS’ debt balance outstanding as at 31 December 2010, which resulted in an immediate write-off of the related debt issuance cost in a total amount of \$24.3 million. Additionally, in 2010, MTS renegotiated the interest rates and maturities of several credit facilities, which led to a significant modification of the related debt agreements and the consequent write-off of capitalised issuance costs totaling

\$26.4 million. None of the amendments to MTS' credit facilities agreements in 2011 were considered to be substantial, so that no additional expense occurred. In addition, hedging activities in 2011 resulted in an interest expense decrease. Furthermore, the extension of MTS' construction activities in 2011 allowed MTS to capitalise more interest expense in 2011 than in 2010. The remaining decrease was due to the decrease in MTS' weighted average interest rate in 2011.

Depreciation and amortisation

Depreciation and amortisation of property, network equipment, numbering capacity, licence costs and other intangible assets increased by \$292.5 million, or 14.6%, from \$2,000.5 million in the year ended 31 December 2010 to \$2,293.0 million in the year ended 31 December 2011. The increase was due to MTS' increased asset base resulting from the continued expansion of its network through build-outs, as well as due to the decrease in the estimated useful life of certain equipment which MTS intends to replace.

Depreciation and amortisation increased in MTS' Russian Federation operations mainly as a result of the build-out of MTS' 3G networks and acquisition of fixed line operators. In MTS' Ukraine operations, depreciation and amortisation decreased. In other countries and business activities, depreciation and amortisation increased in large part due to MTS' operations in Uzbekistan, where MTS has continued the expansion of its network.

Segment operating income

For the reasons stated above, operating income at MTS increased by \$149.8 million, or 5.5%, from \$2,744.1 million in the year ended 31 December 2010 to \$2,893.9 million in the year ended 31 December 2011.

Year Ended 31 December 2010 Compared to the Year Ended 31 December 2009

Revenues

Revenues increased by \$1,431.8 million, or 14.5%, from \$9,867.3 million in the year ended 31 December 2009 to \$11,299.1 million in the year ended 31 December 2010. In functional currency terms, MTS' consolidated revenues increased in all countries in which MTS operates, other than Armenia, mainly due to subscriber growth and an increase in usage in terms of value-added services and increased traffic on MTS' mobile networks. MTS' mobile subscriber base grew by 5.7% from approximately 97.8 million as at 31 December 2009 to approximately 103.3 million as at 31 December 2010. The growth in MTS' subscriber base was mainly attributable to MTS' sales and marketing efforts and the expansion of MTS' network. In Armenia, MTS' consolidated revenues decreased in functional currency terms mainly due to the highly competitive environment in Armenia.

In the Russian Federation, revenues increased by \$1,340.1 million, or 16.6%, from \$8,074.8 million in the year ended 31 December 2009 to \$9,414.9 million in the year ended 31 December 2010 due to increased usage, higher fixed revenues and growth in sales of handsets and accessories. Usage revenues grew as a result of an increase in roaming activity and revenues from value-added services. Roaming activity activity increased as a result of an economic recovery and an increase in the number of subscribers. Revenues from value-added services increased as a result of new marketing initiatives aimed at stimulating greater usage of value-added services among MTS subscribers. Fixed revenues increased primarily because of continued growth in domestic and international long distance and "calling party pays" traffic volumes, growth in the broadband Internet business and a regulatory price increase for residential and corporate voice services. The growth in sales of handsets and accessories was the result of MTS' continued expansion of its monobrand retail chain.

In Ukraine, revenues increased primarily due to growth in the number of subscribers.

MTS' sales in other countries increased due to revenue growth in Uzbekistan and Turkmenistan attributable to an expansion in subscriber base.

Cost of sales, exclusive of depreciation and amortisation

Cost of sales increased by \$726.4 million, or 23.2%, from \$3,130.7 million in the year ended 31 December 2009 to \$3,857.2 million in the year ended 31 December 2010, largely due to an increase in cost of services and cost of handsets and accessories in the Russian Federation.

Cost of services in the Russian Federation increased \$635.7 million, or 34.5%, from \$1,935.8 million in the year ended 31 December 2009 to \$2,571.5 million in the year ended 31 December 2010. The increase was primarily

due to an increase in the number of subscribers, an increase in interconnect expenses, due, in turn, to growth in outgoing network traffic and an increase in utility and energy costs due, in turn, to a rise in state regulated tariffs. Cost of handsets and accessories sold and SIM-cards provided to customers in the Russian Federation increased mainly as a result of MTS' continued expansion of its retail business in 2010.

A decline in the cost of services and cost of handsets and accessories in Ukraine partially offset the increase in cost of sales. This decline, in turn, was primarily due to a decrease in interconnect expenses, resulting from the reduction in interconnect rates with Kyivstar.

Selling, general and administrative expenses

Selling, general and administrative expenses at MTS increased by \$298.3 million, or 16.7%, from \$1,786.0 million in the year ended 31 December 2009 to \$2,084.3 million in the year ended 31 December 2010. This increase was attributable mainly to growth in sales and marketing expenses, which, in turn, was mainly due to the increase in dealer commission rates in the Russian Federation, in expenses surrounding the acquisition of Multiregion and in consulting expenses in connection with the sale of our stake in Svyazinvest, held by MTS, and to the appreciation of the functional currencies in countries in which MTS operates against the U.S. dollar. Growth in salary expenses and related social contributions as well as rent expenses due to the expansion of MTS' retail network also contributed to the increase in selling, general and administrative expenses.

A decrease in advertising and promotion expenses, due mainly to MTS' cost optimisation efforts, and in sales and marketing expenses in Ukraine, due to lower dealer commission rates, as well as improvements in operational efficiencies through the integration of MTS' regional pay-TV operations, partially offset this overall increase in selling, general and administrative expenses.

Interest expense

Interest expense increased by \$200.2 million, or 34.7%, from \$577.1 million in the year ended 31 December 2009 to \$777.3 million in the year ended 31 December 2010. In 2010, MTS voluntarily repaid approximately \$1.4 billion of its debt balance outstanding as at 31 December 2009 before the due date, and this resulted in an immediate write-off of the related debt issuance cost of \$24.3 million. During 2010, MTS renegotiated the interest rates and maturities of several credit facilities, which led to a significant modification of the related debt agreements and the consequent write-off of capitalised issuance costs totaling \$26.4 million. The remaining increase was due to the increase in MTS' average balance of indebtedness in 2010 relative to 2009.

Depreciation and amortisation

Depreciation and amortisation expense increased by \$234.0 million, or 13.2%, from \$1,766.5 million in the year ended 31 December 2009 to \$2,000.5 million in the year ended 31 December 2010. The increase was mainly due to MTS' increased asset base resulting from the continued expansion of MTS' network through build-outs, including the continued build-out and selective modernisation of MTS' network in Moscow and the build-out of MTS' proprietary long-distance network. Accelerated depreciation of certain equipment also contributed to the increase in depreciation and amortisation expense.

Depreciation and amortisation expenses increased in both the Russian Federation and Ukraine, and, due mainly to continued expansion in Uzbekistan, in other countries in 2010 relative to 2009.

Segment operating income

For the reasons stated above, the operating income at MTS increased by \$461.6 million, or 20.2%, from \$2,282.5 million in the year ended 31 December 2009 to \$2,744.1 million in the year ended 31 December 2010.

Bashneft

Bashneft is a vertically integrated oil company with upstream and downstream assets mainly located in the Republic of Bashkortostan. Due to our acquisition of Bashneft in April 2009, our results for 2009 include nine months of Bashneft operations. See "*Business—Business Description—Core Assets—Bashneft*," for a discussion of our acquisition of Bashneft.

For the years ended 31 December 2009, 2010 and 2011, Bashneft's revenues accounted for 26.8%, 43.7% and 50.2%, respectively, of Sistema's consolidated revenues.

In 2009, we consolidated nine months of Bashneft's results, compared to 2010 and 2011, when 12 months were consolidated. The period-to-period comparison of the results of operations in 2010 and 2009, discussed below, needs to be considered in light of this.

Capital expenditures at Bashneft totaled \$403.5 million, \$1,088.8 million and \$877.4 million, respectively, in 2009, 2010 and 2011. We expect capital expenditures at Bashneft to equal approximately \$1.0-\$1.2 billion in 2012, subject to various factors including final approval.

Certain Operating Data

Production

The following table presents Bashneft's production levels during the periods indicated:

	For the year ended 31 December		
	2009	2010	2011
Crude oil production (million metric tonnes)	12.2	14.1	15.1
Average daily production of crude oil (thousand barrels/day)	239.0	282.9	302.1

Refining

The following table presents certain information about Bashneft's refining operations during the periods indicated:

	For the year ended 31 December					
	2009		2010		2011	
	<i>(thousand tonnes, except percentages)</i>					
Crude oil refining	20,747		21,193		21,062	
Oil product output						
Gasoline ⁽¹⁾	5,057	26.8%	4,742	24.4%	4,919	25.6%
Diesel	7,100	37.6%	7,665	39.5%	7,413	38.6%
Fuel oil	3,046	16.1%	2,646	13.6%	2,610	13.6%
Vacuum gasoil	1,700	9.0%	1,699	8.7%	1,891	9.9%
Other	1,994	10.6	2,676	13.8%	2,351	12.3%
Total oil products	18,897	100.0%	19,428	100.0%	19,184	100.0%
Refining depth ⁽²⁾	83.4%		86.3%		85.9%	
Share of light products ⁽³⁾	60.4%		61.8%		59.9%	

(1) Includes stable natural gasoline.

(2) Based on weighted average of refining depth of each of Bashneft's refineries.

(3) The principal light products produced by Bashneft include gasoline and diesel.

Results of Operations

The following table presents the results of operations for Bashneft for the periods under discussion:

	Year ended 31 December					
	2009	% of revenues	2010	% of revenues	2011	% of revenues
	<i>(\$ in thousands, except percentages)</i>					
Revenues ⁽¹⁾	4,849,529	100.0	11,706,740	100.0	16,549,086	100.0
Taxes other than income tax	(1,510,004)	(31.1)	(3,939,677)	(33.7)	(6,065,437)	(36.7)
Cost of sales, exclusive of depreciation, depletion and amortisation shown separately below	(1,788,370)	(36.9)	(4,448,371)	(38.0)	(5,871,359)	(35.5)
Transportation costs	(159,001)	(3.3)	(535,206)	(4.6)	(787,819)	(4.8)
Selling, general and administrative expenses	(230,500)	(4.8)	(465,494)	(4.0)	(442,313)	(2.7)
Equity in net income of investees	4,400	0.1	36,074	0.3	75,245	0.5
Interest income	32,372	0.7	74,511	0.6	74,021	0.4
Interest expense	(218,745)	(4.5)	(327,852)	(2.8)	(559,806)	(3.4)
Depreciation, depletion and amortisation	(415,970)	(8.6)	(591,477)	(5.1)	(611,876)	(3.7)
Operating income	3,349,839	69.1	2,301,342	19.7	2,778,789	16.8
OIBDA ⁽²⁾	3,765,809	77.7	2,892,910	24.7	3,390,665	20.5

- (1) Includes net sales to external customers and intersegment sales. Intersegment sales amounted to \$1,298 thousand, \$772 thousand and \$11,969 thousand in the years ended 31 December 2009, 2010 and 2011, respectively.
- (2) OIBDA represents operating income before depreciation and amortisation. OIBDA is not a measure of financial performance under U.S. GAAP. You should not consider it an alternative to net income as a measure of operating performance or to cash flows from operating activities as a measure of liquidity. Our calculation of OIBDA may be different from the calculation used by other companies and therefore comparability may be limited. We believe that OIBDA provides useful information to investors because it is an indicator of the strength and performance of our ongoing business operations, including our ability to fund discretionary spending such as capital expenditures, acquisitions of subsidiaries and other investments and our ability to incur and services debt. While depreciation and amortisation are considered operating costs under U.S. GAAP, these expenses primarily represent non-cash current period allocation of costs associated with long-lived assets acquired or constructed in prior periods.

The following table presents a reconciliation of OIBDA to operating income for the periods indicated:

	For the year ended		
	2009	2010	2011
		(\$ in thousands)	
Operating income	3,349,839	2,301,342	2,778,789
Depreciation, depletion and amortisation	415,970	591,477	611,876
OIBDA	<u>3,765,809</u>	<u>2,892,819</u>	<u>3,390,665</u>

Year Ended 31 December 2011 Compared to the Year Ended 31 December 2010

Revenues

Revenues from our Bashneft segment increased by \$4,842.3 million, or 41.4%, from \$11,706.7 million in the year ended 31 December 2010 to \$16,549.1 million in the year ended 31 December 2011, mainly due to revenue growth in the sale of crude oil and oil products.

Revenue growth in the sale of crude oil and oil products was both volume and price driven. Bashneft recorded revenue growth in the export and domestic sale of both crude oil and oil products.

The tables below present certain information about the revenue and volume breakdowns of Bashneft for the periods indicated:

	For the year ended 31 December				% change
	2010	2011			
	(\$ in millions, except percentages)				
		%	%		
Revenue					
Export sales of crude oil	1,783	15.2	2,814	17.0	57.8
Domestic sales of crude oil	212	1.8	328	2.0	54.7
Total crude oil sales	1,995	17.0	3,142	19.0	57.5
Oil product exports outside the CIS	3,526	30.1	5,333	32.2	51.2
Oil product exports to CIS countries	726	6.2	1,334	8.1	83.7
Domestic sales of oil products	5,111	43.7	6,339	38.3	24.0
<i>Wholesale</i>	4,620	39.5	5,369	32.4	16.2
<i>Retail</i>	491	4.2	970	5.9	97.6
Total oil product sales	9,363	80.0	13,006	78.6	38.9
Other sales	349	3.0	401	2.4	14.9
Total revenue	11,707	100.0	16,549	100.0	41.4

	For the year ended 31 December				% change
	2010		2011		
	(thousand tonnes, except percentages)		(thousand tonnes, except percentages)		
		%		%	
Sales volumes					
Export sales of crude oil	3,210	14.6	3,599	15.0	12.1
Domestic sales of crude oil	908	4.1	1,026	4.3	13.0
Total crude oil sales	4,118	18.7	4,625	19.3	12.3
Oil product exports outside the CIS	6,515	29.6	6,956	29.0	6.8
Oil product exports to CIS countries	1,282	5.8	2,222	9.3	73.3
Domestic sales of oil products	11,099	50.4	10,171	42.4	(8.4)
Wholesale	10,483	47.6	9,148	38.2	(12.7)
Retail	616	2.8	1,023	4.3	66.1
Total oil product sales	18,896	85.8	19,349	80.7	2.4
Total sales of crude oil and oil products	22,014	100.0	23,974	100.0	4.2

Export sales of crude oil

Revenue from export sales of crude oil increased by \$1,031 million, or 57.8%, from \$1,783 million in the year ended 31 December 2010 to \$2,814 million in the year ended 31 December 2011. The increase was due to an increase in volume and price. The volume of export sales of crude oil increased by 389 thousand tonnes, or 12.1%, from 3,210 thousand tonnes in the year ended 31 December 2010 to 3,599 thousand tonnes in the year ended 31 December 2011 due mainly to an increase in oil production in 2011. The average sales price of Urals crude oil sold on the export market increased by \$30.8/barrel, or 39.3%, from \$78.3/barrel in the year ended 31 December 2010 to \$109.1/barrel in the year ended 31 December 2011.

Domestic sales of crude oil

Revenue from domestic sales of crude oil increased by \$116 million, or 54.7%, from \$212 million in the year ended 31 December 2010 to \$328 million in the year ended 31 December 2011. The increase was due to an increase in volume and price. The volume of domestic sales of crude oil increased by 118 thousand tonnes, or 13.0%, from 908 thousand tonnes in the year ended 31 December 2010 to 1,026 thousand tonnes in the year ended 31 December 2011. The average sales price of Urals crude oil sold on the domestic market increased by \$82.2/tonne, or 37.0%, from \$222.2/tonne in the year ended 31 December 2010 to \$304.4/tonne in the year ended 31 December 2011.

Export sales of oil products

Revenue from the export of oil products increased by \$2,415 million, or 56.8%, from \$4,252 million in the year ended 31 December 2010 to \$6,667 million in the year ended 31 December 2011. Revenues from exports outside the CIS grew by \$1,807 million, or 51.2%, from \$3,526 million in the year ended 31 December 2010 to \$5,333 million in the year ended 31 December 2011, while revenues from exports to other CIS countries grew by \$608 million, or 83.7%, from \$726 million in the year ended 31 December 2010 to \$1,334 million in the year ended 31 December 2011.

The increase in revenues from oil product exports was both volume and price driven.

The volume of oil products exported to countries outside the CIS increased by 441 thousand tonnes, or 6.8%, from 6,515 thousand tonnes in the year ended 31 December 2010 to 6,956 thousand tonnes in the year ended 31 December 2011, and the volume of oil products exported to CIS countries increased by 940 thousand tonnes, or 73.3%, from 1,282 thousand tonnes in the year ended 31 December 2010 to 2,222 thousand tonnes in the year ended 31 December 2011. By volume, Bashneft's principal oil products exports as a share of total oil products exports consisted of diesel fuel (55.2% in 2010 and 58.0% in 2011), vacuum gas oil (21.6% in 2010 and 20.7% in 2011), fuel oil (9.4% in 2010 and 10.5% in 2011), naphtha (5.2% in 2010 and 4.0% in 2011) and high-octane gasoline (6.7% in 2010 and 4.6% in 2011).

The average export sales price of oil products increased in 2011 compared to 2010: the price of fuel oil (average FOB/Rotterdam/CIF NWE) increased by 37.7% to \$607.2/tonne; the price of vacuum gas oil (FOB NWE) increased by 40.8% to \$769.0/tonne; the price of diesel fuel (average FOB Rotterdam/CIF NWE) increased by 39.0% to \$933.8/tonne; and the price of naphtha (average FOB Rotterdam/CIF NWE) increased by 30.7% to \$929.2/tonne.

In 2010, gasoil was mainly exported to Latvia, Netherlands and Belarus; diesel fuel, fuel oil and naphtha were mainly exported to the Netherlands; vacuum gasoil was mainly exported to the Netherlands for onward delivery to end consumers; and gasoline was mainly exported to Kazakhstan and the Netherlands for onward delivery to end consumers.

In 2011, gasoil was mainly exported to Latvia, Hungary and Belarus; diesel fuel, fuel oil and naphtha were mainly exported to the Netherlands; vacuum gasoil was mainly exported to the United States and France for onward delivery to end consumers; and gasoline was mainly exported to Kazakhstan and Estonia for onward delivery to end consumers.

Oil product sales on the domestic market

Revenue from domestic sales of oil products increased by \$1,228 million, or 24.0%, from \$5,111 million in the year ended 31 December 2010 to \$6,339 million in the year ended 31 December 2011 due to 16.2% revenue growth in wholesale deliveries and 97.6% revenue growth in retail sales. In 2010 and 2011, wholesale revenues accounted for 90.4% and 84.7%, respectively, of Bashneft's revenues from domestic oil products sales. The overall increase in revenues was due to an increase in prices.

The average domestic sales price of oil products increased in 2011 compared to 2010: the price of fuel oil increased by 18.8% to \$299.5/tonne; the price of diesel fuel (summer grade) increased by 42.7% to \$670.0/tonne; the price of diesel fuel (winter grade) increased by 36.3% to \$741.6/tonne; the price of jet fuel increased by 43.1% to \$701.8/tonne; the price of high-octane gasoline increased by 19.9% to \$821.5/tonne; and the price of low-octane gasoline increased by 32.3% to \$753.0/tonne.

The overall decrease in the volume of domestic oil products sales partially offset the increase in sales prices. The volume of domestic sales of oil products decreased by 928 thousand tonnes, or 8.4%, from 11,099 thousand tonnes in the year ended 31 December 2010 to 10,171 thousand tonnes in the year ended 31 December 2011, attributable to a 12.7% decline in wholesale deliveries. Domestic retail sales volumes of oil products increased by 66.1% in 2011 compared to 2010 due in part to the acquisition of Orenburgnefteprodukt and the consolidation of BN-Nefteprodukt in 2011. In 2010 and 2011, wholesale deliveries accounted for 94.4% and 89.9%, respectively, of Bashneft's domestic oil products sales volumes. The decline in wholesale deliveries in 2011 was primarily due to the expansion of Bashneft's retail operations.

Taxes other than income tax

Taxes other than income tax increased by \$2,125.8 million, or 54.0%, from \$3,939.7 million in the year ended 31 December 2010 to \$6,065.4 million in the year ended 31 December 2011 mainly as a result of an increase in export duties, excise taxes and the mineral extraction tax.

Export duties on crude oil increased by \$590 million, or 67.4%, from \$876 million in the year ended 31 December 2010 to \$1,466 million in the year ended 31 December 2011 due to an increase in export sales volumes and export duties. Export sales volumes of crude oil increased by 12.1% in 2011 compared to 2010. See "*—Revenues—Export sales of crude oil.*" The crude oil export duty increased by 49.3% from \$274/tonne in the year ended 31 December 2010 to \$409/tonne in the year ended 31 December 2011.

Export duties on oil products increased by \$587 million, or 48.6%, from \$1,205 million in the year ended 31 December 2010 to \$1,792 million in the year ended 31 December 2011 due to an increase in export sales volumes and export duties. Export sales volumes of oil products increased by 17.7% in 2011 compared to 2010. See "*—Revenues—Export of oil products.*" Export duties on light and medium distillates increased by 39.1% from \$197/tonne in the year ended 31 December 2010 to \$274/tonne in the year ended 31 December 2011, and export duties on fuel oil increased by 96.2% from \$106/tonne in the year ended 31 December 2010 to \$208/tonne in the year ended 31 December 2011.

Excise taxes increased by \$302 million, or 44.9%, from \$672 million in the year ended 31 December 2010 to \$974 million in the year ended 31 December 2011 due to an increase in excise tax rates in 2011 compared to 2010. Effective 1 January 2011, the Russian government introduced new legislation whereby excise tax rates are set based on fuel quality. Excise tax rates for high- and low-octane gasoline were RUB 3,992/tonne and RUB 2,923/tonne, respectively, in 2010, compared to a range of rates in 2011 from RUB 5,143/tonne for Euro 4 and 5 compliant gasoline to RUB 5,672/tonne for Euro 3 compliant gasoline and RUB 5,995/tonne for lower quality gasoline. Excise tax rates for naphtha increased from RUB 4,290/tonne in 2010 to RUB 6,089/tonne in 2011.

Excise tax rates on diesel fuel increased from RUB 1,188/tonne in 2010 to RUB 2,247/tonne for Euro 4 and 5 compliant diesel fuel, to RUB 2,485/tonne for Euro 3 compliant diesel fuel and to RUB 2,753/tonne for diesel fuel of lower quality. An 8.4% decrease in domestic sales volumes of oil products partially offset this increase.

The mineral extraction tax increased by \$646 million, or 58.3%, from \$1,108 million in the year ended 31 December 2010 to \$1,754 million in the year ended 31 December 2011 primarily as a result of an increase in both the mineral extraction tax rate and the volumes of oil produced. The mineral extraction tax rate increased from \$10.7/barrel in 2010 to \$16.1/barrel in 2011, and the volume of crude oil production increased by 961 thousand tonnes, or 6.8%, from 14,145 thousand tonnes in 2010 to 15,106 thousand tonnes in 2011. The mineral extraction tax rate takes into account discounts extended to Bashneft due to the fact that certain of its fields were characterised by depletion levels of greater than 80%. Had these discounts not been in effect, Bashneft would have been subject to mineral extraction tax rates of \$13.9/barrel in 2010 and \$20.8/barrel in 2011.

See “—Key Factors Affecting Our Results of Operations—Factors Affecting Bashneft’s Results of Operations—Taxation,” for further discussion.

Cost of sales, exclusive of depreciation, depletion and amortisation

Cost of sales, which consists of the cost of purchased crude oil, gas and oil products and production and operating expenses, increased by \$1,423.0 million, or 32.0%, from \$4,448.4 million in the year ended 31 December 2010 to \$5,871.4 million in the year ended 31 December 2011. The increase in the cost of sales was largely driven by an increase in the cost of purchased crude oil, gas and petroleum products and in production and operating expenses.

In addition to extracting its own crude oil, Bashneft also purchases oil and gas condensate for processing at its refineries. Spending on crude oil and gas condensate purchases increased by 38.6%, from \$2,882 million in the year ended 31 December 2010 to \$3,994 million in the year ended 31 December 2011, mainly as a result of the rise in domestic prices for crude oil. The average price of Urals crude increased by 39.3% from \$78.3/barrel in the year ended 31 December 2010 to \$109.1/barrel in the year ended 31 December 2011. The increase in price was partially offset by a decrease in the volumes of purchased crude oil and gas from 11.0 million tonnes in the year ended 31 December 2010 to 10.7 million tonnes in the year ended 31 December 2011, which, in turn, was due to an increase in the share of Bashneft’s own crude oil used for refining. In 2011, Bashneft also purchased 378 thousand tonnes of oil products, compared to 2010, when it engaged in no such purchases. The principal reason for these purchases was Bashneft’s acquisition of Orenburgnefteprodukt and consolidation of BN-Nefteprodukt in 2011. These companies, in turn, purchased oil products from third-party suppliers to meet demand in the regions where they operate.

Production and operating expenses increased by \$248 million, or 17.3%, from \$1,436 million in the year ended 31 December 2010 to \$1,684 million in the year ended 31 December 2011 mainly due to an increase in expenses in Bashneft’s production and refining units. Production expenses increased by 21.6% to \$759 million in 2011 mainly due to the 6.8% growth in crude oil production and the 15.0% increase in unit lifting costs for crude oil from \$6.0/barrel in 2010 to \$6.9/barrel in 2011, as well as to a rise in electricity prices in 2011. Refining expenses increased by 23.1% to \$859 million in 2011 mainly due to the 24.4% increase in unit refining costs from \$4.5/barrel in 2010 to \$5.6/barrel in 2011, the repair works at Ufaneftekhim, Novoil and Ufa Oil Refinery and an increase in prices for electricity.

The table below sets forth the breakdown in Bashneft’s production and operating expenses for the periods indicated:

	<u>For the year ended 31 December</u>				<u>% change</u>
	<u>2010</u>		<u>2011</u>		
	<i>(\$ in millions, except percentages)</i>				
		<i>%</i>		<i>%</i>	
Production	624	43.5	759	45.1	21.6
Refining	698	48.6	859	51.0	23.1
Other	114	7.9	66	3.9	(42.1)
Total	1,436	100.0	1,684	100.0	17.3

Transportation expenses

Transportation expenses, which represent all expenses incurred in the transportation of crude oil and oil products via the Transneft pipeline network or by railway or other transportation means, increased by \$252.6 million, or 47.2%, from \$535.2 million in the year ended 31 December 2010 to \$787.8 million in the year ended 31 December 2011, mainly due to the 16.1% increase in the export sales volumes of crude oil and oil products, a rise in transport tariffs and appreciation of the rouble against the U.S. dollar. Transportation expenses are generally higher for exports relative to domestic sales. The increase of exports as a share of Bashneft's overall sales contributed to the rise in transportation expenses in 2011 compared to 2010.

Selling, general and administrative expenses

Selling, general and administrative expenses decreased by \$23.2 million, or 5.0%, from \$465.5 million in the year ended 31 December 2010 to \$442.3 million in the year ended 31 December 2011, primarily due to a decrease in management compensation in 2011.

Equity in net income of investees

In 2010, Bashneft recorded equity in the net income of investees of \$36.1 million due to (i) the reclassification of its 38.5% stake in Belkamneft as an investment in associates, which was due to Sistema JSFC's purchase of a 49.0% interest in RussNeft, Belkamneft's parent company; and (ii) its acquisition in July 2010 of a 49.99% stake in ASPEC, which is engaged in the wholesale and retail of oil products and real estate development and also owns an automotive retail business.

In 2011, Bashneft recorded equity in the net income of investees of \$75.2 million, which reflected higher profits at Belkamneft and Bashneft's share of the profits of BN-Nefteprodukt, of which it is a 100% shareholder since July 2011. In July 2011, Bashneft swapped its 49.9% stake in ASPEC for a 100% stake in BN-Nefteprodukt as part of the reorganisation of ASPEC into two entities: ASPEC and BN-Nefteprodukt, which acquired ASPEC's oil products trading business.

Interest income

Interest income remained stable in 2010 and 2011, amounting to \$74.5 million in the year ended 31 December 2010 and \$74.0 million in the year ended 31 December 2011.

Interest expense

Notwithstanding the decrease in average weighted interest rates, interest expense increased by \$232.0 million, or 70.7%, from \$327.9 million in the year ended 31 December 2010 to \$559.8 million in the year ended 31 December 2011, mainly due to an increase in interest expenses on Bashneft's borrowings, in turn, due to a higher average level of indebtedness in 2011 compared to 2010, and to a premium on bonds redeemed in the year ended 31 December 2011.

Depreciation, depletion and amortisation

Depreciation, depletion and amortisation expense increased by \$20.4 million, or 3.4%, from \$591.5 million in the year ended 31 December 2010 to \$611.9 million in the year ended 31 December 2011. The increase was mainly attributable to growth in depreciation costs in the exploration and production division, which, in turn, was due to the 6.8% increase in crude oil production in 2011 relative to 2010.

Segment operating income

For the reasons set forth above, Bashneft's operating income increased by \$477.4 million, or 20.7%, from \$2,301.3 million in the year ended 31 December 2010 to \$2,778.8 million in the year ended 31 December 2011. Bashneft's operating income margin decreased from 19.7% in 2010 to 16.8% in 2011.

Year Ended 31 December 2010 Compared to the Year Ended 31 December 2009

In 2009, we consolidated Bashneft's results for nine months starting from our acquisition of Bashneft compared to 2010, when the results for 12 months were consolidated. The period-to-period comparison of the results of operations in 2010 and 2009, discussed below, needs to be considered in light of this.

Revenues

Revenues from our Bashneft segment increased by \$6,857.2 million, or 141.4%, from \$4,849.5 million in the year ended 31 December 2009 to \$11,706.7 million in the year ended 31 December 2010.

The principal reason for this increase was our consolidation of nine months of Bashneft accounts in 2009, compared to 2010, when 12 months of accounts were consolidated.

The increase in revenues was also due to our decision to no longer participate in the tolling scheme, effective in the second half of 2009 and to revenue growth in the sale of crude oil and oil products. Revenue growth in the sale of crude oil and oil products was both volume and price driven. Bashneft recorded revenue growth in the export of both crude oil and oil products and in the domestic sale of oil products and experienced a decline in revenues in the domestic sale of crude oil.

The tables below present certain information about the revenue and volume breakdowns of Bashneft for the periods indicated. The figures for 2009 represent revenues and volumes for the period 1 April 2009 to 31 December 2009, corresponding with the period consolidated into our accounts.

	For the period 1 April 2009 to 31 December 2009		For the year ended 31 December		% change
	2009		2010		
	(\$ in millions, except percentages)				
	%		%		
Revenue					
Export sales of crude oil	686	14.1	1,783	15.2	159.9
Domestic sales of crude oil	611	12.6	212	1.8	(65.3)
Total crude oil sales	1,297	26.7	1,995	17.0	53.8
Oil product exports outside CIS	879	18.1	3,526	30.1	301.0
Oil product exports to CIS countries	253	5.2	726	6.2	187.5
Domestic sales of oil products	1,821	37.5	5,111	43.7	180.7
<i>Wholesale</i>	1,404	29.0	4,620	39.5	229.1
<i>Retail</i>	416	8.6	491	4.2	18.0
Total oil product sales	2,953	60.9	9,363	80.0	217.1
Other sales	600	12.14	349	3.0	(41.9)
Total revenue	4,850	100.0	11,707	100.0	141.4
	(thousand tonnes, except percentages)				
	%		%		
Sales volumes					
Export sales of crude oil	1,450	12.3	3,210	14.6	121.4
Domestic sales of crude oil	3,417	28.9	908	4.1	(73.4)
Total crude oil sales	4,867	41.2	4,118	18.7	(15.3)
Oil product exports outside CIS	1,973	16.7	6,515	29.6	230.2
Oil product exports to CIS countries	715	6.1	1,282	5.8	79.3
Domestic sales of oil products	4,251	36.0	11,099	50.4	161.1
<i>Wholesale</i>	3,764	31.9	10,483	47.6	178.5
<i>Retail</i>	487	4.1	616	2.8	26.5
Total oil product sales	6,939	58.8	18,896	85.8	172.3
Total sales of crude oil and oil products	11,806	100.0	23,014	100.0	94.9

Export sales of crude oil

Revenue from export sales of crude oil increased by \$1,097 million, or 159.9%, from \$686 million in the year ended 31 December 2009 to \$1,783 million in the year ended 31 December 2010. The increase was due to an increase in volume and price. The volume of export sales of crude oil increased by 1,760 thousand tonnes, or 121.4%, from 1,450 thousand tonnes in the year ended 31 December 2009 to 3,210 thousand tonnes in the year ended 31 December 2010 due to mainly the consolidation of 12 months of sales volumes in 2010, compared to nine months in 2009, and to an increase in oil production in 2010. The average sales price of Urals crude oil sold on the export market increased by approximately 28.4% in 2010 compared to 2009.

Domestic sales of crude oil

Revenue from domestic sales of crude oil decreased by \$399 million, or 65.3%, from \$611 million in the year ended 31 December 2009 to \$212 million in the year ended 31 December 2010. The decrease was due to a significant decrease in volume. The volume of domestic sales of crude oil decreased by 2,509 thousand tonnes, or 73.4%, from 3,417 thousand tonnes in the year ended 31 December 2009 to 908 thousand tonnes in the year ended 31 December 2010. The decrease in volume was partially offset by an increase in price. The average sales price of Urals crude oil sold on the domestic market increased by approximately 22% in 2010 compared to 2009.

Export of sales oil products

Bashneft entered the oil products export market in the second half of 2009. Revenue from the export of oil products increased by \$3,120 million, or 275.7%, from \$1,132 million in the year ended 31 December 2009 to \$4,252 million in the year ended 31 December 2010. This increase was, in turn, driven by an increase in revenues from the export of oil products outside the CIS and to other CIS countries. Revenues from exports outside the CIS grew by \$2,647 million, or 301.0%, from \$879 million in the year ended 31 December 2009 to \$3,526 million in the year ended 31 December 2010, while revenues from exports to other CIS countries grew by \$473 million, or 187.5%, from \$253 million in the year ended 31 December 2009 to \$726 million in the year ended 31 December 2010.

The increase in revenues from oil product exports was both volume and price driven.

The volume of oil products exported to countries outside the CIS increased by 4,542 thousand tonnes, or 230.2%, from 1,973 thousand tonnes in the year ended 31 December 2009 to 6,515 thousand tonnes in the year ended 31 December 2010, and the volume of oil products exported to CIS countries increased by 567 thousand tonnes, or 79.3%, from 715 thousand tonnes in the year ended 31 December 2009 to 1,282 thousand tonnes in the year ended 31 December 2010. By volume, Bashneft's principal oil products exports in 2009 were diesel fuel, vacuum gas oil, fuel oil, naphtha and high-octane gasoline. See "*—Year Ended 31 December 2011 Compared to the Year Ended 31 December 2010—Revenues—Export of oil products*" for a discussion of principal oil products' exports in 2010.

The average export sales price of Bashneft's principal oil products, including fuel oil, vacuum gas oil, diesel fuel, naphtha and high-octane gasoline, recorded double-digit growth in 2010 compared to 2009.

In 2009 and 2010, gasoil was mainly exported to Latvia, Netherlands and Belarus; diesel fuel, fuel oil and naphtha were mainly exported to the Netherlands; vacuum gasoil was mainly exported to the Netherlands for onward delivery to end consumers; and gasoline was mainly exported to Kazakhstan and the Netherlands for onward delivery to end consumers.

Oil product sales on the domestic market

Revenue from domestic sales of oil products increased by \$3,290 million, or 180.7%, from \$1,821 million in the year ended 31 December 2009 to \$5,111 million in the year ended 31 December 2010 due to 229% revenue growth in wholesale deliveries and 18.0% revenue growth in retail sales. In 2009 and 2010, wholesale revenues accounted for 77.1% and 90.4%, respectively, of Bashneft's revenues from domestic oil products sales.

The overall increase in revenues from domestic sales of oil products was due to both volume and price growth. The volume growth was primarily due to a significant increase in wholesale deliveries from 3,630 thousand tonnes in the year ended 31 December 2009 to 11,099 thousand tonnes in the year ended 31 December 2010, which, in turn, was mainly due to the consolidation of 12 months of sales volumes in 2010, compared to nine months in 2009. Volume growth was also supported by the fact that, beginning in the second half of 2009, Bashneft no longer participates in tolling schemes, and as a consequence had greater capacity to refine its own oil products. The average sales price of Bashneft's principal oil products sold on the domestic market, including fuel oil, diesel fuel, jet fuel and both high- and low-octane gasoline experienced double-digit growth in 2010 compared to 2009.

Taxes other than income tax

Taxes other than income tax increased by \$2,429.7 million, or 160.9%, from \$1,510.0 million in the year ended 31 December 2009 to \$3,939.7 million in the year ended 31 December 2010.

The principal reason for this increase was our consolidation of nine months of Bashneft accounts in 2009, compared to 2010, when 12 months of accounts were consolidated.

Taxes other than income tax also increased because of an increase in export duties, excise taxes and the mineral extraction tax.

Export duties on crude oil increased by \$547 million, or 166.3%, from \$329 million in the year ended 31 December 2009 to \$876 million in the year ended 31 December 2010 due to an increase in export sales volumes and export duties. Export sales volumes of crude oil increased by 67.6% in 2010 compared to 2009. See “—Revenues—Export sales of crude oil.” The crude oil export duty increased by approximately 50% in 2010 compared to 2009.

Export duties on oil products increased by \$935 million, or 346.3%, from \$270 million in the year ended 31 December 2009 to \$1,205 million in the year ended 31 December 2010 due to an increase in export sales volumes and export duties. Export sales volumes of oil products increased by 190.3% in 2010 compared to 2009. See “—Revenues—Export sales of oil products.” Export duties on light and medium distillates and on fuel oil increased by over 40% in 2010 compared to 2009.

Excise taxes increased by \$478 million, or 246.4%, from \$193.5 million in the year ended 31 December 2009 to \$672 million in the year ended 31 December 2010 due to an increase in domestic sales volumes and an increase in excise tax rates in 2010 compared to 2009. Domestic sales volumes of oil products increased by 161.1% in 2010 compared to 2009. See “—Revenues—Export sales of crude oil” and “—Revenues—Export sales of oil products.” Excise tax rates recorded an across-the-board increase of 10% in 2010. As a result, in 2010, the following excise tax rates were in effect: RUB 3,992/tonne for high-octane gasoline; RUB 2,923/tonne for low-octane gasoline; RUB 4,290/tonne for naphtha; RUB 1,188/tonne for diesel fuel; and RUB 3,246/tonne for lubricants.

The mineral extraction tax increased by \$421 million, or 61.3%, from \$687 million in the year ended 31 December 2009 to \$1,108 million in the year ended 31 December 2010 primarily as a result of an increase in both the mineral extraction tax rate and the volumes of oil produced. The mineral extraction tax rate increased by over 30% in 2010 compared to 2009, and the volume of crude oil production increased by 1,911 thousand tonnes, or 15.6%, from 12,234 thousand tonnes in 2009 to 14,145 thousand tonnes in 2010. The oil production increase was mainly due to the consolidation of 12 months of production in 2010, compared to nine months in 2009. The mineral extraction tax rate takes into account discounts extended to Bashneft due to the fact that certain of its fields were characterised by depletion levels of greater than 80%. Had these discounts not been in effect, Bashneft’s mineral extraction tax rate would have been higher in 2009 and would have equalled \$13.9/barrel in 2010.

See “—Key Factors Affecting Our Results of Operations—Factors Affecting Bashneft’s Results of Operations—Taxation,” for further discussion.

Cost of sales, exclusive of depreciation, depletion and amortisation

Cost of sales, exclusive of depreciation, depletion and amortisation, increased by \$2,660.0 million, or 148.7%, from \$1,788.4 million in the year ended 31 December 2009 to \$4,448.4 million in the year ended 31 December 2010. The principal reason for this increase was our consolidation of nine months of Bashneft accounts in 2009, compared to 2010, when 12 months of accounts were consolidated. The increase in the cost of sales, exclusive of depreciation, depletion and amortisation, was also driven by an increase in the cost of purchased crude oil, gas and petroleum products and in production and operating expenses.

Spending on crude oil and gas condensate purchases increased substantially in 2010 relative to 2009 mainly due to the consolidation of nine months of purchases in 2009 compared to 12 months in 2010 and due to the rise in domestic prices for crude oil. The average price of Urals crude increased by 28.4% from \$61.0/barrel in the year ended 31 December 2009 to \$78.3/barrel in the year ended 31 December 2010. The increase in price was supported by an increase in the volumes of purchased crude oil and gas in 2010 compared to 2009 due mainly to consolidation of full-year results in 2010 compared to nine months in 2009.

Production and operating expenses increased by \$461 million, or 47.3%, from \$975 million in the year ended 31 December 2009 to \$1,436 million in the year ended 31 December 2010 mainly due to an increase in expenses in Bashneft’s exploration & production and refining units, which, in turn, were primarily due to the consolidation of 12 months of expenses in 2010 compared to nine months in 2009. Expenses related to exploration and production also increased as a result of growth in unit lifting costs.

The table below sets forth the breakdown in Bashneft's production and operating expenses for the periods indicated:

	For the year ended 31 December				% change
	2009		2010		
	<i>(\$ in millions, except percentages)</i>				
		<i>%</i>		<i>%</i>	
Exploration and production	347	35.6	624	43.5	79.8
Refining	506	51.9	698	48.6	37.9
Other	122	12.5	114	7.9	(6.6)
Total	975	100.0	1,436	100.0	47.3

Transportation expenses

Transportation expenses increased by \$376.2 million, or 236.6%, from \$159.0 million in the year ended 31 December 2009 to \$535.2 million in the year ended 31 December 2010.

The principal reason for this increase was our consolidation of nine months of Bashneft accounts in 2009, compared to 2010, when 12 months of accounts were consolidated and to revenue growth in the sale of crude oil and oil products.

Transportation costs also increased due to the 67.6% increase in the volume of crude oil export sales, the 175.1% increase in the volume of oil products sold and an increase in transport tariffs.

Selling, general and administrative expenses

Selling, general and administrative expenses increased by \$235.0 million, or 101.9%, from \$230.5 million in the year ended 31 December 2009 to \$465.5 million in the year ended 31 December 2010.

The principal reason for this increase was our consolidation of nine months of Bashneft results in 2009, compared to 2010, when 12 months of results were consolidated.

Interest income

Interest income increased by \$42.1 million, or 130.1%, from \$32.4 million in the year ended 31 December 2009 to \$74.5 million in the year ended 31 December 2010, due to an increase in the interest income earned on loans and promissory notes.

The principal reason for this increase was our consolidation of nine months of Bashneft accounts in 2009, compared to 2010, when 12 months of accounts were consolidated.

Interest expense

Interest expense increased by \$109.1 million, or 49.9%, from \$218.7 million in the year ended 31 December 2009 to \$327.9 million in the year ended 31 December 2010.

The principal reason for this increase was our consolidation of nine months of Bashneft accounts in 2009, compared to 2010, when 12 months of accounts were consolidated.

The increase in interest expense was also due to an increase in borrowings. Total debt, consisting mainly of unsecured non-convertible bonds and unsecured borrowings, at Bashneft increased from \$117 million as at 31 January 2009, compared to \$1,750 million as at 31 December 2009 and \$3,933 million as at 31 December 2010.

Depreciation, depletion and amortisation

Depreciation, depletion and amortisation expense increased by \$175.5 million, or 42.2%, from \$416.0 million in the year ended 31 December 2009 to \$591.5 million in the year ended 31 December 2010.

The principal reason for this increase was our consolidation of nine months of Bashneft accounts in 2009, compared to 2010, when 12 months of accounts were consolidated.

The increase in depreciation, depletion and amortisation was also due to growth in depreciation costs in Bashneft's exploration and production operations, which, in turn, was due to an increase in extraction activities.

Segment operating income

For the reasons set forth above, Bashneft's operating income decreased by \$1,048.5 million, or 31.3%, from \$3,349.8 million in the year ended 31 December 2009 to \$2,301.3 million in the year ended 31 December 2010. Bashneft's operating income margin decreased from 69.1% in 2009 to 19.7% in 2010.

RTI

RTI is a leading Russian technology holding company in the fields of defence, complex security systems, systems integration, microelectronics and high-tech research and development ("R&D"). Its principal assets include a 97% stake in OAO RTI Systems Concern ("RTI Systems Concern"), a large military-industrial holding, and a 63% stake in SITRONICS, a high-tech company operating in the fields of telecommunications solutions, information technologies, systems integration and consulting.

We and the Bank of Moscow formed RTI in February 2011. We took an 84.6% stake in RTI in exchange for our 97% stake in RTI Systems Concern, and the Bank of Moscow acquired a 15.4% in RTI in exchange for RUB 3.0 billion. See "Business—Business Description—Developing Assets—RTI" for further discussion of the formation of RTI and the history of RTI Systems Concern and SITRONICS.

RTI is comprised of five principal business units: defence solutions, complex defence systems, telecom solutions, microelectronic solutions and systems integration. The financial results of RTI Systems Concern and SITRONICS are consolidated into RTI's financial results starting from July 2011. The figures in the table below for 2009 and 2010 were restated to show the effect of this consolidation.

For the years ended 31 December 2009, 2010 and 2011, RTI's sales accounted for 7.7%, 6.0% and 6.2%, respectively, of our consolidated revenues. Capital expenditures at RTI totaled \$125.7 million, \$91.2 million and \$127.2 million, respectively, in 2009, 2010 and 2011.

The following table presents the results of operations for RTI for the periods under review:

	Year ended 31 December					
	2009	% of revenues	2010	% of revenues	2011	% of revenues
	(\$ in thousands, except percentages)					
Revenues ⁽¹⁾	1,403,176	100.0	1,631,816	100.0	2,093,039	100.0
Cost of sales, exclusive of depreciation and amortisation shown separately below	(1,046,326)	(74.6)	(1,270,476)	(77.9)	(1,688,375)	(80.7)
Selling, general and administrative expenses	(184,765)	(13.2)	(172,903)	(10.6)	(215,117)	(10.3)
Equity in results of affiliates	—	—	1,389	0.1	—	—
Interest income	18,012	1.3	7,774	0.5	13,028	0.6
Interest expense	(80,847)	(5.8)	(87,923)	(5.4)	(83,403)	(4.0)
Depreciation and amortisation	(69,699)	(5.0)	(97,950)	(6.0)	(104,010)	(5.0)
Operating/(loss) income	(10,997)	(0.8)	82,604	5.0	50,382	2.4
OIBDA ⁽²⁾	58,702	4.2	180,554	11.0	154,392	7.4

(1) Includes net sales to external customers and intersegment sales. Intersegment sales amounted to \$316,591 thousand, \$462,473 thousand and \$737,676 thousand in the years ended 31 December 2009, 2010 and 2011, respectively. Most of the intersegment sales consisted of sales to MTS.

(2) OIBDA represents operating income before depreciation and amortisation. OIBDA is not a measure of financial performance under U.S. GAAP. You should not consider it an alternative to net income as a measure of operating performance or to cash flows from operating activities as a measure of liquidity. Our calculation of OIBDA may be different from the calculation used by other companies and therefore comparability may be limited. We believe that OIBDA provides useful information to investors because it is an indicator of the strength and performance of our ongoing business operations, including our ability to fund discretionary spending such as capital expenditures, acquisitions of subsidiaries and other investments and our ability to incur and service debt. While depreciation and amortisation are considered operating costs under U.S. GAAP, these expenses primarily represent non-cash current period allocation of costs associated with long-lived assets acquired or constructed in prior periods.

The following table presents a reconciliation of OIBDA to operating income for the periods indicated:

	<u>For the year ended</u>		
	<u>2009</u>	<u>2010</u>	<u>2011</u>
	(\$ in thousands)		
Operating income	(10,997)	82,604	50,382
Depreciation and amortisation	69,699	97,950	104,010
OIBDA	<u>58,702</u>	<u>180,554</u>	<u>154,392</u>

Year Ended 31 December 2011 Compared to the Year Ended 31 December 2010

Revenues

Revenues at RTI increased by \$461.2 million, or 28.3%, from \$1,631.8 million in the year ended 31 December 2010 to \$2,093.0 million in the year ended 31 December 2011 mainly as a result of a significant increase in sales in the systems integration and microelectronics solutions units and the completion of an increased number of government defence contracts in the defence solutions unit.

Cost of sales, exclusive of depreciation, depletion and amortisation

Cost of sales, exclusive of depreciation and amortisation, increased by \$417.9 million, or 32.9%, from \$1,270.5 million in the year ended 31 December 2010 to \$1,688.4 million in the year ended 31 December 2011 in line with the growth in revenues, described above, and, in particular, the growth in the volume of supply contracts as a share of RTI's overall operations. Supply contracts relative to design and development contracts generally result in higher costs since they entail greater spending on purchases of materials and greater reliance on the use of contractors.

Selling, general and administrative expenses

Selling, general and administrative expenses increased by \$42.2 million, or 24.4%, from \$172.9 million in the year ended 31 December 2010 to \$215.1 million in the year ended 31 December 2011 mainly due to the expansion and diversification of RTI's operations, as well as due to an increase in expenses on measures to improve management qualifications.

Segment operating income

For the reasons set forth above, RTI recorded operating income of \$82.6 million in the year ended 31 December 2010 and \$50.4 million in the year ended 31 December 2011.

Year Ended 31 December 2010 Compared to the Year Ended 31 December 2009

Revenues

Revenues at RTI increased by \$228.6 million, or 16.3%, from \$1,403.2 million in the year ended 31 December 2009 to \$1,631.8 million in the year ended 31 December 2010 mainly as a result of growth in the defence solutions, microelectronic solutions and systems integration units.

Sales in the defence solutions unit increased mainly as a result of the fulfilment of several large orders and the increase in government spending on defense. Sales in the microelectronic solutions unit and systems integration unit increased mainly as a result of a substantially higher number of completed contracts.

Cost of sales, exclusive of depreciation and amortisation

Cost of sales, exclusive of depreciation and amortisation, increased by \$224.2 million, or 21.2%, from \$1,046.3 million in the year ended 31 December 2009 to \$1,270.5 million in the year ended 31 December 2010, which was largely due to the same factors driving revenue growth, as described above.

Segment operating income

RTI recorded a segment operating loss of \$11.0 million in the year ended 31 December 2009, compared to segment operating income of \$82.6 million in the year ended 31 December 2010.

MTS Bank

MTS Bank provides a broad range of banking services, maintaining a diversified corporate loan portfolio. In 2010, MTS Bank resumed its retail lending program, including mortgage, credit card and emergency loans. For the years ended 31 December 2009, 2010 and 2011, MTS Bank's revenues accounted for 3.9%, 2.3% and 1.7%, respectively, of our consolidated revenues. Capital expenditures at MTS Bank totaled \$25.9 million, \$19.2 million and \$34.4 million, respectively, in 2009, 2010 and 2011.

The following table presents the results of operations for MTS Bank for the periods under review:

	Year ended 31 December					
	2009	% of revenues	2010	% of revenues	2011	% of revenues
	(\$ in thousands, except percentages)					
Revenues ⁽¹⁾	713,844	100.0	613,745	100.0	560,906	100.0
Costs related to banking activities, exclusive of depreciation and amortisation	(590,513)	(82.7)	(416,275)	(67.8)	(353,522)	(63.0)
Selling, general and administrative expenses	(160,184)	(22.4)	(173,027)	(28.2)	(209,171)	(37.3)
Net interest (expenses)/revenue ⁽²⁾	(51,980)	(5.2)	24,444	4.0	(1,912)	(0.3)
Depreciation and amortisation	(13,554)	(1.9)	(18,571)	(3.0)	(17,339)	(3.1)
Operating (loss)/income	<u>(83,514)</u>	<u>(11.7)</u>	<u>21,329</u>	<u>3.5</u>	<u>(23,510)</u>	<u>(4.2)</u>
OIBDA ⁽³⁾	<u>(69,960)</u>	<u>(9.8)</u>	<u>39,900</u>	<u>6.5</u>	<u>(6,171)</u>	<u>(1.1)</u>

- (1) Includes net sales to external customers and intersegment sales. Intersegment sales amounted to \$16,617 thousand, \$24,779 thousand and \$31,894 thousand in the years ended 31 December 2009, 2010 and 2011, respectively.
- (2) MTS Bank derives a majority of its revenue from interest. In addition, management primarily relies on net interest revenue, not the gross revenue and expense amounts, in managing MTS Bank.
- (3) OIBDA represents operating income before depreciation and amortisation. OIBDA is not a measure of financial performance under U.S. GAAP. You should not consider it an alternative to net income as a measure of operating performance or to cash flows from operating activities as a measure of liquidity. Our calculation of OIBDA may be different from the calculation used by other companies and therefore comparability may be limited. We believe that OIBDA provides useful information to investors because it is an indicator of the strength and performance of our ongoing business operations, including our ability to fund discretionary spending such as capital expenditures, acquisitions of subsidiaries and other investments and our ability to incur and service debt. While depreciation and amortisation are considered operating costs under U.S. GAAP, these expenses primarily represent non-cash current period allocation of costs associated with long-lived assets acquired or constructed in prior periods.

The following table presents a reconciliation of OIBDA to operating income for the periods indicated:

	For the year ended		
	2009	2010	2011
	(\$ in thousands)		
Operating income	(83,514)	21,329	(23,510)
Depreciation and amortisation	<u>13,554</u>	<u>18,571</u>	<u>17,339</u>
OIBDA	<u>(69,960)</u>	<u>39,900</u>	<u>(6,171)</u>

Year Ended 31 December 2011 Compared to the Year Ended 31 December 2010

Revenues

MTS Bank derives a majority of its revenue from interest income.

Revenues decreased by \$52.8 million, or 8.6%, from \$613.7 million in the year ended 31 December 2010 to \$560.9 million in the year ended 31 December 2011 due mainly to a reduction in average interest rates.

Interest income decreased by \$84.4 million, or 16.0%, from \$529.7 million in the year ended 31 December 2010 to \$445.3 million in the year ended 31 December 2011.

The decline in interest income was mainly the result of a decline in effective average interest rates for loans to corporate customers, which, in the years ended 31 December 2010 and 2011, accounted for 67.1% and 73.9%, respectively of overall loans to customers and banks. The effective average interest rate for U.S. dollar-denominated loans to corporate customers declined from 11.6% in the year ended 31 December 2010 to 7.6% in the year ended 31 December 2011, and the effective average interest rate for rouble-denominated loans to corporate customers declined from 13.4% in the year ended 31 December 2010 to 11.1% in the year ended 31 December 2011. The decline in interest income was partially offset by an increase in loans made to customers and banks, which grew by \$585.9 million, or 15.4%, from \$3,803.9 million in the year ended 31 December 2010 to \$4,389.9 million in the year ended 31 December 2011.

Non-interest income increased by \$31.6 million, or 37.4%, from \$84.0 million in the year ended 31 December 2010 to \$115.6 million in the year ended 31 December 2011.

Costs related to banking activities, exclusive of depreciation and amortisation

Costs related to banking activities, exclusive of depreciation and amortisation, decreased by \$62.8 million, or 15.1%, from \$416.3 million in the year ended 31 December 2010 to \$353.5 million in the year ended 31 December 2011 mainly due to the extension of better quality loans in 2011 compared to 2010. Higher quality loans are generally associated with lower costs than loans of relatively worse quality.

Selling, general and administrative expenses

Selling, general and administrative expenses increased by \$36.1 million, or 20.9%, from \$173.0 million in the year ended 31 December 2010 to \$209.2 million in the year ended 31 December 2011 mainly as a result of an increase in the number of employees following further expansion of retail operations.

Segment operating income

For the reasons stated above and because of the result of the disposal of certain property in 2010, MTS Bank recorded an operating income of \$21.3 million in the year ended 31 December 2010. MTS Bank recorded an operating loss of \$23.5 million in the year ended 31 December 2011.

Year Ended 31 December 2010 Compared to the Year Ended 31 December 2009

Revenues

Revenues decreased by \$100.1 million, or 14.0%, from \$713.8 million in the year ended 31 December 2009 to \$613.7 million in the year ended 31 December 2010 due mainly to a decrease in the total portfolio of banking assets, including loans to customers and banks, and to a reduction in average interest rates.

Interest income decreased by \$94.8 million, or 15.2%, from \$624.5 million in the year ended 31 December 2009 to \$529.7 million in the year ended 31 December 2010.

The decline in interest income was mainly the result of a decline in effective average interest rates for both rouble-denominated and U.S.\$ denominated loans to corporate customers. The decline in interest income was partially offset by an increase in loans made to customers and banks.

Non-interest income decreased by \$11.9 million, or 12.4%, from \$95.9 million in the year ended 31 December 2009 to \$84.0 million in the year ended 31 December 2010.

Costs related to banking activities, exclusive of depreciation and amortisation

Costs related to banking activities, exclusive of depreciation and amortisation, decreased by \$174.3 million, or 29.5%, from \$590.5 million in the year ended 31 December 2009 to \$416.3 million in the year ended 31 December 2010 mainly as a result of a decrease in loans issued.

Selling, general and administrative expenses

Selling, general and administrative expenses totaled \$160.2 million in the year ended 31 December 2009 and \$173.0 million in the year ended 31 December 2010.

Segment operating income

For the reasons stated above, and because of the result of the disposal of certain property in 2010, MTS Bank recorded an operating loss of \$83.5 million in the year ended 31 December 2009 and operating income of \$21.3 million in the year ended 31 December 2010.

SSTL

SSTL is an Indian mobile and fixed communication operator with a spectrum in 22 licence circles covering a total population of approximately 1.2 billion people located in all of the 28 administrative states and seven union territories. For a discussion of the suspension of SSTL's operating licences, as well as the litigation surrounding such suspension, see "*Business—Material Litigation*," "*Risk Factors—Risks Relating to Our Business and Industry—General Risks—As a result of litigation proceedings involving SSTL, certain financing arrangements of SSTL and Sistema JSFC may well currently be capable of being accelerated. In addition, pursuant to a put option agreement, we may be required to repurchase the stake in SSTL held by the Russian government. If the Russian government were to exercise its put option over its stake in SSTL, there can be no assurance that such exercise would not have a material adverse effect on our financial condition*" and "*Liquidity and Capital Resources—Capital Requirements*."

For the years ended 31 December 2009, 2010 and 2011, SSTL's revenues accounted for 0.2%, 0.4% and 0.8%, respectively, of Sistema's consolidated revenues. Capital expenditures at SSTL totaled \$210.1 million, \$169.0 million and \$178.2 million, respectively, in 2009, 2010 and 2011.

The following table presents the results of operations for SSTL for the periods under review:

	Year ended 31 December					
	2009	% of revenues	2010	% of revenues	2011	% of revenues
	(\$ in thousands, except percentages)					
Revenues ⁽¹⁾	36,374	100.0	114,615	100.0	262,264	100.0
Cost of sales, exclusive of depreciation and amortisation shown separately below	(163,332)	(449.0)	(188,778)	(164.7)	(274,302)	(104.6)
Selling, general and administrative expenses	(142,022)	(390.4)	(190,129)	(165.9)	(275,115)	(104.9)
Impairment loss	(14,944)	(41.1)	(3,625)	(3.2)	(717,675)	(133.8)
Interest income	8,625	23.7	4,971	4.3	34,152	13.0
Interest expense	(44,498)	(122.3)	(91,982)	(80.3)	(162,442)	(61.9)
Depreciation and amortisation	(28,065)	(77.2)	(81,822)	(71.4)	(99,424)	(37.9)
Operating loss	(250,791)	(689.5)	(410,789)	(358.4)	(1,196,084)	(456.1)
OIBDA (negative) ⁽²⁾	(222,726)	(612.3)	(328,967)	(287.0)	(1,096,660)	(418.2)

(1) Consists of net sales to external customers. SSTL recorded no intersegment sales in the years ended 31 December 2009, 2010 and 2011.

(2) OIBDA represents operating income before depreciation and amortisation. OIBDA is not a measure of financial performance under U.S. GAAP. You should not consider it an alternative to net income as a measure of operating performance or to cash flows from operating activities as a measure of liquidity. Our calculation of OIBDA may be different from the calculation used by other companies and therefore comparability may be limited. We believe that OIBDA provides useful information to investors because it is an indicator of the strength and performance of our ongoing business operations, including our ability to fund discretionary spending such as capital expenditures, acquisitions of subsidiaries and other investments and our ability to incur and service debt. While depreciation and amortisation are considered operating costs under U.S. GAAP, these expenses primarily represent non-cash current period allocation of costs associated with long-lived assets acquired or constructed in prior periods.

The following table presents a reconciliation of OIBDA to operating income for the periods indicated:

	<u>For the year ended</u>		
	<u>2009</u>	<u>2010</u>	<u>2011</u>
		<i>(\$ in thousands)</i>	
Operating loss	(250,791)	(410,789)	(1,196,084)
Depreciation and amortisation	28,065	81,822	99,424
OIBDA	<u>(222,726)</u>	<u>(328,967)</u>	<u>(1,096,660)</u>

Year Ended 31 December 2011 Compared to the Year Ended 31 December 2010

Revenues

Revenues at SSTL grew by \$147.6 million, or 128.8%, from \$114.6 million in the year ended 31 December 2010 to \$262.3 million in the year ended 31 December 2011 due to growth in its subscriber base and non-voice revenues from both mobile and data value-added services.

SSTL's mobile subscriber base nearly doubled and mobile broadband subscribers more than tripled in 2011, compared to 2010. Non-voice revenues from mobile valued-added and data services increased by over 300% in 2011 compared to 2010.

In 2011, SSTL launched new networks in an additional seven telecom circles, bringing its coverage to 22 circles, and expanded its high-speed data network to over 300 locales.

Cost of sales, exclusive of depreciation and amortisation

Cost of sales, exclusive of depreciation and amortisation, increased by \$85.5 million, or 45.3%, from \$188.8 million in the year ended 31 December 2010 and \$274.3 million in the year ended 31 December 2011 due mainly to the increase in SSTL's customer base.

Selling, general and administrative expenses

Selling, general and administrative expenses increased by \$84.9 million, or 44.7%, from \$190.1 million in the year ended 31 December 2010 to \$275.1 million in the year ended 31 December 2010 mainly in connection with the continued expansion of SSTL's operations, including the rollout of mobile networks in new circles.

Impairment loss

SSTL recorded a loss from impairment and provisions of other assets of \$717.7 million mainly in connection with the suspension of 21 of its 22 operating licences in India. See "*Business—Material Litigation*" and Note 11 of the U.S. GAAP Financial Statements for further discussion.

Interest expense

Interest expense increased by \$70.5 million, or 76.6%, from \$92.0 million in the year ended 31 December 2010 to \$162.4 million in the year ended 31 December 2011 due to an increase in SSTL's indebtedness from \$1,245.9 million as at 31 December 2010 to \$1,573.5 million as at 31 December 2011, which, in turn, was mainly due to an increase in the quantum of loans in 2011.

Depreciation and amortisation

Depreciation and amortisation increased by \$17.6 million, or 21.5%, from \$81.8 million in the year ended 31 December 2010 to \$99.4 million in the year ended 31 December 2011 mainly due to the increase in SSTL's asset base.

Segment operating loss

For the reasons set forth above, SSTL's operating loss increased by \$785.3 million, or 191.2%, from a loss of \$410.8 million in the year ended 31 December 2010 to a loss of \$1,196.1 million in the year ended 31 December 2011.

Year Ended 31 December 2010 Compared to the Year Ended 31 December 2009

Revenues

Revenues at SSSL grew by \$78.2 million, or 215.1%, from \$36.4 million in the year ended 31 December 2009 to \$114.6 million in the year ended 31 December 2010 due to growth in its subscriber base and non-voice revenues from both mobile and data value-added services.

SSSL's mobile subscriber base nearly tripled, reaching 8.4 million customers in 2010, compared to 3.1 million customers in 2009. Mobile broadband subscribers also increased to 430,000 customers as at 31 December 2010, from 7,000 customers as at 31 December 2009. SSSL's ARPU increased by 5.9% from \$1.7 in the year ended 31 December 2009 to \$1.8 in the year ended 31 December 2010.

In 2010, SSSL launched new networks in an additional five telecom circles, bringing its coverage to 15 circles, as well as high speed data services in 99 of India's largest cities.

Cost of sales, exclusive of depreciation and amortisation

Cost of sales, exclusive of depreciation and amortisation, remained roughly stable at \$163.3 million in the year ended 31 December 2009 and \$188.8 million in the year ended 31 December 2010.

Selling, general and administrative expenses

Selling, general and administrative expenses increased by \$48.1 million, or 33.9%, from \$142.0 million in the year ended 31 December 2009 to \$190.1 million in the year ended 31 December 2010 mainly in connection with the continued rollout of mobile networks in new circles.

Interest expense

Interest expense increased by \$47.5 million, or 106.7%, from \$44.5 million in the year ended 31 December 2009 to \$92.0 million in the year ended 31 December 2010 due to an increase in SSSL's indebtedness from \$530.7 million at 31 December 2009 to \$1,245.9 million at 31 December 2010.

Depreciation and amortisation

Depreciation and amortisation increased by \$53.8 million, or 191.5%, from \$28.1 million in the year ended 31 December 2009 to \$81.8 million in the year ended 31 December 2010 mainly due to the increase in SSSL's asset base.

Segment operating loss

For the reasons set forth above, SSSL's operating loss increased by \$160.0 million, or 63.8%, from a loss of \$250.8 million in the year ended 31 December 2009 to a loss of \$410.8 million in the year ended 31 December 2010 due mainly to the roll-out of new mobile networks.

Other

The Other category consists of the following assets: Bashkirenergo; Detsky Mir; Intourist; Medsi Group; Sistema Mass Media; Binnopharm; and NIS.

Russian law requires the unbundling of power generation assets from power transmission and distribution assets. Consequently, Bashkirenergo is currently under a reorganisation, so that its power and heat generation assets and heat distribution assets are controlled by one company, Bashenergoaktiv, and its power transmission and distribution assets are controlled by another company, BESK. In December 2011, we entered into a non-binding memorandum of understanding with INTER RAO UES, a the Russian Federation energy holding company, expressing the intention to sell the generation assets and heat distribution assets to INTER RAO UES. On 12 May 2012, we entered into an agreement with INTER RAO UES in respect of the proposed reorganisation of Bashkirenergo where we have given certain warranties, indemnities and other undertakings to INTER RAO UES. As a result of this reorganisation, we expect to receive a combination of cash and promissory notes from INTER RAO UES. Subject to the approval of shareholders of Sistema and of Bashkirenergo and certain other conditions, including receipt of necessary government approvals and the execution of additional ancillary agreements, the

reorganisation is expected to be completed in the fourth quarter of 2012 or first quarter of 2013. Following the reorganisation, we expect to hold a 75% stake in the power transmission and distribution company, BESK, and no stake in Bashenergoaktiv. Consequently, the results of Bashkirenergo's generation business were reported in discontinued operations as at 31 December 2011. See "Business—Business Description—Core Assets—Bashkirenergo."

Historically, substantially all of Bashkirenergo's revenues were attributable to its generation business, not its transmission or distribution operations. Therefore, we expect that, following the sale of its generation assets, Bashkirenergo's power transmission and distribution assets will account for a very small portion of our results of operations. For this reason, in the U.S. GAAP Financial Statements, we have excluded Bashkirenergo as part of our Other category. Prior periods have been restated to provide for comparability across the periods under review.

For the years ended 31 December 2009, 2010 and 2011, revenues from the companies comprising the Other category accounted for 9.0%, 7.1% and 6.0%, respectively, of our consolidated revenues. Capital expenditures in the Other category totaled \$574.3 million, \$105.3 million and \$321.7 million, respectively, in 2009, 2010 and 2011.

The following table presents the results of operations for the Other category for the periods under review:

	Year ended 31 December					
	2009	% of revenues	2010	% of revenues	2011	% of revenues
	(\$ in thousands, except percentages)					
Revenues ⁽¹⁾	1,626,520	100.0	1,902,546	100.0	1,974,977	100.0
Cost of sales, exclusive of depreciation and amortisation shown separately below	(1,045,310)	(63.1)	(1,232,561)	(64.8)	(1,133,845)	(57.4)
Selling, general and administrative expenses	(375,621)	(23.1)	(380,012)	(20.0)	(435,053)	(22.0)
Equity in results of affiliates	(73,071)	(4.5)	(15,877)	(0.8)	(3,759)	(0.2)
Interest income	3,002	0.2	4,145	0.2	74,310	3.8
Interest expense	(148,313)	(9.1)	(120,654)	(6.3)	(110,684)	(5.6)
Depreciation and amortisation	(123,278)	(7.6)	(64,895)	(3.4)	(146,560)	(7.4)
Operating (loss)/income	(508,974)	(31.3)	84,251	4.4	(129,373)	(6.6)
OIBDA ⁽²⁾	(385,696)	(23.7)	149,146	7.8	17,187	0.9

(1) Includes net sales to external customers and intersegment sales. Intersegment sales amounted to \$51,871 thousand, \$3,926 thousand and \$27,537 thousand in the years ended 31 December 2009, 2010 and 2011, respectively.

(2) OIBDA represents operating income before depreciation and amortisation. OIBDA is not a measure of financial performance under U.S. GAAP. You should not consider it an alternative to net income as a measure of operating performance or to cash flows from operating activities as a measure of liquidity. Our calculation of OIBDA may be different from the calculation used by other companies and therefore comparability may be limited. We believe that OIBDA provides useful information to investors because it is an indicator of the strength and performance of our ongoing business operations, including our ability to fund discretionary spending such as capital expenditures, acquisitions of subsidiaries and other investments and our ability to incur and service debt. While depreciation and amortisation are considered operating costs under U.S. GAAP, these expenses primarily represent non-cash current period allocation of costs associated with long-lived assets acquired or constructed in prior periods.

The following table presents a reconciliation of OIBDA to operating income for the periods indicated:

	For the year ended		
	2009	2010	2011
	(\$ in thousands)		
Operating (loss)/income	(508,974)	84,251	(129,373)
Depreciation and amortisation	123,278	64,895	146,560
OIBDA	(385,696)	149,146	17,187

Year Ended 31 December 2011 Compared to the Year Ended 31 December 2010

Revenues

Revenues in our Other category increased by \$72.4 million, or 3.8%, from \$1,902.5 million in the year ended 31 December 2010 to \$1,975.0 million in the year ended 31 December 2011 mainly due to growth in sales at Detsky Mir, Medsi Group, Sistema Mass Media and Binnopharm. This increase in revenues was also supported by sales growth at NIS. NIS commenced active operations in 2010, and, as a consequence, its sales in 2011 were five-fold higher, amounting to RUB 3,295 million (\$112.3 million at the 2011 average exchange rate of RUB 29.35/\$1.00). Overall growth in the Other category was partially offset by a decline in sales at Intourist.

Detsky Mir is a leading Russian operator in children's goods retail, maintaining a chain of over 150 stores. Sales at Detsky Mir increased by \$123.0 million, or 15.7%, from \$659.9 million in the year ended 31 December 2010 to \$782.9 million in the year ended 31 December 2011 mainly due to the opening of 21 new stores and improved sales performance.

Medsi Group is one of the Russian Federation's leading national networks of private clinics, providing healthcare services in Moscow and other Russian regions. Sales at Medsi Group increased by \$42.5 million, or 27.2%, from \$156.5 million in the year ended 31 December 2010 to \$199.0 million in the year ended 31 December 2011 mainly due to an increase in services provided, an increase in client visits and an increase in the average bill.

Sistema Mass Media is a holding company managing assets in pay TV, premium movie and TV content production and advertising. Sales of Sistema Mass-Media increased by \$6.9 million, or 7.3%, from \$94.0 million in the year ended 31 December 2010 to \$101.9 million in the year ended 31 December 2011 primarily due to a 15.8% increase in the subscriber base for STREAM TV, growth in content aggregation and more than a two-fold increase in advertising revenue.

Binnopharm is a pharmaceuticals company managing one of the largest full-cycle facilities in the Russian Federation for the manufacturing of bio-technology drugs in line with GMP (Good Manufacturing Practice) international quality standards. Sales at Binnopharm increased by \$6.4 million, or 19.9%, from \$32.1 million in the year ended 31 December 2010 to \$38.5 million in the year ended 31 December 2011 mainly due to the launch of new drugs into production and to new contracts signed with GSK and ViiV in 2011.

Intourist is a large, vertically integrated tourism holding company in the Russian Federation. Sales at Intourist decreased by \$241.6 million, or 46.6%, from \$518.2 million in the year ended 31 December 2010 to \$276.6 million in the year ended 31 December 2011. The decline in revenues was mainly due to the deconsolidation of tour operating and retail divisions, as well as to the loss on disposal of the Pekin Hotel, which Intourist sold in March 2011. The deconsolidation resulted from the creation of a joint venture in July 2011 between Intourist and Thomas Cook. The joint venture, in which Intourist holds a 49% stake and which is therefore no longer consolidated, was established to manage Intourist's tour operating assets and retail sales network. Partially offsetting the decrease in tour revenues, the revenue from Intourist's hotel business increased due to the fact that the average price per hotel room per night increased by 1.5% from RUB 2,682 in 2010 to RUB 2,723 in 2011, and revenue per room increased by 5.8% from RUB 1,395 to RUB 1,476.

Cost of sales, exclusive of depreciation and amortisation

Cost of sales, exclusive of depreciation and amortisation, decreased by \$98.7 million, or 8.0%, from \$1,232.6 million in the year ended 31 December 2010 to \$1,133.8 million in the year ended 31 December 2011 mainly as a result of Intourist's exit from the tour operating and retail business, discussed above. Intourist's cost of sales decreased by \$226.1 million, or 49.6%, from \$455.8 million in 2010 to \$229.7 million in 2011. A 26.9% increase in cost of sales at Detsky Mir partially offset this overall decrease in cost of sales in the Other category.

In 2010, cost of sales at Detsky Mir, Intourist and Bashkirenergo accounted for 29.7%, 37.0% and 19.3%, respectively, of overall cost of sales in the Other category. In 2011, cost of sales at Detsky Mir, Intourist and Bashkirenergo accounted for 40.9% and 20.3% and 21.1%, respectively, of overall cost of sales in the Other category.

Selling, general and administrative expenses

Selling, general and administrative expenses increased by \$55.0 million, or 14.5%, from \$380.0 million in the year ended 31 December 2010 to \$435.1 million in the year ended 31 December 2011, mainly due to a 16.8% increase in such expenses at Detsky Mir. In 2010 and 2011, Detsky Mir accounted for 62.9% and 64.2%, respectively, of overall selling, general and administrative expenses in the Other category.

Depreciation and amortisation

Depreciation and amortisation increased by \$81.7 million, or 125.8%, from \$64.9 million in the year ended 31 December 2010 to \$146.6 million in the year ended 31 December 2011 mainly due to overall growth of depreciable assets at the various companies comprising the Other category.

Segment operating (loss)/income

Bashkirenergo recorded operating income of \$55.9 million in 2010 and \$57.7 million in 2011. Detsky-Mir had operating income of \$24.4 million in 2010 and \$9.8 million in 2011. Intourist had operating income of \$34.5 million in 2011, compared to an operating loss of \$4.0 million in 2010. Medsi Group recorded operating income of \$8.1 million in 2010 and \$19.6 million in 2011. Sistema Mass Media had an operating loss of \$73.7 million in 2011, in large part due to an impairment loss at RWS, reflecting a downward revision of secondary sales forecasts of Sistema Mass Media's content library. Sistema Mass Media had operating income of \$2.2 million in 2010. Binnopharm recorded operating losses in both 2010 and 2011.

For the reasons discussed above, our Other category, in aggregate, recorded an operating loss of \$129.4 million in 2011, compared to an operating income of \$84.3 million in 2010.

Year Ended 31 December 2010 Compared to the Year Ended 31 December 2009

Revenues

Revenues in our Other category increased by \$276.0 million, or 17.0%, from \$1,626.5 million in the year ended 31 December 2009 to \$1,902.5 million in the year ended 31 December 2010 due to growth in sales at Detsky Mir, Intourist, Bashkirenergo, Medsi Group and Sistema Mass Media. This overall growth was partially offset by a decline in sales at Binnopharm.

Sales at Detsky Mir increased by \$76.8 million, or 13.2%, from \$583.1 million in the year ended 31 December 2009 to \$659.9 million in the year ended 31 December 2010 mainly due to the opening of three stores in 2010, improved market conditions, store traffic growth and changes in the basket mix.

Sales at Intourist increased by \$118.6 million, or 29.7%, from \$399.7 million in the year ended 31 December 2009 to \$518.2 million in the year ended 31 December 2010 mainly due to an increase in the number of tourists using Intourist services. The increase in tourists was, in turn, mainly the result of improved market conditions and the launch of new travel routes. The increase in revenues from the rise in tourists was partially offset by a 9% decrease in the total number of hotel rooms as at 31 December 2010 compared to 31 December 2009.

Sales at Bashkirenergo increased by \$106.8 million, or 37.5%, from \$285.0 million in the year ended 31 December 2009 to \$391.8 million in the year ended 31 December 2010 mainly as a result of growth in electricity and heat supplies, both to retail and wholesale consumers (including on the wholesale electricity and capacity markets) and in average electricity and heat tariffs, which were regulated by the Russian government. In 2009 and 2010, electricity and capacity sales accounted for 73.2% and 75.4%, respectively, of overall revenues at Bashkirenergo.

Sales at Medsi Group increased by \$30.6 million, or 24.3%, from \$125.8 million in the year ended 31 December 2009 to \$156.5 million in the year ended 31 December 2010 mainly due to an increase in services provided, an increase in client visits and an increase in the average bill.

Sales of Sistema Mass-Media increased by \$7.2 million, or 8.3%, from \$87.2 million in the year ended 31 December 2009 to \$94.5 million in the year ended 31 December 2010 primarily due to an increase in both the subscriber base for STREAM TV and film sales.

Sales at Binnopharm decreased by \$23.6 million, or 42.3%, from \$55.7 million in the year ended 31 December 2009 to \$32.1 million in the year ended 31 December 2010, which was mainly because of a delay in the production of new drugs and because Binnopharm had been contracted in 2009 to produce significant volumes of vaccine for Hepatitis B. No such contracts existed in 2010.

Cost of sales, exclusive of depreciation and amortisation

Cost of sales, exclusive of depreciation and amortisation, increased by \$187.3 million, or 17.9%, from \$1,045.3 million in the year ended 31 December 2009 to \$1,232.6 million in the year ended 31 December 2010 mainly as

a result of an increase in cost of sales at Intourist and Bashkirenergo. In 2009, cost of sales at Detsky Mir and Intourist accounted for 33.7% and 33.0%, respectively, of overall cost of sales in the Other category.

Cost of sales, exclusive of depreciation and amortisation, at Intourist increased by \$110.6 million, or 32.0%, from \$345.2 million in the year ended 31 December 2009 to \$455.8 million in the year ended 31 December 2010 mainly as a result of higher competition and pricing pressure in the tour operating and hotel markets.

Cost of sales, exclusive of depreciation and amortisation, at Bashkirenergo increased by \$67.5 million, or 35.3%, from \$191.2 million in the year ended 31 December 2009 to \$258.7 million in the year ended 31 December 2010 mainly as a result of an increase in fuel costs and in the price of electricity purchased by Bashkirenergo. Fuel costs, in turn, increased mainly due to one-time, 15% rise in the price of gas (for indexation purposes) and to an increase in power generation at thermal power stations.

Selling, general and administrative expenses

Selling, general and administrative expenses amounted to \$375.6 million in the year ended 31 December 2009 and \$380.0 million in the year ended 31 December 2010. In 2009 and 2010, Detsky Mir accounted for 67.3% and 62.3% of overall selling, general and administrative expenses in the Other category.

Depreciation and amortisation

Depreciation and amortisation decreased by \$58.4 million, or 47.4%, from \$123.3 million in the year ended 31 December 2009 to \$64.9 million in the year ended 31 December 2010.

Segment operating income/(loss)

Bashkirenergo, Detsky Mir, Sistema Mass Media and Medsi Group recorded operating incomes in 2010, and Intourist and Binnopharm recorded operating losses in 2010. See “—Year Ended 31 December 2011 Compared to the Year Ended 31 December 2010—Segment operating income/(loss).”

In 2009, operating losses were recorded at Detsky Mir in the amount of \$65.1 million, Sistema Mass Media in the amount of \$72.1 million, Intourist in the amount of \$1.1 million and Medsi Group in the amount of \$0.4 million. Bashkirenergo and Binnopharm recorded operating income of \$36.6 million and \$8.2 million, respectively, in 2009.

For the reasons discussed above, our Other category, in aggregate, recorded an operating gain of \$84.3 million in 2010, compared to an operating loss of \$509.0 million in 2009.

Liquidity and Capital Resources

Sistema JSFC and its subsidiaries use a variety of sources to finance operations, both external and internal. In addition to net cash provided by operations, short- and long-term borrowings to fund capital expenditures and strategic investments are used. Short- and long-term funding sources may change with time, but currently include notes issued in the international and Russian capital markets and credit facilities with international and Russian banks, denominated both in roubles and foreign currencies.

We expect to repay all long-term debts as they become due from our operating cash flows, including distributions received from subsidiaries, or through re-financings. Because we may be required to pay on demand all of the outstanding indebtedness under the SSTL Agreements where we serve as guarantor and all of the outstanding indebtedness under the Sistema Agreements, we have reclassified all such outstanding indebtedness, in an amount of \$1,573.5 million, as short-term debt as at 31 December 2011. See “—Capital Requirements.” See Notes 19 and 20 to our U.S. GAAP Financial Statements for a description of our indebtedness.

While no decision has been made, Sistema JSFC is considering the repurchase in 2012 of up to \$300 million of its equity.

Dividend policy

Our parent company, Sistema JSFC, is an investment company, and its ability to repay its debts depends in large part on the receipt of dividends, distributions and other payments from our subsidiaries, proceeds from the sale of our subsidiaries and from additional borrowings. See “Risk Factors—Risks Relating to Our Business and Industry—General Risks—Sistema JSFC is an investment company and its ability to meet its obligations depends to a large extent upon receipt of sufficient funds from its subsidiaries.”

Because most of our operating subsidiaries are incorporated in the Russian Federation, their ability to pay dividends to Sistema JSFC is limited by provisions of Russian law. For example, Russian law requires that, among other things, dividends can only be paid in an amount not exceeding net profits as determined under RAS. In addition, dividends may only be paid if the value of the company's net assets is not less than the sum of the company's charter capital, the company's reserve fund and the difference between the liquidation value and the par value of the issued and outstanding preferred stock of the company, if any, as determined under RAS. Our subsidiaries located in other jurisdictions are likely to be subject to similar or other limitations on their ability to declare and pay dividends as a result of regulatory, fiscal and other restrictions.

In October 2011, the Board of Directors approved our dividend policy, which sets forth recommendations on the size of dividends as well as our obligations on dividend payments and relevant disclosures. According to the dividend policy, dividends shall be paid in cash and shall be equal to at least 10% of Sistema's consolidated net income under U.S. GAAP (net of any special dividends paid). In the event of a cash transaction, such as a large asset sale, the Board of Directors may also recommend a special dividend that equals at least 10% of the net gain under U.S. GAAP from such transaction. No dividends were declared or paid in 2009. In 2010, Sistema JSFC declared and paid dividends for the year ended 31 December 2009 of RUB 530.8 million (\$17.5 million), or RUB 0.055 per share. In 2011, Sistema declared and paid dividends for the year ended 31 December 2010 of RUB 2.509 billion (\$87.1 million), or RUB 0.26 per share.

In respect of the years ended 31 December 2009 and 2010, MTS declared dividends of \$999.2 million (\$0.50 per share) and \$1,006.8 million (\$0.52 per share), respectively. In April 2012, the board of directors of MTS recommended dividends of RUB 30.4 billion (RUB 14.71 per share) in respect of the year ended 31 December 2011.

In 2009, Bashneft paid dividends equal to \$240 million representing amounts declared in prior years. Also in 2009, Bashneft paid dividends of \$96 million, or \$0.468 per share, in respect of dividends declared in 2009. In June 2010, Bashneft declared dividends of \$725 million, or \$3.54 per share, which were paid in the second half of 2010, and in December 2010 declared dividends of \$696 million, or \$3.40 per share of which \$623 million of which was paid by year-end 2010 and \$73 million in the first quarter of 2011. In 2011, Bashneft declared and paid dividends of \$952 million, or \$4.65 per share.

Stock-Option Plans

Sistema JSFC and several of its subsidiaries operate share-based compensation plans for their employees. Sistema JSFC operates two such plans: an equity plan, in which employees may exercise options granted to them in exchange for shares; and the three-year Motivation Programme.

According to the Motivation Programme, participants were granted phantom shares in Sistema JSFC contingent upon their continued employment with Sistema. Participants had the right to convert up to 2/3 of their phantom shares prior to 31 December 2010 into cash based on the weighted-average market price of our ordinary shares on MICEX for 60 trading days preceding 31 December 2010. The remaining shares, plus any additional shares granted in 2011, were converted into ordinary shares of Sistema JSFC in January 2012. See "*Recent Developments.*"

In the years ended 31 December 2009, 2010 and 2011, compensation expenses under the Motivation Programme totaled \$41 million, \$75.5 million and \$31.7 million, respectively.

Cash Flows

A summary of our cash flows is presented in the table below for the periods indicated:

	Year ended 31 December		
	2009	2010	2011
	<i>(\$ in thousands)</i>		
Cash flows			
Net cash from operating activities	3,684,569	4,056,752	5,571,408
Net cash used in investing activities	(6,298,273)	(4,839,344)	(5,185,884)
Net cash from/(used in) financing activities	5,207,891	(6,878)	(481,938)
Increase/(decrease) in cash and cash equivalents	2,650,623	(799,580)	(250,798)

Net cash from operating activities

Despite the decline in net income from \$2,117.2 million in 2010 to \$1,191.2 million in 2011, net cash from operating activities increased by \$1,514.6 million, or 37.4%, from \$4,056.8 million in the year ended 31 December 2010 to \$5,571.4 million in the year ended 31 December 2011. This increase was due mainly to the following adjustments to net income and changes in working capital:

- The \$717.9 million, or 229.1%, increase in the loss from impairment of goodwill and provisions of other assets, which was due, in turn, to the write-down as at 31 December 2011 of certain of SSTL's operating licences in India and goodwill in the amount of \$694.7 million. See Note 11 of the U.S. GAAP Financial Statements and "*Business—Material Litigation*," for a discussion of the suspension of SSTL's operating licences in India.
- No gain upon adoption of equity method in 2011, compared to a gain of \$477.4 million in 2010 in connection with the acquisition of significant influence over Belkamneft following the purchase of a 49.0% stake in its parent company OJSC RussNeft.
- A \$418.9 million, or 14.6%, increase in depreciation, depletion and amortisation in 2011 compared to 2010, which, in turn reflected the increase in our depreciable assets, including the increased asset base at MTS, which led to higher depreciation of property, plant and equipment.
- A \$326.4 million foreign currency transaction loss in 2011, compared to a \$26.2 million foreign currency transaction gain in 2010, due to depreciation of the rouble against the U.S. dollar in 2011 and appreciation of the rouble against the dollar in 2010.
- A \$574.6 million increase in accounts payable in 2011, compared to a \$226.2 million increase in 2010.
- A \$186.1 million increase in accounts receivable in 2011, compared to a \$417.6 million increase in accounts receivable in 2010.
- A \$190.8 million increase in inventories and spare parts in 2011, compared to a \$395.1 million increase in 2010, which was mainly due to the overall increase in sales at our subsidiaries in 2011.
- A \$167.4 million increase in VAT receivable in 2011, compared to a \$467.6 million increase in VAT receivable in 2010.

The increase in net cash inflows from operating activities in 2011 compared to 2010 was partially offset by a \$198.9 million outflow in accrued expenses and other liabilities in 2011, compared to an inflow of \$406.0 million in 2010.

Despite the decline in net income from \$2,286.1 million in 2009 to \$2,117.2 million in 2010, net cash inflows from operating activities increased by \$372.2 million, or 10.1%, from \$3,684.6 million in the year ended 31 December 2009 to \$4,056.8 million in the year ended 31 December 2010. This increase was due mainly to the following adjustments to net income and changes in working capital:

- The \$428.0 million, or 17.6%, increase in depreciation, depletion and amortisation, in 2010 compared to 2009, which was mainly due to the consolidation of 12 months of Bashneft operations in 2010, compared to nine months in 2009, and the increased asset base at MTS, which, in turn, was the result of continued expansion of MTS' network through build-outs.
- A \$2,782.8 million acquisition gain in 2009, compared to no such gains in 2010. We recognised a gain on acquisition in 2009 in connection with our purchase of several stakes in various oil and energy companies in the Republic of Bashkortostan. See "*Consolidated Financial Results Overview—Year Ended 31 December 2010 Compared to the Year Ended 31 December 2009—Gain on acquisition*," above.
- A \$226.2 million increase in accounts payable in 2010, compared to a decrease in accounts payable of \$484.9 million in 2009.

The increase in net cash inflows from operating activities in 2010 compared to 2009 was partially offset by the following adjustment and changes in working capital:

- A \$324.7 million gain from the disposal of discontinued operations in 2010, compared to a \$26.2 million loss from the disposal of discontinued operations in 2009. The gain in 2010 was due to the disposal of Sky Link in October 2010. See "*Consolidated Financial Results Overview—Year Ended 31 December 2011 Compared to the Year Ended 31 December 2010—Gain/(loss) from disposal of*

discontinued operations.” The loss in 2009 was in connection with the disposal by SITRONICS of seven distribution companies in April 2009. See “*Consolidated Financial Results Overview—Year Ended 31 December 2010 Compared to the Year Ended 31 December 2009—Gain/(loss) from disposal of discontinued operations.*”

- A \$417.6 million increase in accounts receivable in 2010, compared to a \$234.5 million increase in accounts receivable in 2009, which was mainly due to the overall increase in sales at our subsidiaries in 2010.
- A \$464.5 million increase in VAT receivable in 2010, compared to a \$133.1 million increase in VAT receivable in 2009.
- A \$298.3 million increase in other current assets in the year ended 31 December 2010, compared to a \$256.8 million decrease in other current assets in the year ended 31 December 2009 mainly due to an increase in overall sales, particularly to the consolidation of 12 months of Bashneft results in 2010, compared to nine months in 2009.
- A \$395.1 million increase in inventories in 2010, compared to a \$120.2 million increase in inventories in 2009 primarily due to an increase in overall sales, particularly to the consolidation of 12 months of Bashneft results in 2010, compared to nine months in 2009.

Net cash outflow from investing activities

Net cash outflow from investing activities increased by 7.2% from \$4,839.3 million in the year ended 31 December 2010 to \$5,185.9 million in the year ended 31 December 2011. This increase was primarily due to (i) a 94.2% increase in purchases of long-term investments from \$478.5 million in 2010 to \$929.1 million in 2011; and (ii) a 39.9% decrease in proceeds from the sale of subsidiaries, net of cash disposed, from \$307.4 million in 2010 to \$184.6 million in 2011. This increase in net cash outflow from investing activities was offset by several factors, the most significant of which were the following: a \$341.1 million net decrease in loans to customers and banks in 2011, compared to a \$107.9 million net increase in loans in 2010 at MTS; (ii) a 156.4% increase in proceeds from the sale of short-term investments from \$461.9 million in 2010 to \$1,184.1 million in 2011; (iii) a 35.0% decrease in purchases of intangible assets from \$693.1 million in 2010 to \$451.2 million in 2011; and (iv) a significant increase in proceeds from the sale of property, plant and equipment from \$18.8 million in 2010 to \$170.2 million in 2011.

Net cash outflow from investing activities decreased by 23.2% from \$6,298.3 million in the year ended 31 December 2009 to \$4,839.3 million in the year ended 31 December 2010. This decrease was primarily due to (i) a 78.9% decrease in cash spent on the purchase of businesses from \$1,729.1 million in 2009 to \$364.5 million in 2010; (ii) a 36.9% decrease in the purchase of long-term investments from \$758.6 million in 2009 to \$478.5 million in 2010; (iii) a 149.5% increase in proceeds from the sale of subsidiaries from \$123.2 million in 2009 to \$307.4 million in 2010, which reflected the sale of our stake in Sky Link (see Notes 3 and 4 of the U.S. GAAP Financial Statements); and (iv) a 37.4% increase in the proceeds from the sale of short-term investments from \$336.1 million in 2009 to \$461.9 million in 2010. This decrease in net cash outflow from investing activities was offset by several factors, the most significant of which were the following: (i) a 16.2% increase in cash spent on the acquisition of property, plant and equipment from \$3,000.9 million in 2009 to \$3,486.5 million in 2010, which reflected operational expansion, particularly at MTS and Bashneft; and (ii) a 59.9% increase in cash spent on the purchase of intangible assets from \$433.5 million in 2009 to \$693.1 million 2010, also a reflection of operational expansion.

Net cash outflow from financing activities

Net cash outflows from financing activities increased from \$6.9 million in the year ended 31 December 2010 to \$481.9 million in the year ended 31 December 2011 due mainly to the following factors: (i) principal payments on short-term borrowings of \$276.9 million in 2011, compared to proceeds from short-term borrowings of \$460.6 million in 2010; (ii) a net decrease in deposits from customers in the banking division of \$651.1 million in 2011, compared to a net increase of \$597.9 million in 2010; (iii) the \$602.3 million advance received in 2010 for shares in SSSL; and (iv) a 103.0% net increase in debt securities issued and other liabilities by the banking division from \$225.5 million in 2010 to \$457.9 million in 2011. The increase in net cash outflows from financing activities was offset principally by two factors: (i) a 18.3% decrease in principal payments on long-term borrowings from \$5,302.6 million in 2010 to \$4,331.5 million in 2011; and (ii) a 66.8% decrease in outflows on the acquisition of noncontrolling interests in existing subsidiaries from \$787.4 million in 2010 to \$261.2 million in 2011.

In the year ended 31 December 2009, there was a net cash inflow from financing activities of \$5,207.9 million, compared to a net cash outflow from financing activities of \$6.9 million in the year ended 31 December 2010. This change was mainly the result of three factors: (i) a 53.1% decrease in proceeds received from long-term borrowings from \$11,639.0 million in 2009 to \$5,459.4 million in 2010, which, in turn, reflected higher borrowings in 2009 than in 2010, and, in particular, the \$2 billion loan from VTB for the purchase of a stake in Bashneft (see Note 3 of the U.S. GAAP Financial Statements) and loans obtained to refinance short-term borrowings; (ii) a net increase in debt securities issued and other liabilities of \$1,008.4 million in 2009, compared to a net decrease of \$225.5 million in 2010, which, in turn, was caused by less borrowing in 2010 relative to 2009; and (iii) an increase in spending on the acquisition of noncontrolling interests in existing subsidiaries from \$194.2 million in 2009 to \$787.4 million in 2010, which reflected the consolidation of our telecom and oil assets. See “—Acquisitions—Divestitures and Key Corporate Restructurings.” Several factors offset this change in cash flows from financing activities, the most significant of which are the following: (i) principal payments on short term borrowings of \$864.4 million in 2009, compared to proceeds received on short term borrowings equal to \$460.6 million in 2010; (ii) a net decrease in deposits from customers of \$1,201.2 million in 2009, compared to a net increase in such deposits of \$597.9 million in 2010; and (iii) a 20.8% increase in principal payments on long-term borrowings from \$4,390.5 million in 2009 to \$5,302.6 million in 2010.

Working Capital

Working capital is defined as current assets (cash included) less current liabilities. As at the date hereof, we believe our working capital is sufficient for our present requirements. As at 31 December 2011, we had a positive working capital of \$1,543.4 million, compared to positive working capital of \$1,726.4 million as at 31 December 2010.

Capital Requirements

Sistema JSFC and each of its subsidiaries require funding to finance the following:

- capital expenditures, which consist of purchases of property, plant and equipment and intangible assets;
- acquisitions;
- repayment of debt;
- changes in working capital;
- general corporate activities, including dividends;
- potential payments of obligations under judgments; and
- potential payments of obligations under other contractual obligations.

We anticipate that capital expenditures, acquisitions and repayment of long-term debt will represent the most significant uses of funds for several years to come.

Our capital expenditures in the years ended 31 December 2009, 2010 and 2011 were \$3,434.4 million, \$4,179.6 million and \$4,132.1 million, respectively. We expect our capital expenditure to remain at a similar level in 2012, and also do not expect a material difference for funding our operations in 2013 and 2014. MTS expects to spend approximately \$2.5 billion (USD amount at exchange rate on 31 December 2011) in 2012. Bashneft expects to spend \$1.0 billion-\$1.2 billion in 2012. Actual capital expenditures may vary depending on the availability of financing, demand, currency volatility and other factors, including, with regard to Sistema JSFC, the availability of dividends from subsidiaries. We expect to continue to finance most of our capital expenditure needs through our operating cash flows, and to the extent required, additional indebtedness, such as borrowings or additional capital raising activities. From 2009 through 2011, a significant portion of our capital expenditures was related to the installation and build-out of our telecommunication networks, in particular, the upgrade of MTS’ 3G network, to the development of MTS’ retail business and to MTS’ expansion into new licence areas. We have also begun to spend a greater share of our capital expenditures on investment programmes at Bashneft. We expect that capital expenditures will remain a large portion of our cash outflows, especially in light of the proposed development of the Trebs and Titov oil fields and if new telecommunications technologies become available and/or the full digitalisation of the Moscow public switch telephone network is implemented.

In addition to our capital expenditures, we spent \$1,923.3 million, \$1,152.0 million and \$636.5 million in the years ended 31 December 2009, 2010 and 2011, respectively, on acquisitions, including acquisitions of non-controlling interests in existing subsidiaries and certain intragroup transfers of ownership interest. See

“—*Acquisitions, Divestitures and Key Corporate Restructurings—Acquisitions*,” above, and Notes 3 and 4 of the U.S. GAAP Financial Statements for further description of our acquisitions. We may continue to expand our business through acquisitions. Our cash requirements relating to potential acquisitions can vary significantly based on market opportunities. For a discussion of acquisitions made after 31 December 2011, see “—*Recent Developments*,” above.

In 2010 and 2011, we restructured certain of our debt obligations. As at 31 December 2011, short-term debt equaled \$4,396.7 million, of which \$4,097.1 million represented the current portion of long-term debt. As at 31 December 2010, short-term debt equaled \$3,177.5 million, of which \$2,103.4 million represented the current portion of long-term debt. As at 31 December 2010 and 2011, short-term debt (including the current portion of long-term debt) accounted for 20.7% and 26.8%, respectively, of our overall debt.

On 2 February 2012, the Indian Supreme Court delivered the Indian Judgment on two public interest petitions seeking cancellation of 122 cellular phone licences granted by the Government of India in 2008, including licences granted to SSTL in 21 telecom circles, which SSTL relies upon to operate its mobile telecommunications business in India. The Indian Judgment granted the petition, with cancellation of the licences initially set to become effective as of 2 June 2012 and subsequently extended by the Indian Supreme Court on 24 April 2012 until 7 September 2012. The Indian Supreme Court also directed the Government of India to conduct 2G spectrum auctions and grant licences on or before 31 August 2012. Without the licences subject to cancellation under the Indian Judgment, SSTL will be unable to conduct more than 85% of its operations in India in terms of 2011 revenues. See “*Business—Material Litigation*.”

The terms of the financing arrangements of SSTL and Sistema JSFC with various lenders include restrictive, financial and other covenants, representations, warranties and events of default. As a result of the impact of the situation related to the Indian Judgment on these provisions, the SSTL Agreements and the Sistema JSFC Agreements may well currently be capable of being accelerated by the lenders. See “—*Liquidity and Capital Resources—Capital Resources—Description of material loan agreements*” and “*Risk Factors—Risks Relating to Our Business and Industry—General Risks—As a result of litigation proceedings involving SSTL, certain financing arrangements of SSTL and Sistema JSFC may well currently be capable of being accelerated. In addition, pursuant to a put and call option agreement, we may be required to repurchase the stake in SSTL held by the Russian government. If the Russian government were to exercise its put option over its stake in SSTL, there can be no assurance that such exercise would not have a material adverse effect on our financial condition.*”

The Lenders under these loan agreements have not yet accelerated any payments thereunder or indicated that they intend to do so, and we do not expect them to accelerate in the context of the current circumstances. Nevertheless, there can be no assurance they will not ultimately do so. The total amount of indebtedness outstanding under the SSTL Agreements and the Sistema JSFC Agreements as of 26 April 2012 was \$1,656.1 million. If the lenders under these agreements were to accelerate all or a portion of our debt under these agreements, we believe that we have sufficient liquidity to meet these obligations when due from cash and other short-term assets and availability of credit pursuant to other credit facilities.

As a consequence of the cancellation of the licences with effect from 7 September 2012, we reassessed the carrying amount of assets in SSTL as at 31 December 2011. A total impairment loss of \$694.7 million was recognised. Of this total impairment loss, the loss from impairment of the operating licences amounted to \$346.0 million and the loss from impairment of goodwill amounted to \$348.7 million. In addition, because we may be required to pay on demand all of the outstanding indebtedness under the SSTL Agreements where we serve as guarantor and all of the outstanding indebtedness under the Sistema Agreements, we have reclassified all such outstanding indebtedness, in an amount of \$1,573.5 million, as short-term debt as at 31 December 2011.

In addition, notwithstanding the potential or actual cancellation of the licences, at any time between March 2016 and March 2017 we may be required pursuant to a put option agreement with the Russian government to purchase the 17.14% stake in SSTL that is currently held by Rosimushchestvo for the higher of \$777 million or the market value as determined by an independent valuator. See “—*Commitments and Contingencies—Obligations under derivative contracts*.”

If the Russian government were to exercise its put option over its stake in SSTL, there can be no assurance that such exercise would not have a material adverse effect on our financial condition. Furthermore, we would likely be compelled to divert resources away from other important funding requirements, such as planned capital expenditures, and there can be no assurance that such diversions would not have a material adverse effect on our business, results of operations or prospects.

See “—*Capital Resources—Description of notes and bonds*” and “*Business—Material Litigation*” for a discussion of the potential impact that the Nomihold matter or the Trebs and Titov licence dispute may have on our liquidity.

Capital Resources

We plan to finance our capital requirements through operating cash flows and financing activities, as described above.

Cash

As at 31 December 2010 and 2011, excluding our assets from banking activities, we had cash and cash equivalents of \$2,245.9 million and \$2,924.0 million, respectively.

As at 31 December 2010 and 2011, the current portion of our assets from banking activities amounted to \$5,502.7 million and \$4,205.0 million, respectively.

Loans and Borrowings

As at 31 December 2011, our indebtedness consisted mainly of notes and corporate bonds and loans from banks and financial institutions. Total indebtedness as at 31 December 2011 was \$16,409.9 million, consisting of \$12,013.2 million in long-term debt, \$4,097.1 million in long-term debt maturing within one year and \$299.6 million in short-term loans payable. Because we may be required to pay on demand all of the outstanding indebtedness under the SSTL Agreements where we serve as guarantor and all of the outstanding indebtedness under the Sistema Agreements, we have reclassified all such outstanding indebtedness, in an amount of \$1,573.5 million, as short-term debt as at 31 December 2011. See “—*Capital Requirements*.”

As at 31 December 2011, the net cash position at Sistema JSFC was \$564.4 million, compared to net debt of \$684.5 million and gross debt of \$1,246.8 million.

The table below sets forth our notes and corporate bonds and loans from banks and financial institutions outstanding as at 31 December 2011. See Note 20 to our U.S. GAAP Financial Statements for further description of our material debt obligations.

	Currency	Annual interest rate	31 December 2011
		<i>(Actual at 31 December 2011)</i>	<i>(\$ in thousands)</i>
Notes and Corporate Bonds			
MTS International Notes due 2020	USD	8.6%	750,000
MTS Notes due 2016	RUB	14.3%	465,895
MTS Notes due 2020	RUB	8.2%	457,928
MTS Notes due 2014	RUB	7.6%	422,988
MTS Finance Notes due 2012	USD	8.0%	400,000
Bashneft Bonds due 2016	RUB	12.5%	357,301
Sistema JSFC Bonds due 2014	RUB	14.8%	352,641
Sistema JSFC Bonds due 2016	RUB	7.7%	349,940
MTS Notes due 2017	RUB	8.7%	310,597
Bashneft Bonds due 2014	RUB	9.4%	310,597
MTS Notes due 2018	RUB	8.0%	298,499
Sistema JSFC Bonds due 2016	RUB	12.5%	247,333
MTS Notes due 2015	RUB	7.8%	234,706
Sistema JSFC Bonds due 2013	RUB	9.8%	154,829
SITRONICS Bonds due 2013	RUB	10.8%	93,179
Intourist Bonds due 2013	RUB	14.0%	62,119
SITRONICS Bonds due 2013	RUB	11.8%	39,011
DM-Center Bonds due 2015	RUB	8.5%	35,719
MTS Notes due 2013	RUB	7.0%	13,318
Total Notes and Corporate Bonds⁽¹⁾			5,356,583
Bank Borrowings			
Calyon, ING B.V., Nordea Bank A.B.; Raiffeisen Zentralbank Österreich AG	USD	LIBOR +1.15% (1.96%)	580,742
Deutsche Bank	USD	LIBOR +1.55% (1.85%)	300,000
China Development Bank	USD	LIBOR +1.5% (2.31%)	249,616
Gazprombank	USD	LIBOR +4.9% (5.48%)	229,309
Skandinaviska Enskilda Banken AB	USD	LIBOR +0.23%- 1.8% (1.03%- 2.61%)	204,507
Bank of China	USD	LIBOR +1.5%- 1.95% (2.31%- 2.76%)	139,805
Bank of Moscow	USD	LIBOR +6.75%- 9.5% (7.33-9.8%)	117,450
EBRD	USD	LIBOR +1.51%- 3.1% (2.32%- 3.91%)	83,333
HSBC Bank; ING BHF Bank AG	USD	LIBOR +0.3% (1.11%)	51,503
HSBC Bank; ING Bank AG; Bayerische Landesbank	USD	LIBOR +0.3% (1.11%)	42,961
Citibank International plc; ING Bank AG; HSBC Bank plc	USD	LIBOR +0.43% (1.23%)	40,688
Commerzbank AG; ING Bank AG; HSBC Bank plc	USD	LIBOR +0.3% (1.11%)	36,495
Golden Gates (Bank of Moscow)	USD	9.75%	20,000
Societe Generale	USD	LIBOR +1.25% (2.06%)	18,860
The Royal Bank of Scotland	USD	LIBOR +0.35% (1.16%)	12,574

	<u>Currency</u>	<u>Annual interest rate</u>	<u>31 December 2011</u>
		<i>(Actual at 31 December 2011)</i>	<i>(\$ in thousands)</i>
Other	USD	Various	6,324
Total USD-denominated debt			2,134,167
EBRD	EUR	EURIBOR +5.2% (6.49%)	77,658
Syndicated Loan to Intracom Telecom	EUR	EURIBOR +4.5% (5.61%)	116,487
Bank of China; BNP Paribas	EUR	EURIBOR +1.95% (3.57%)	116,812
BNP Paribas; Credit Agricole Corporate and Investment Bank	EUR	EURIBOR +1.65% (3.27%)	64,033
LBWW	EUR	EURIBOR +0.75% (2.37%)	36,215
The Royal Bank of Scotland	EUR	EURIBOR 0.35% (1.97%)	8,958
Other	EUR	Various	16,282
Total EUR-denominated debt			436,445
Sberbank	RUB	7.75%-8.90%	4,388,106
Gazprombank	RUB	8.75%-9.00%	1,830,699
Bank of Moscow	RUB	MosPrime+7.25% (14.47%); 7.8%-10.25%	590,309
Unicredit	RUB	MosPrime+4.5%- 7.5% (10.87%-13.87%)	69,271
Raiffeisenbank	RUB	MosPrime +3% (9.37%- 10.22%)	83,861
ING Bank	RUB	10.74%	32,613
Other	RUB	Various	6,875
Total RUB denominated debt			7,001,734
State Bank of India	INR	13.5%	396,095
Other	Various	Various	357,757
Total debt denominated in other currencies			753,852
Total Bank Borrowings			10,326,198

(1) Net of unamortised discount of \$17 thousand.

The following table presents the aggregate scheduled maturities of debt principal outstanding as at 31 December 2011:

<u>Payments due in the year ended 31 December</u>	<u>(\$ in thousands)</u>
2012	4,097,076
2013	2,354,096
2014	1,467,499
2015	2,363,042
2016	2,189,133
Thereafter	3,639,427
Total	16,110,273⁽¹⁾

(1) Includes only long-term debt and current portion of long-term debt. Does not include \$299.6 million in short-term loans payable in 2012.

Description of notes and corporate bonds

Certain of our notes and corporate bonds and bank borrowings are subject to financial and non-financial restrictive covenants, including limitations on our ability to incur additional indebtedness or to enter into certain mergers, acquisitions, sales and sales-leaseback transactions.

According to the terms of certain of our notes, noteholders have the unilateral right to require us to repurchase outstanding notes at par value where a subsequent sequential coupon is announced.

In January 2011, an arbitration tribunal constituted under the London Court of International Arbitration declared final its award (the “**Nomihold Award**”) against our subsidiary MTS Finance in the arbitration matter commenced by Nomihold Securities Inc. in January 2007. The ruling requires MTS Finance to honor Nomihold’s option to sell to MTS Finance a 49% stake in Tarino Limited for \$170 million, plus interest, back dividends and costs, representing a total of approximately \$210.8 million. On 26 January 2011, Nomihold obtained a freezing order in respect of the Nomihold Award from the English High Court of Justice which, in part, restricts MTS Finance from dissipating its assets. Additionally, MTS Finance has been granted permission to appeal the Nomihold Award, but the Court has imposed conditions upon the appeal. MTS Finance is currently seeking to have the conditions lifted. Further, on 1 February 2011, Nomihold obtained an order of the Luxembourg District Court enforcing the Nomihold Award in Luxembourg. This order is in the process of being appealed. As the issuer of the MTS Finance Notes due 2012 (the “**2012 Notes**”) pursuant to an Indenture dated 28 January 2005 (as amended), MTS Finance was due to redeem the principal of the 2012 Notes and pay the final coupon payment on 28 January 2012. MTS therefore applied to and obtained from the English court an order authorising both payments to be made by MTS on behalf of MTS Finance (the “**Direct Payments**”), since MTS Finance was subject to the freezing order. The Direct Payments to noteholders by the trustee under the Indenture were made on or around 28 January 2012.

Pursuant to the intercompany loan agreement dated 28 January 2005 between MTS Finance and MTS (the “**Intercompany Loan Agreement**”), MTS Finance had lent the proceeds of the issuance of the 2012 Notes to MTS. MTS believes that the Direct Payments should have satisfied MTS’ obligations under the Intercompany Loan Agreement. To resolve this question, MTS Finance and MTS have agreed to refer it to arbitration. On 9 February 2012, MTS received a request for arbitration from MTS Finance. The process is underway and will clarify the rights between the parties under the Intercompany Loan Agreement. The arbitration will be conducted under the Rules of the LCIA and it is expected to last between 6 and 12 months.

As at the date of this Prospectus, MTS Finance has not satisfied the award. We have obtained consents from the noteholders of the MTS International Notes due 2020 and from the relevant lenders to waive certain defaults or events of default that may arise as a result of the Nomihold Award and failure by MTS to satisfy its obligations under the Intercompany Loan Agreement and to make certain amendments to the loan agreements to avoid possible future events of default that may arise as a result of the Nomihold Award. See “*Business—Material Litigation*” for further discussion of proceedings concerning the Nomihold matter.

See also “—*Description of material loan agreements.*”

Description of material loan agreements

For a general discussion concerning the suspension of certain of our licences in India and its impact on certain of our borrowings, see “*Business—Material Litigation,*” “*Risk Factors—Risks Relating to Our Business and Industry—General Risks—As a result of litigation proceedings involving SSTL, certain financing arrangements of SSTL and Sistema JSFC may well currently be capable of being accelerated. In addition, pursuant to a put option agreement, we may be required to repurchase the stake in SSTL held by the Russian government. If the Russian government were to exercise its put option over its stake in SSTL, there can be no assurance that such exercise would not have a material adverse effect on our financial condition*” and “—*Liquidity and Capital Resources—Capital Requirements.*”

For a general discussion concerning the legal proceedings brought by a minority shareholder in Bashneft in respect of the Bashneft’s exploration and development licence to the Trebs and Titov oil fields and their impact on certain of our borrowings, see “*Business—Material Litigation,*” “*Risk Factors—Risks Relating to Our Oil and Energy Business—Bashneft’s exploration and development licence to the Trebs and Titov oil fields is currently the subject of the legal proceedings brought by a minority shareholder in Bashneft. A negative outcome in these proceedings may lead to significant delays in Bashneft’s exploration and development plans and may otherwise have a material adverse effect on Bashneft’s business and results of operations. In addition, the cancellation of Bashneft’s Trebs and Titov licence may well result in JSOC Bashneft’s pre-export facility being capable of being accelerated, which, in turn, would trigger cross-default provisions under certain of our other financing agreements.*”

MTS

MTS International Notes due 2020

As at 31 December 2011, the principal amount of MTS International Notes due 2020 outstanding was \$750 million. Those notes and the related loan agreement between MTS and MTS International Funding Limited are subject to a number of restrictive covenants, violation of which may constitute an event of default. In addition, other events specified in the loan agreement and under the notes also constitute an event of default. These events include, without limitation, failure to pay any debt (including all obligations for borrowed money and not excluding intercompany debt) of MTS (or any subsidiary of MTS) over \$15 million, which default either (i) results in acceleration of that debt, or (ii) has not been cured or waived and constitutes failure to pay principal or interest on such debt when due (after the expiration of any applicable grace period). If a default were to occur under the notes and the related loan, they would be capable of being accelerated. See “*Risk Factors—Risks Relating to Our Business and Industry—General Risks—The servicing and refinancing of our indebtedness will require a significant amount of cash. Our ability to generate cash is subject to the terms of our existing indebtedness, which contains certain restrictive covenants and stringent events of default, and is dependent on other factors beyond our control*” and “*Business—Material Litigation—MTS.*”

Credit facility agreements with Sberbank

On 13 December 2010, MTS OJSC entered into two non-revolving credit facility agreements with Sberbank allowing borrowings of up to RUB 40 billion and RUB 60 billion, respectively. The loans were provided to refinance MTS’ debt, including bond debt, to finance the MTS’ investment programme and business activities, to finance loans to affiliates and acquire shares (participatory interests) in the charter capital of legal entities. As at 31 December 2011, the amounts outstanding under these facilities were RUB 40 billion and RUB 60 billion, respectively. The loans have a final maturity date of 12 December 2017.

The credit facility agreements are subject to a number of restrictive covenants including restrictions on granting security over assets exceeding a certain threshold. In addition, the loans are capable of being accelerated upon a number of events, including acceleration of, or other creditor action taken in relation to, MTS’ other indebtedness over a certain amount and certain court decisions being granted against MTS. See “—*Description of notes and corporate bonds,*” “*Risk Factors—Risks Relating to Our Business and Industry—General Risks—The servicing and refinancing of our indebtedness will require a significant amount of cash. Our ability to generate cash is subject to the terms of our existing indebtedness, which contains certain restrictive covenants and stringent events of default, and is dependent on other factors beyond our control*” and “*Business—Material Litigation—MTS.*”

Credit agreement with the Bank of Moscow

On 6 April 2010, MTS entered into a credit agreement with the Bank of Moscow allowing borrowings of up to RUB 22 billion. The loan was provided to refinance MTS’ debt and to finance MTS’ working capital. As at 31 December 2011, the outstanding amount under this credit agreement was RUB 14.0 billion (\$434.8 million). On 16 March 2012, MTS voluntarily repaid \$310.6 million out of \$434.8 million outstanding under this credit agreement. The loan has a final maturity date of 5 April 2013.

The credit agreement is subject to a number of restrictive covenants, the violation of which may constitute an event of default. In addition, other events specified in the credit agreement with the Bank of Moscow also constitute events of default. These events include acceleration of MTS’ other indebtedness over a certain amount and certain court decisions being granted against MTS. See “—*Description of notes and corporate bonds,*” “*Risk Factors—Risks Relating to Our Business and Industry—General Risks—The servicing and refinancing of our indebtedness will require a significant amount of cash. Our ability to generate cash is subject to the terms of our existing indebtedness, which contains certain restrictive covenants and stringent events of default, and is dependent on other factors beyond our control*” and “*Business—Material Litigation—MTS.*”

Credit facility agreement with the EBRD

On 8 December 2004, MTS entered into a credit facility agreement with the EBRD allowing borrowings of up to \$250 million. The loan was provided to finance expansion by any MTS company into the regions of the Russian Federation (other than Moscow and St. Petersburg) or the CIS by way of network development and/or acquisitions, as well as to finance the technological upgrade of MTS. As at 31 December 2011, the total amount outstanding under the facility agreement was \$83.3 million. The loan has a final maturity date of 15 June 2014.

The loan is subject to a number of early repayment events, including, without limitation, change of control over MTS, material adverse change, defaults under MTS' and its subsidiaries' other indebtedness over a certain amount and material litigation.

MTS has obtained waivers under the credit facility agreement with EBRD in relation to any default arising from the Nomihold Award and MTS' failure to pay under the Intercompany Loan Agreement.

Export credit agreement with Skandinaviska Enskilda Banken AB

On 1 August 2008, MTS entered into an export credit agreement with Skandinaviska Enskilda Banken AB allowing borrowings of up to \$362 million for payment of the purchase price for mobile telephone equipment supplied by Ericsson AB and up to \$20.8 million for payment of the insurance premium to Swedish Export Credit Guarantee Board. As of 31 December 2011, the outstanding amount under this export credit agreement was \$204.5 million. The loan has a final maturity date of 1 August 2017.

The loan is subject to a number of early repayment events, including, without limitation, default under MTS' and its subsidiaries' other indebtedness over a certain amount, material adverse change and material litigation.

MTS has obtained waivers under the export credit agreement with Skandinaviska Enskilda Banken AB in relation to any default arising from the Nomihold Award and MTS' failure to pay under the Intercompany Loan Agreement.

Term loan facility with BNP Paribas and Credit Agricole Corporate and Investment Bank

On 18 February 2010, MTS entered into a term loan facility agreement with BNP Paribas and Credit Agricole Corporate and Investment Bank allowing borrowings of up to a Euro equivalent of approximately \$97.0 million. The loan was provided to finance equipment and software supplies and to pay insurance coverage provided by Euler Hermes Kreditversicherungs-AG acting on behalf of the Federal Republic of Germany ("Hermes"). As at 31 December 2011, the outstanding amount under this term loan facility agreement was approximately \$64.0 million. The loan has a final maturity date of 28 September 2018.

The loan is subject to a number of early repayment events, including, without limitation, change of control over MTS, downgrade of MTS' ratings, default under MTS' and its subsidiaries' other indebtedness over a certain amount, material adverse change and material litigation.

MTS has obtained waivers under the term loan facility with BNP Paribas and Credit Agricole Corporate and Investment Bank in relation to any default arising from the Nomihold Award and MTS' failure to pay under the Intercompany Loan Agreement.

Euro term loan facilities with Bank of China and BNP Paribas

On 8 December 2009, MTS entered into a framework agreement in respect of Euro term loan facilities with Bank of China Limited, Shenzhen Branch and BNP Paribas allowing borrowings of up to \$212.5 million in Euros. The loan was provided to refinance purchase orders with certain Chinese counterparties. As at 31 December 2011, the total amount outstanding under the facility agreement was \$116.8 million. The loan has a final maturity date of 8 December 2016.

The loan is subject to a number of early repayment events, including, without limitation, default under MTS' and its subsidiaries' other indebtedness over a certain amount, material adverse change and material litigation (subject to certain specific carve-outs).

MTS has obtained waivers under the Euro term loan facilities with Bank of China and BNP Paribas in relation to any default arising from the Nomihold Award and MTS' failure to pay under the Intercompany Loan Agreement.

Credit facility agreement with Calyon, ING Bank N.V., Nordea Bank AB (PUBL) and Raiffeisen Zentralbank Österreich AG

On 19 November 2009, MTS entered into a EKN supported facility agreement with the Calyon, ING Bank N.V., Nordea Bank AB (PUBL) and Raiffeisen Zentralbank Österreich AG allowing borrowings of up to \$1.1 billion. The purpose of the loan was to reimburse the payments previously made by MTS to (i) the Ericsson Russia and

Ericsson Sweden in relation to deliveries of foreign goods and services and (ii) the ING Bank N.V. for the account of EKN in respect of EKN premium. As at 31 December 2011, the total amount outstanding under the facility agreement was \$580.7 million. Tranche A of the facility has a final maturity date on 1 June 2019 and Tranche B of the facility has a final maturity date on 1 September 2020.

The loan is subject to a number of early repayment events, including, without limitation, change of control over MTS, default under MTS' and its subsidiaries' other indebtedness over a certain amount, material adverse change and material litigation (subject to certain specific carve-outs).

MTS has obtained waivers under the credit facility agreement with Calyon, ING Bank N.V., Nordea Bank AB (PUBL) and Raiffeisen Zentralbank Österreich AG in relation to any default arising from the Nomihold Award and MTS' failure to pay under the Intercompany Loan Agreement.

Bashneft

Credit facility agreements with Sberbank

On 30 September 2010, Bashneft entered into a non-revolving credit facility agreement with Sberbank allowing borrowings of up to RUB 17.5 billion. The loan was provided to finance Bashneft's participation in a tender on the acquisition of oil deposits. As at 31 December 2011, the amount outstanding under the loan was RUB 17.5 billion. The loan has a final maturity date on 27 September 2013.

On 15 October 2010, Bashneft entered into a revolving credit facility agreement with Sberbank allowing borrowings of up to RUB 10 billion for the purpose of financing business activities. As at 31 December 2011, Bashneft had no outstanding indebtedness under this credit facility. The final maturity date of the agreement is 14 October 2013. In January 2012, Bashneft made a full drawdown in the amount of RUB 10 billion under this facility. See "*—Recent Developments.*"

On 23 August 2011, Bashneft entered into a revolving credit facility agreement with Sberbank allowing borrowings of up to RUB 10 billion. The loan was provided to finance Bashneft' business activities and working capital. As at 31 December 2011, Bashneft had no outstanding indebtedness under this credit facility and, as of 30 April 2012 this facility had not been utilised. The loan has a final maturity date of 22 August 2014.

On 30 September 2011, Bashneft entered into a non-revolving credit facility agreement with Sberbank allowing borrowings of up to RUB 20 billion. The loan was provided for general corporate purposes, including the refinancing Bashneft debt owed to third parties. As at 31 December 2011, the amount outstanding under the loan was RUB 20 billion. The loan has a final maturity date of 29 September 2016.

The facilities are subject to a number of events of default, including default under Bashneft's other indebtedness over a certain amount, certain court claims being made or having entered into force against Bashneft. See "*Risk Factors—Risks Relating to Our Oil and Energy Business—Bashneft's exploration and development licence to the Trebs and Titov oil fields is currently the subject of legal proceedings brought by a minority shareholder in Bashneft. A negative outcome in these proceedings may lead to significant delays in Bashneft's exploration and development plans and may otherwise have a material adverse effect on Bashneft's business and results of operations. In addition, the cancellation of Bashneft's Trebs and Titov licence may well result in JSOC Bashneft's pre-export facility being capable of being accelerated, which, in turn, would trigger cross-default provisions under certain of our other financing agreements.*"

Credit agreement with Gazprombank

On 20 October 2011, Bashneft entered into a credit agreement with Gazprombank, allowing borrowings of up to RUB 10 billion. The loan was provided for general corporate purposes, including the refinancing of Bashneft debt. As at 31 December 2011, the amount outstanding under the loan was RUB 10 billion. The loan has a final maturity date of 20 October 2016.

The facilities are subject to a number of events of default, including certain court claims or other governmental proceedings being brought against Bashneft.

Credit agreements with LLC Regional Financial Company

On 28 June 2010, Bashneft entered into a credit agreement with Gazprombank allowing borrowings of up to RUB 15 billion. The loan was provided for general corporate purposes, including the financing of business

activities and capital expenditures of Bashneft, the acquisition of securities (other than promissory note) of oil companies and of treasury shares and own bonds and the provision of certain intragroup loans. On 19 July 2010, Gazprombank assigned its rights under the credit agreement to LLC Regional Financial Company. As at 31 December 2011, the amount outstanding under the loan was RUB 15 billion. The loan has a final maturity date of 28 June 2017.

On 22 February 2011, Bashneft entered into a credit agreement with Gazprombank allowing borrowings of up to RUB 15 billion. The loan was provided for general corporate purposes, including for the same purposes of the 28 June 2010 loan agreement with Gazprombank. On 25 February 2011, Gazprombank assigned its rights under the credit agreement to LLC Regional Financial Company. As at 31 December 2011, the amount outstanding under the loan was RUB 15 billion. The loan has a final maturity date of 22 February 2018. The facilities with LLC Regional Financial Company are subject to events of default similar to the ones contained in the facility agreements with Gazprombank described above.

Pre-export finance term loan facility agreement with BNP Paribas ZAO, Deutsche Bank AG, Amsterdam Branch, Goldman Sachs International Bank and ING Bank N.V.

On 16 August 2011, Bashneft entered into a pre-export finance term loan facility agreement with BNP Paribas ZAO, Deutsche Bank AG, Amsterdam Branch, Goldman Sachs International Bank and ING Bank N.V. (as original lenders) allowing borrowings of up to \$300 million (the “**Pre-export Finance Term Loan Facility**”). The loan was provided for general corporate purposes of the Bashneft group, including trade finance purposes and the refinancing of existing indebtedness. As at 31 December 2011, the amount outstanding under the loan was \$300 million. The loan has a final maturity date on 16 August 2014.

The Pre-export Finance Term Loan Facility is subject to a number of covenants, failure to comply with which may constitute an event of default and other events of default, including certain claims being brought or awarded against Bashneft or its significant subsidiaries, loss of subsoil licences accounting for a specified percentage of the Bashneft group oil reserves, material adverse change and cross-default. See “*Risk Factors—Risks Relating to Our Oil and Energy Business—Bashneft’s exploration and development licence to the Trebs and Titov oil fields is currently the subject of legal proceedings brought by a minority shareholder in Bashneft. A negative outcome in these proceedings may lead to significant delays in Bashneft’s exploration and development plans and may otherwise have a material adverse effect on Bashneft’s business and results of operations. In addition, the cancellation of Bashneft’s Trebs and Titov licence may well result in JSOC Bashneft’s pre-export facility being capable of being accelerated, which, in turn, would trigger cross-default provisions under certain of our other financing agreements.*”

SSTL

Facility agreement with Gazprombank (Switzerland) Ltd

On 22 December 2011, SSTL entered into a facility agreement with Gazprombank (Switzerland) Ltd allowing borrowings of up to \$230 million. The loan was provided to refinance certain SSTL debt owed to Sistema JSFC. As at 31 December 2011, the amount outstanding under the loan was \$229.3 million. The loan has a final maturity date of 3 December 2014 and is guaranteed by Sistema JSFC.

The loan is subject to a number of early repayment events, including change of control over the borrower. Non-compliance with covenants under the agreement, in addition to other events, may constitute an event of default. These other events include: (i) any breach of representation (which automatically repeat on each draw-down request date and on the first day of each interest period), including (without limitation) a representation that no litigation has been commenced which, if adversely determined, might reasonably be expected to have a material adverse effect on, or change in, the operations, property, business, assets, financial condition or prospects of Sistema or SSTL; (ii) any creditor becoming entitled to declare the debt of SSTL (and its subsidiaries) or Sistema JSFC over a certain amount due and payable as a result of an event of default; (iii) any event or series of events which, in the opinion of the majority lenders, has or will have a material adverse effect on, or change in, the operations, property, business, assets, financial condition of prospects of SSTL or Sistema or their ability to fulfill their obligations under the agreement; and (iv) any expropriation, attachment, sequestration, distress or execution affecting any asset or assets of SSTL or Sistema with certain value and not discharged within a specified period of time. See “*Risk Factors—Risks Relating to Our Business and Industry—General Risks—As a result of litigation proceedings involving SSTL, certain financing arrangements of SSTL and Sistema JSFC may well currently be capable of being accelerated. In addition, pursuant to a put option agreement, we may be required to repurchase the stake in SSTL held by the Russian government. If the Russian government were to exercise its put option over its stake in SSTL, there can be no assurance that such exercise would not have a material adverse effect on our financial condition.*”

Credit agreement with Bank of China Limited, Shenzhen Branch

On 29 June 2009, SSTL entered into a credit agreement with Bank of China Limited, Shenzhen Branch allowing borrowings of up to approximately \$69.9 million. The loan was provided to finance telecommunication equipment supplies. As at 31 December 2011, the total amount outstanding under the credit agreement was approximately \$69.6 million. The loan has a final maturity date of 6 October 2017. The facility is guaranteed by Sistema JSFC.

The loan is subject to a number of early repayment events, including change of control over the borrower. Non-compliance with covenants under the credit agreement with Bank of China Limited, Shenzhen Branch, in addition to other events, may constitute an event of default. These other events include: (i) any creditor becoming entitled to declare the debt of SSTL (and its subsidiaries) or Sistema JSFC over a certain amount due and payable as a result of an event of default; (ii) any litigation, arbitration, administrative, governmental, regulatory or other investigation, proceedings or disputes which could reasonably be expected to have a material adverse effect on the business, assets, financial condition, results of operations or prospects of SSTL or Sistema JSFC; (iii) any event or circumstance or environmental incident which are in the opinion of the lender reasonably likely to have, or result in, a material adverse effect on SSTL or Sistema; (iv) termination, expiration, renewal of an Indian telecom licence, or any circumstance subsisting which permits termination of an Indian telecom licence, which the lenders determine has or is likely to have a material adverse effect on the business, assets, financial condition, results of operations or prospects of SSTL or Sistema JSFC; (v) any expropriation, attachment, sequestration, distress or execution affecting any asset or assets of SSTL (or any of its subsidiaries), or Sistema JSFC (or any of its material subsidiaries as listed in the agreement) with a value above a certain amount; (vi) any breach of representation (which automatically repeat on each draw-down request date and on the first day of each interest period), including (without limitation) a representation that no litigation has been commenced which, if adversely determined, might reasonably be expected to have a material adverse effect on the business, assets, financial condition, results of operations or prospects of SSTL or Sistema JSFC; and (vii) any steps taken (or statement of intention to take steps) by any governmental authority with a view to the seizure, expropriation, nationalisation or acquisition of controlling stake in SSTL or assets or revenues of SSTL with a value above a certain amount. See *“Risk Factors—Risks Relating to Our Business and Industry—General Risks—As a result of litigation proceedings involving SSTL, certain financing arrangements of SSTL and Sistema JSFC may well currently be capable of being accelerated. In addition, pursuant to a put option agreement, we may be required to repurchase the stake in SSTL held by the Russian government. If the Russian government were to exercise its put option over its stake in SSTL, there can be no assurance that such exercise would not have a material adverse effect on our financial condition.”*

In addition to the agreement described above, SSTL is party to three further credit agreements with Bank of China Limited, Shenzhen Branch, entered into on 7 December 2009 on substantially the same terms with the approximate amounts outstanding thereunder as at 31 December 2011 of \$12.2 million, \$15.6 million and \$42.9 million.

Loan agreement with Central Bank of India

On 22 March 2010, SSTL entered into a loan agreement with the Central Bank of India allowing borrowings of up to approximately INR 5 billion (approximately \$96.0 million). As at 31 December 2011, the amount outstanding under the loan was INR 5 billion (approximately \$96.0 million). The loan had a final maturity date of 25 March 2012. On 24 March 2012, SSTL entered into a new loan agreement with the Central Bank of India on substantially the same terms as were provided for in the agreement dated 22 March 2010. The facility is guaranteed by Sistema JSFC.

Non-compliance with the covenants of the facility agreement with the Central Bank of India, in addition to other events, may constitute an event of default. These other events include: (i) any default of SSTL under this loan agreement or any other agreements provided that such default has continued for a certain grace period; (ii) expropriation of SSTL or an event of total loss or nationalisation of all or substantially all of SSTL’s licences or a temporary nationalisation of a material portion of such licences, in each case as are necessary for the operation of telecom services in India by SSTL, and such temporary nationalisation could reasonably be expected to be a material adverse change having an adverse effect on the business or financial condition of SSTL or Sistema JSFC or the operation of telecom services in India by SSTL (as described in the agreement); (iii) commencement of proceedings by any government authority for the purpose of revoking, terminating or modifying any government approval or revocation, termination, withdrawal, suspension or modification of any such government approval, in each case which could, in the reasonable opinion of the lender, be a material

adverse change having an adverse effect on the business or financial condition of SSTL or Sistema JSFC or the operation of telecom services in India by SSTL (as described in the agreement); (iv) any litigation, arbitration or administrative proceeding or claim commenced against SSTL before any court, tribunal, arbitrator or other relevant authority, which, by itself or together with any other such proceeding or claim, could reasonably be expected to be a material adverse change having an adverse effect on the business or financial condition of SSTL or Sistema JSFC or the operation of telecom services in India by SSTL (as described in the agreement); and (v) any event or circumstance which had, or in the reasonable opinion of the lender, could be expected to be a material adverse change having an adverse effect on the business or financial condition of SSTL or Sistema JSFC or the operation of telecom services in India by SSTL (as described in the agreement). See *“Risk Factors—Risks Relating to Our Business and Industry—General Risks—As a result of litigation proceedings involving SSTL, certain financing arrangements of SSTL and Sistema JSFC may well currently be capable of being accelerated. In addition, pursuant to a put option agreement, we may be required to repurchase the stake in SSTL held by the Russian government. If the Russian government were to exercise its put option over its stake in SSTL, there can be no assurance that such exercise would not have a material adverse effect on our financial condition.”*

Facility agreement with China Development Bank Corporation

On 23 December 2009, SSTL entered into a facility agreement with the China Development Bank Corporation allowing borrowings of up to approximately \$255 million. The loan was provided to finance telecommunication equipment supplies. As at 31 December 2011, the total amount outstanding under the credit agreement was approximately \$250.36 million. The loan has a final maturity date of 22 December 2017. The facility is guaranteed by Sistema JSFC.

Non-compliance with the covenants of the facility agreement with the China Development Bank Corporation, in addition to other events, may constitute an event of default. These other events include: (i) any creditor becoming entitled to declare the debt of SSTL (and its subsidiaries) or Sistema JSFC over a certain amount due and payable as a result of an event of default provided that such default has continued for a specified period of time; (ii) the termination, suspension or cancellation of any authorization or licence of SSTL to provide wireless telephony services, or the modification or renewal of any such licence, in each case which would have a material adverse effect on the business, operations, assets or financial condition of SSTL or Sistema JSFC; (iii) the commencement or threat of any litigation, arbitration or administrative proceeding of or before any court, arbitral body or agency against SSTL, any of its subsidiaries or Sistema JSFC, which, if adversely determined, might reasonably be expected to have a material adverse effect on the business, operations, assets or financial condition of SSTL or Sistema JSFC; (iv) any event or circumstance which has a material adverse effect on the business, financial condition, results of operations or prospectus of SSTL or Sistema JSFC; (v) any legal proceeding initiated with a view to the seizure, compulsory acquisition, expropriation or nationalisation of all or a material part of the undertakings, assets, rights, revenues or shares of SSTL; (vi) any breach of representation (which automatically repeat on each draw-down request date and on each interest payment date), including (without limitation) a representation that no litigation has been commenced which, if adversely determined, might reasonably be expected to have a material adverse effect on the business, financial condition, results of operations or prospectus of SSTL or Sistema JSFC; and (vii) any expropriation, attachment, sequestration, distress or execution that affects any asset or assets of SSTL or any of its subsidiaries or Sistema JSFC. See *“Risk Factors —Risks Relating to Our Business and Industry—General Risks—As a result of litigation proceedings involving SSTL, certain financing arrangements of SSTL and Sistema JSFC may well currently be capable of being accelerated. In addition, pursuant to a put option agreement, we may be required to repurchase the stake in SSTL held by the Russian government. If the Russian government were to exercise its put option over its stake in SSTL, there can be no assurance that such exercise would not have a material adverse effect on our financial condition.”*

Facility agreement with ICICI Bank Limited

On 9 September 2011, SSTL entered into a facility agreement with ICICI Bank Limited allowing borrowings of up to approximately INR 4.6 billion (approximately \$88.3 million). The loan was provided to partially finance the rollout of telecom operations across various circles. As at 31 December 2011, the amount outstanding under the loan was INR 4.6 billion (approximately \$88.3 million). The loan has a final maturity date of 22 September 2014.

The loan is subject to a number of early repayment events, including change of control over the borrower. Non-compliance with covenants under the facility agreement with ICICI Bank Limited, in addition to other events, may constitute an event of default. These other events include: (i) any default under any document

pertaining to any indebtedness of SSTL in an aggregate amount exceeding a certain amount; and (ii) any event or circumstance which constitutes a material adverse change in the business, condition (financial or otherwise), operations, performance, properties or prospects of SSTL or any other event, whether domestic or international, which in the opinion of the lender, will adversely affect the terms of the facility. See *“Risk Factors—Risks Relating to Our Business and Industry—General Risks—As a result of litigation proceedings involving SSTL, certain financing arrangements of SSTL and Sistema JSFC may well currently be capable of being accelerated. In addition, pursuant to a put option agreement, we may be required to repurchase the stake in SSTL held by the Russian government. If the Russian government were to exercise its put option over its stake in SSTL, there can be no assurance that such exercise would not have a material adverse effect on our financial condition.”*

Facility agreement with Barclays Bank Plc, Mumbai Branch

On 19 September 2011, SSTL entered into a facility agreement with Barclays Bank Plc, Mumbai Branch allowing borrowings of up to INR 4.6 billion (approximately \$88.3 million). The loan was provided to finance capital expenditures and operating expenses and to refinance SSTL’s maturing debt owed to other banks. As at 31 December 2011, the amount outstanding under the loan was INR 4.6 billion (approximately \$88.3 million). The loan has a final maturity date of 10 June 2014.

Non-compliance with covenants under the facility agreement with Barclays Bank Plc, Mumbai Branch, in addition to other events, may constitute an event of default. These other events include: (i) any creditor becoming entitled to declare the debt of SSTL over a certain amount due and payable as a result of an event of default; (ii) the majority lenders determine that a material adverse effect on or a material adverse change in the condition (financial or otherwise), assets, operations, prospects or business of SSTL exists, has occurred or might occur; (iii) other than the public interest petition related to the Indian Judgment, any litigation, arbitration, investigative or administrative proceeding that is current, pending or threatened and the majority lenders determine has (or might, if adversely determined, have) a material adverse effect on or a material adverse change in the condition (financial or otherwise), assets, operations, prospects or business of SSTL; (iv) any expropriation, attachment, sequestration, distress or execution that affects any asset or assets of SSTL not discharged within a specified period of time; (v) nationalisation, compulsory acquisition, expropriation or seizure (whether de jure or de facto) of all or a material part of the business or assets of SSTL by any governmental or other authority; and (vi) any breach of representation (which automatically repeat on each draw-down request date and on each interest payment date), including (without limitation) a representation that, except for the public interest petition related to the Indian Judgment, no litigation has been commenced which, if adversely determined, might reasonably be expected to have a material adverse effect on or a material adverse change in the condition (financial or otherwise), assets, operations, prospects or business of SSTL. *“Risk Factors—Risks Relating to Our Business and Industry—General Risks—As a result of litigation proceedings involving SSTL, certain financing arrangements of SSTL and Sistema JSFC may well currently be capable of being accelerated. In addition, pursuant to a put option agreement, we may be required to repurchase the stake in SSTL held by the Russian government. If the Russian government were to exercise its put option over its stake in SSTL, there can be no assurance that such exercise would not have a material adverse effect on our financial condition.”*

Debenture Trust Deed with IDBI Trusteeship Services Limited

On 23 December 2011, SSTL entered into Debenture Trust Deed with IDBI Trusteeship Services Limited for the issuance of secured redeemable, non-convertible debentures in aggregate amount of INR 12.8 billion (approx. USD 245.6 million) on a private placement basis to the company controlled by Deutsche Bank AG. The proceeds were to be used for pre-agreed capital and operating expenditure, funding a long-term working capital gap and repayment of INR term loans. The debentures were guaranteed by Sistema JSFC. The debentures have a maturity date of 22 December 2019. As at 4 January 2012, the total amount outstanding under the debentures was INR 12.8 billion (approx. \$245.6 million).

Non-compliance with covenants under the debenture trust deed with IDBI Trusteeship Services Limited, in addition to other events, may constitute an event of default. These other events include: (i) change of control; (ii) any creditor becoming entitled to declare the debt of SSTL or Sistema JSFC or any of its material subsidiaries over a certain amount due and payable as a result of an event of default in the aggregate amount; (iii) any event or series of events which, in the opinion of the debenture trustee or majority debenture holders, might have a material adverse effect on or a material adverse change in the condition (financial or otherwise), operations, prospects or business of SSTL, Sistema JSFC, a material subsidiary of Sistema JSFC or Sistema JSFC and its subsidiaries taken as a whole; (iv) any legal proceedings or other procedure or step initiated or taken by any person in relation to any expropriation, attachment, sequestration, distress or execution that affects any assets of SSTL with a value over a certain amount; (v) any step taken by or under the authority of any governmental

authority with a view to the seizure, expropriation, nationalisation, requisition or compulsory acquisition of the whole or a substantial part of the assets or material rights of SSTL; (vi) cancellation, revocation, suspension, non-renewal or non-issuance of any of the key telecom approvals or any other approval held or required by the issuer in relation to any of its business that is material in the sole opinion of the debenture trustee, as well as the cancellation of any 2G spectrum allotted to SSTL for any reason (including pursuant to the public interest petition related to the Indian Judgment); (vii) any litigation, arbitration, governmental, regulatory or other investigation, proceeding, requisition or dispute is commenced or threatened in relation to any assets of Sistema JSFC or a material subsidiary thereof, which if adversely determined could have a material adverse effect on or a material adverse change in the condition (financial or otherwise), operations, prospects or business of Sistema JSFC, a material subsidiary of Sistema JSFC or Sistema JSFC and its subsidiaries taken as a whole; and (viii) other than the public interest petition related to the Indian Judgment, any action (including any litigation or other proceedings) is current, pending, commenced or threatened, which, in the sole opinion of the debenture trustee, has or is reasonably likely to have a material adverse effect on or a material adverse change in the condition (financial or otherwise), operations, prospects or business of SSTL. See *“Risk Factors—Risks Relating to Our Business and Industry—General Risks—As a result of litigation proceedings involving SSTL, certain financing arrangements of SSTL and Sistema JSFC may well currently be capable of being accelerated. In addition, pursuant to a put option agreement, we may be required to repurchase the stake in SSTL held by the Russian government. If the Russian government were to exercise its put option over its stake in SSTL, there can be no assurance that such exercise would not have a material adverse effect on our financial condition.”*

Sistema JSFC

For a discussion of the possible impact of litigation proceedings involving SSTL and litigation proceedings relating to Bashneft-Polus’ licence to Trebs and Titov on the terms of these facilities see *“Risk Factors—Risks Relating to Our Business and Industry—As a result of litigation proceedings involving SSTL, certain financing arrangements of SSTL and Sistema JSFC may well currently be capable of being accelerated. In addition, pursuant to a put option agreement exercisable between March 2016 and March 2017, we may be required to repurchase the stake in SSTL held by the Russian government. If the Russian government were to exercise its put option over its stake in SSTL, there can be no assurance that such exercise would not have a material adverse effect on our financial condition”* and *“Risk Factors—Risks Relating to Our Oil and Energy Business—Bashneft’s exploration and development licence to the Trebs and Titov oil fields is currently the subject of legal proceedings brought by a minority shareholder in Bashneft. A negative outcome in these proceedings may lead to significant delays in Bashneft’s exploration and development plans and may otherwise have a material adverse effect on Bashneft’s business and results of operations. In addition, the cancellation of Bashneft’s Trebs and Titov licence may well result in JSOC Bashneft’s pre-export facility being capable of being accelerated, which, in turn, would trigger cross-default provisions under certain of our other financing agreements.”*

Credit facility with ING Bank N.V.

On 11 October 2010, Sistema JSFC entered into a letter of credit facility with ING Bank N.V. allowing borrowings of up to approximately INR 7 billion (approximately \$134.3 million) for the purpose of supporting a working capital facility to be provided to SSTL by ING India. As at 31 December 2011, the total amount outstanding under the credit agreement was approximately \$129.2 million. The loan has a final maturity date of 15 December 2012. The facility agreement between SSTL and ING India is guaranteed by Sistema JSFC.

The loan is subject to a number of early repayment events, including change of control over Sistema. Non-compliance with covenants under the facility agreement with ING Bank N.V., in addition to other events, may constitute an event of default. These other events include: (i) any financial indebtedness of Sistema JSFC or any of its subsidiaries owed to any creditor over a certain amount becomes capable of being declared prematurely due and payable; (ii) any litigation, arbitration, administrative, governmental, regulatory or other investigation commenced or threatened in relation to Sistema JSFC (and its subsidiaries) or their assets which on aggregate is likely to give rise to liabilities of Sistema JSFC (and its subsidiaries) in excess of a certain amount or do give rise to aggregate liabilities in excess of a certain amount upon their outcome or final judgment (provided that the relevant proceedings are not discharged within a specified time period and remain outstanding and unsatisfied); and (iii) any event or series of events which in the opinion of the lender, has or is reasonably likely to have a material adverse effect on the business, prospects or financial condition of Sistema JSFC or any of its material subsidiaries or Sistema JSFC and its subsidiaries as a whole.

Facility agreement with The Royal Bank of Scotland N.V.

On 29 December 2011, Sistema JSFC entered into a facility agreement with The Royal Bank of Scotland N.V. allowing borrowings of up to approximately \$300 million for the purpose of supporting Rupee denominated

facilities provided and/or to be provided to SSTL by RBS India. As at 31 December 2011, the amount outstanding under this facility was nil. The facility agreement has a final maturity date of 14 June 2012. The facility agreement is secured by a pledge of Sistema's funds. As at 31 March 2012, the outstanding indebtedness under this facility agreement was approximately \$267.4 million.

The loan is subject to a number of early repayment events, including change of control over Sistema. Non-compliance with covenants under the facility agreement with The Royal Bank of Scotland N.V. in addition to other events, may constitute an event of default. These other events include: (i) any financial indebtedness of Sistema JSFC or any of its subsidiaries owed to any creditor (excluding that arising solely under the Intercompany Loan Agreement) over a certain amount becomes capable of being declared prematurely due and payable; (ii) other than the Nomihold award, any litigation, arbitration, administrative, governmental, regulatory or other investigation commenced or threatened in relation to Sistema JSFC (and its subsidiaries) or their assets which on aggregate are likely to give rise to liabilities of Sistema JSFC (and its subsidiaries) in excess of a certain amount or do give rise to aggregate liabilities in excess of a certain amount upon their outcome or final judgment (provided that the relevant proceedings are not discharged within a specified period of time and remain outstanding and unsatisfied); and (iii) any event or series of events which in the opinion of the lender, has or is reasonably likely to have a material adverse effect on the business, prospects or financial condition of Sistema JSFC or any of its material subsidiaries or Sistema JSFC and its subsidiaries as a whole.

Facility agreement with Raiffeisen Bank International AG.

On 30 March 2012, Sistema JSFC entered into a facility agreement with Raiffeisen Bank International AG allowing borrowings of up to INR 10.3 billion (approximately \$202.4 million) for the purpose of supporting Rupee denominated facilities provided and/or to be provided to SSTL. As at 31 March 2012, the loan was fully drawn and the amount outstanding thereafter was approximately \$202.4 million. The facility agreement has a final maturity date of 31 March 2015.

Non-compliance with covenants under the facility agreement with Raiffeisen Bank International AG, in addition to other events, may constitute an event of default. These other events include: (i) any financial indebtedness of Sistema JSFC or any of its subsidiaries owed to any creditor (excluding that arising solely under the MTS Intercompany Loan Agreement) over a certain amount becomes capable of being declared prematurely due and payable; (ii) any litigation, arbitration, administrative, governmental, regulatory or other investigation commenced or threatened in relation to Sistema JSFC (and its subsidiaries) or their assets which on aggregate are likely to give rise to liabilities of Sistema JSFC (and its subsidiaries) in excess of a certain amount or do give rise to aggregate liabilities in excess of a certain amount upon their outcome or final judgment (provided that the relevant proceedings are not discharged within a specified period of time and remain outstanding and unsatisfied); and (iii) any event or series of events which in the opinion of the lender, has or is reasonably likely to have a material adverse effect on the business, prospects or financial condition of Sistema JSFC or any of its material subsidiaries or Sistema JSFC and its subsidiaries as a whole.

RTI

RTI loans to SITRONICS

On 25 November 2011, SITRONICS entered into two loan agreements with RTI allowing borrowings of up to \$115 million and RUB 3.6 billion, respectively. The loans were provided to refinance certain debt owed by SITRONICS to Golden Gates B.V. and were supported by the loans provided by the Bank of Moscow to RTI. As at 31 December 2011, the total amount outstanding under these loans was approximately \$228 million. The loans have a final maturity date of 31 December 2018.

RTI financings under defence contracts

RTI has three long-term contracts with the Russian Ministry of Defence under a new credit system to allow defence contractors to finance their construction obligations using bank loans, that are subsequently paid off with payments from the Ministry of Defence. RTI Systems Concern is the RTI-affiliated party to two of these contracts and RTI Mintz is a party to the third. The loans provide for an initial period of credit from 2011 to 2014 and are guaranteed by the Ministry of Finance. The interest payments under the loans are reimbursed by the Ministry of Defence, which is scheduled to make payments under the contracts in 2015-2018.

In order to finance these contracts, RTI Systems Concern has entered into four rouble credit agreements with Gazprombank for an aggregate amount of RUB 7.7 billion (approximately \$255 million). These credit agreements have final maturity dates in 2015-2016. As at 31 December 2011, the outstanding amount under these credit agreements was approximately \$112.8 million.

RTI Mintz has entered into two rouble credit agreements with Sberbank for an aggregate amount of RUB 5.0 billion (approximately \$168 million). These credit agreements have final maturity dates in 2015. As at 31 December 2011, the outstanding amount under these credit agreements was approximately \$74.5 million.

RTI expects that its indebtedness under these state contracts will be increased to approximately \$423 million in aggregate over the next nine months and expects that all of these financings will be guaranteed by the Ministry of Finance and supported by procurement contracts with the Ministry of Defence.

Commitments and Contingencies

For further discussion of our commitments and contingencies, see Note 27 of our U.S. GAAP Financial Statements.

Operating leases

We lease land, buildings and office space mainly from municipal organisations through contracts which expire in various years through 2060. In the years ended 2009, 2010 and 2011, we had total rental expenses under operating leases of \$565.1 million, \$678.1 million and \$759.2 million. See “—*Tabular disclosure of contractual obligations*,” below, for the amount of operating lease payments expected in 2012-2016 and thereafter.

Capital commitments

As at 31 December 2011, we had executed agreements valued at approximately \$764.1 million to acquire property, plant and equipment and intangible assets.

Obligations under derivative contracts

Derivative financial instruments

We currently use derivative instruments, including swaps, forward and option contracts, to manage foreign currency and interest rate risk exposures. Derivatives are classified as either fair value hedges or cash flow hedges, if the required criteria are met. Our interest rate swap agreements qualify as cash flow hedge instruments.

The following table presents the fair value of our derivative financial instruments as at 31 December 2011. See Note 22 of the U.S. GAAP Financial Statements.

Derivative instrument	Fair value measurements using			Total fair value
	Level 1 ⁽¹⁾	Level 2 ⁽²⁾	Level 3 ⁽³⁾	
Assets at fair value:				
Trading securities	774,659	—	—	774,659
Available-for-sale securities	97,625	111,464	—	209,089
Interest rate swaps	—	2,341	—	2,341
Currency option agreements	—	894	—	894
Total assets	872,284	114,699	—	986,983
Liabilities at fair value:				
Interest rate swaps	—	(15,959)	—	(15,959)
Put options	—	—	(24,958)	(24,958)
Redeemable noncontrolling interests ⁽⁴⁾	—	—	(99,819)	(99,819)
Total liabilities	—	(15,959)	(124,777)	(140,736)

(1) Quoted prices in active markets for identical assets.

(2) Significant other observable inputs.

(3) Significant unobservable inputs.

(4) Represents put and call option agreements to acquire noncontrolling interests in existing subsidiaries, which are entered into from time to time to optimise the structure of business acquisitions, including deferral of payment of purchase price.

Russian government put option in SSTL

In March 2011, during the course of an additional placement of shares, Rosimushchestvo purchased a 17.1% stake in SSTL for approximately \$600 million and certain minority investors purchased a 2.2% stake in SSTL for approximately \$42 million. The agreement between Sistema and Rosimushchestvo provides for a set of put and call arrangements. In particular, Rosimushchestvo has a put option to sell its stake in SSTL to Sistema during a one-year period beginning five years after its purchase of shares in SSTL. In the event the put option is exercised,

Sistema has an obligation to purchase the Russian government's stake in SSTL for the higher of \$777 million or the market value as determined by an independent valuator. Furthermore, under the terms of the agreement, until the put has been exercised or expires, Sistema has agreed not to reduce its stake in SSTL below 50% +1 share.

SITRONICS-Nano

In October 2009, SITRONICS entered into an agreement to establish SITRONICS-Nano, 49.75% of which is owned by SITRONICS, 49.75% by RUSNANO and 0.5% by a third party. The primary purposes of SITRONICS-Nano are to acquire equipment and licences necessary to launch the production of 90 nanometer microchips and to lease them to SITRONICS, and to provide project financing to SITRONICS.

RUSNANO has two put options that allow it to sell its 49.75% stake in SITRONICS-Nano to Sistema. Under the first option, RUSNANO has the right to sell its stake to Sistema at market price plus 25% no earlier than nine years and no later than 10 years and six months from December 2009, the date of financing. Under the second option, RUSNANO has the right to sell its stake in SITRONICS-Nano to Sistema during the first nine years of operations of SITRONICS-Nano upon the non-fulfilment of certain criteria for RUB 6,480.0 million plus 18% per year, less any net profit attributed and paid to RUSNANO during the period from the date of the put application.

Sistema has a call option to acquire at any time RUSNANO's stake for RUB 6,480 million plus 18% interest per annum.

Commitments on loans and unused credit lines

As at 31 December 2011, MTS Bank had \$528.6 million of commitments on loans and unused credit lines available to its customers.

Agreement with Apple

In 2008, MTS entered into an unconditional purchase agreement with Apple Sales International to buy 1.5 million iPhone handsets at the list price on the purchase date over a three year period. Pursuant to the agreement, MTS is also required to incur certain iPhone promotion costs. MTS did not fulfill its commitment under the agreement, having made 28.6% of the total purchase instalment as at 31 December 2011. In 2009, 2010 and 2011, the total amount paid for handsets purchased under the agreement amounted to \$3.4 million, \$79.4 million and \$140.8 million, respectively. MTS prolonged the purchase agreement with Apple Sales International through 31 March 2012.

Taxation

In 2009, 2010 and 2011, the Russian tax authorities completed a number of tax audits at our subsidiaries. Based on the results of these audits, we were assessed additional taxes, penalties and fines in the amount of \$5.8 million payable as at 31 December 2009, \$17.4 million payable as at 31 December 2010 and \$61.8 million payable as at 31 December in 2011. We have appealed certain of these assessments.

As at 31 December 2009, 2010 and 2011, we accrued provisions for tax and customs liabilities in the amount of \$68.2 million, \$10.0 million and \$7.1 million, respectively.

With regard to matters where the practice concerning payment of taxes is unclear, we estimated potential tax exposure to be approximately \$184 million as at 31 December 2010 and \$550 million as at 31 December 2011.

Tabular disclosure of contractual obligations

We have various contractual obligations to make future payments, including debt agreements and lease obligations. The following table summarises certain of our future obligations under notes payable and bank loans, capital leases and operating leases and services agreements due by the periods indicated as at 31 December 2011:

	<u>2012</u>	<u>2013</u>	<u>2014</u>	<u>2015</u>	<u>2016</u>	<u>After 2016</u>	<u>Total</u>
	<i>(\$ in thousands)</i>						
Contractual obligations:							
Notes payable and bank loans . . .	3,988,463	2,294,978	1,429,727	2,282,834	2,155,985	3,530,795	15,682,781
Capital lease	45,752	42,595	24,622	59,602	19,841	35,235	227,647
Operating leases and services agreements	387,384	186,023	172,452	171,873	172,020	568,870	1,658,622
Total	<u>4,421,599</u>	<u>2,523,596</u>	<u>1,626,801</u>	<u>2,514,309</u>	<u>2,347,846</u>	<u>4,134,900</u>	<u>17,569,050</u>

Credit Ratings

Our credit ratings impact our ability to obtain short- and long-term financing, and the cost of such financing. In determining our credit ratings, the rating agencies consider a number of factors, including our operating cash flows, total debt outstanding, commitments, interest requirements, liquidity needs and availability of liquidity. Other factors considered may include our business strategy, corporate governance, the condition of our industry and our position within the industry. Although we understand that these and other factors are among those considered by the rating agencies, each agency might calculate and weigh each factor differently.

The credit ratings of our parent company and our subsidiaries as at the date of this Prospectus were as follows:

<u>Name of issuer</u>	<u>Rating Agency</u>	<u>Date of Rating</u>	<u>Rating</u>	<u>Outlook</u>
Sistema	S&P	3 February 2012	BB	Stable
Sistema	Fitch	28 November 2011	BB-	Stable
Sistema	Moody's	12 April 2012	Ba3	Stable
MTS	S&P	3 February 2012	BB	Stable
MTS	Moody's	12 April 2012	Ba2	Stable
MTS	Fitch	28 November 2011	BB+	Stable
Bashneft	Moody's	19 April 2012	Ba2	Stable

Market Risks

We are exposed to a variety of market risks, including foreign currency risk, interest rate risk, credit risk and liquidity risk. We actively seek to minimise the potential adverse effects of these risks on our financial performance, and, in particular, use derivative instruments, including swap, forward and option contracts to manage foreign currency and interest rate risks. We do not use derivatives for trading purposes. See “—Key Factors Affecting Our Results of Operations—General Factors—Russian and CIS Macroeconomic Conditions and Trends,” above, for a discussion of our foreign currency and inflation risks.

Interest Rate Risk

Interest rate risk is the risk that changes in variable interest rates will adversely impact our financial results. Our interest rate risk arises from fixed-rate and variable-rate loans and borrowings. Borrowings issued at fixed rates expose us to fair value interest rate risk, while borrowings issued at variable rates, particularly fluctuations in LIBOR, EURIBOR and MosPrime, expose us to cash flow interest rate risk.

As at 31 December 2011, approximately \$2,835 million, or 17.3% of our total indebtedness was variable interest rate debt, while \$13,575 million, or 82.7% of our total indebtedness was fixed interest rate debt.

We currently use derivative instruments, including swaps, forward and option contracts, to manage interest rate risk exposures. In particular, we have entered into variable-to-fixed interest rate swap agreements to manage the exposure to changes in variable interest rates related to debt obligations. These interest rate swap agreements qualify as cash flow hedge instruments. Interest rate swap contracts outstanding as at 31 December 2011 mature in 2012-2015. We continue to consider other financial instruments available to us on the market to mitigate exposure to variability in interest rates. See “—Commitments and Contingencies—Obligations under derivative contracts—Derivative financial instruments.”

For indebtedness with variable interest rates, the table below presents principal cash flows and related weighted average interest rates by contractual maturity dates as at 31 December 2011.

	Currency	31 December						Total	Average rate at 31 December 2011
		2012	2013	2014	2015	2016	Thereafter		
Calyon, ING Bank N.V., Nordea Bank AB, Raiffeisen Zentralbank Österreich AG	USD	62,010	74,186	74,186	74,186	74,186	221,988	580,742	1.96%
Deutsche Bank	USD	50,000	150,000	100,000	—	—	—	300,000	1.85%
China Development Bank	USD	20,801	41,603	41,603	41,603	41,603	62,404	249,616	2.31%
Gazprombank	USD	229,309	—	—	—	—	—	229,309	5.48%
Skandinaviska Enskilda Banken AB	USD	37,506	37,506	37,506	37,506	35,094	19,389	204,507	1.30%
Bank of China	USD	6,307	26,700	26,700	26,700	26,700	26,700	139,805	2.54%
Bank of Moscow	USD	2,450	—	—	—	—	115,000	117,450	7.38%
EBRD	USD	33,334	33,334	16,665	—	—	—	83,333	2.73%
HSBC Bank plc and ING BHF Bank AG	USD	19,741	19,741	12,021	—	—	—	51,503	1.11%
HSBC Bank plc, ING Bank AG and Bayerische Landesbank	USD	16,609	16,609	8,726	1,017	—	—	42,961	1.11%
Citibank International plc and ING Bank N.V.	USD	21,800	18,888	—	—	—	—	40,688	1.23%
Commerzbank AG, ING Bank AG and HSBC Bank plc	USD	14,790	14,790	6,915	—	—	—	36,495	1.11%
Societe Generale	USD	3,785	3,769	3,769	3,769	3,769	—	18,859	2.06%
The Royal Bank of Scotland	USD	6,287	6,287	—	—	—	—	12,574	1.16%
Total USD variable debt		524,729	443,412	328,090	184,780	181,351	445,481	2,107,842	
Weighted average USD interest rate		2.49%	2.42%	2.63%	2.87%	3.18%	3.41%		
Bank of China Syndicated Loan to Intracom Telecom	EUR	23,362	23,362	23,362	23,362	23,362	—	116,812	3.57%
EBRD	EUR	116,487	—	—	—	—	—	116,487	5.61%
BNP Paribas	EUR	77,658	—	—	—	—	—	77,658	6.49%
LBWW	EUR	8,963	8,963	8,963	8,963	8,963	19,219	64,033	3.27%
The Royal Bank of Scotland	EUR	6,036	6,036	6,036	6,036	6,036	6,036	36,215	2.37%
Total EUR variable debt		236,985	42,840	38,361	38,361	38,361	25,255	420,164	
Weighted average EUR interest rate		4.11%	3.27%	3.26%	3.23%	3.17%	3.05%		
Bank of Moscow Raiffeisenbank	RUB	26,704	1,864	3,727	8,131	—	112,960	153,386	10.98%
Unicredit	RUB	—	—	83,861	—	—	—	83,861	9.75%
Total RUB variable debt		34,904	14,664	107,088	24,031	12,871	112,960	306,517	
Weighted average RUB interest rate		10.91%	10.85%	10.97%	11.17%	11.05%	10.98%		

Sensitivity Analysis

We would experience an additional interest expense of approximately \$7.9 million in the year ended 31 December 2012, \$5.0 million in the year ended 31 December 2013, \$4.7 million in the year ended 31 December 2014, \$2.5 million in the year ended 31 December 2015 and \$2.3 million in the year ended 31 December 2016 on an annual basis as a result of a hypothetical increase in the LIBOR/EURIBOR/MosPrime by 1% over the current rate as at 31 December 2011. This analysis assumes that all other variables, in particular, foreign currency rates, remain constant.

The fair value of our publicly traded long-term notes as at 31 December 2011 ranged from 94.0% to 107.3% of the principal amount. At 31 December 2011, the fair value of our other debt approximated its book value. We have not experienced significant changes in the market risks associated with our debt obligations in the table above subsequent to 31 December 2011.

Credit Risk

Credit risk is the risk of financial loss to us if a customer or counterparty to a financial instrument fails to meet its contractual obligations, and arises principally from cash and cash equivalents, assets from banking activities, short-term investments, net accounts receivable and net prepaid expenses, other receivables and other current assets.

Credit risk with regard to cash and cash equivalents is managed by placing funds primarily in a select group of foreign and domestic banks.

Credit risk with regard to assets from banking activities is managed by evaluating the creditworthiness of our customers.

Credit risk with respect to short term investments is managed by assessing the creditworthiness of each borrower, taking into account the type of security that can be pledged, as well as the purpose of each investment or loan.

Credit risk connected with other current assets is managed by assessing the creditworthiness of each customer, taking into account its financial position, past experience and other factors.

The carrying amount of our financial assets represents our maximum credit exposure. The following table sets forth the maximum exposure to credit risk as at the periods indicated:

	Year ended 31 December		
	2009	2010	2011
		(\$ in thousands)	
Cash and cash equivalents	3,436,680	2,245,884	2,923,957
Assets from banking activities	5,184,265	7,302,349	6,508,081
Short term investments	575,966	879,680	763,631
Accounts receivable, net	1,334,169	1,780,423	1,756,278
Other current assets	1,358,226	1,685,336	1,722,844
Total	11,889,306	13,893,672	13,674,791

Liquidity Risk

Liquidity risk is the risk that we will not be able to settle all liabilities as they become due. Our approach to managing liquidity is to ensure, as far as possible, that we will always have sufficient liquidity to meet our liabilities when due, under both normal and stressed conditions, without incurring unacceptable losses or risking damage to our reputation. Our liquidity in the future will primarily depend on our ability to maintain adequate cash flows from operations to meet our debt obligations as they become due, on our ability to obtain adequate external financing to meet our committed future capital expenditures and on the extent to which we will be obligated to make payments under certain judgments and other contractual obligations. See “—*Liquidity and Capital Resources—Capital Requirements.*”

Our operating cash flows could be adversely affected by numerous factors beyond our control, including but not limited to, fluctuations in exchange rates and inflation, the price of acquisitions, the change in telecommunications tariffs, changes in crude oil and oil products’ prices, taxation, feedstock prices in the oil industry, increased competition or potential payments of obligations under judgments. Our ability to obtain external financing depends on numerous factors, including but not limited to, our financial performance and creditworthiness as well as our relationships with lenders.

For example, as a result of the impact of the situation related to the Indian Judgment, the SSTL Agreements and the Sistema JSFC Agreements may well currently be capable of being accelerated by the lenders. See “*Business—Material Litigation,*” “—*Liquidity and Capital Resources*” and “*Risk Factors—Risks Relating to Our Business and Industry—General Risks—As a result of litigation proceedings involving SSTL, certain financing arrangements of SSTL and Sistema JSFC may well currently be capable of being accelerated. In addition, pursuant to a put and call option agreement, we may be required to repurchase the stake in SSTL held by the Russian government. If the Russian government were to exercise its put option over its stake in SSTL, there can be no assurance that such exercise would not have a material adverse effect on our financial condition.*”

The Lenders under these loan agreements have not yet accelerated any payments thereunder or indicated that they intend to do so, and we do not expect them to accelerate in the context of the current circumstances. Nevertheless, there can be no assurance they will not ultimately do so. The total amount of indebtedness outstanding under the SSTL Agreements and the Sistema JSFC Agreements as of 26 April 2012 was \$1,656.1 million. If the lenders under these agreements were to accelerate all or a portion of our debt under these agreements, we believe that we have sufficient liquidity to meet these obligations when due from cash and other short-term assets and availability of credit pursuant to other credit facilities.

Critical Accounting Policies

Critical accounting policies are those policies that require the application of management’s most challenging, subjective or complex judgments, often as a result of the need to make estimates about the effect of matters that are inherently uncertain and may change in subsequent periods. Critical accounting policies involve judgments and uncertainties that are sufficiently sensitive to result in materially different results under different assumptions and conditions. We believe that our most critical accounting policies are those described below.

Revenue Recognition

Revenue recognition policies have a significant impact on our results of operations. Generally, revenues are recognised when all of the following conditions have been met: (i) there is persuasive evidence of an arrangement; (ii) delivery has occurred; (iii) the fee is fixed and determinable; and (iv) collectability of the fee is reasonably assured. Revenue amounts are presented net of value added taxes.

Below we have summarised key elements of our revenue recognition policies for our Core Assets and certain of our Developing Assets:

MTS

Revenues derived from wireless, local telephone, long distance, data and video services are recognised when services are provided. This is based upon either usage (minutes of traffic processed, volume of data transmitted) or period of time (monthly subscription fees).

The content revenue is presented net of related costs when MTS acts as an agent of the content providers while the gross revenue and related costs are recorded when MTS is a primary obligor in the arrangement.

Upfront fees received for connection of new subscribers, installation and activation of wireless, wireline and data transmission services are deferred and recognised over the estimated average subscriber life, as follows:

Mobile subscribers	1-5 years
Residential wireline voice phone subscribers	15 years
Residential subscribers of broadband internet service	1 year
Other fixed line subscribers	3-5 years

MTS calculates an average life of mobile subscribers for each region in which it operates and amortises regional connection fees.

Incentives provided to customers are usually offered on signing a new contract or as part of a promotional offering. Incentives, representing the reduction of the selling price of the service (free minutes and discounts) are recorded in the period to which they relate, when the respective revenue is recognised, as a reduction to both accounts receivable and revenue. However, if the sales incentive is a free product or service delivered at the time of sale, the cost of the free product or service is classified as an expense. In particular, we sell handsets at prices below cost to contract subscribers. Such subsidies are recognised in the cost of handsets and accessories when the sale is recorded.

Bashneft

Revenues from the production and sale of crude oil and petroleum products are recognised when title passes to customers at which point the risks and rewards of ownership are assumed by the customer and the price is fixed and determinable. Revenues include excise taxes on petroleum products sales and duties on export sales of crude oil and petroleum products. Excise taxes, which are re-charged to third parties under the terms of processing agreements, are excluded from revenues.

Revenue from a contract to provide services is recognised by reference to the stage of completion of the contract. Revenue from time and material contracts is recognised at the contractual rates as labour hours are delivered and direct expenses are incurred.

Construction contracts revenue includes the initial amount agreed in the contract plus any variations in contract work, claims and incentive payments, to the extent that it is probable that they will result in revenue and can be measured reliably. As soon as the outcome of a construction contract can be estimated reliably, contract revenue is recognised in profit or loss in proportion to the stage of completion of the contract. Contract expenses are recognised as incurred unless they create an asset related to future contract activity. The stage of completion is assessed by reference to surveys of work performed. When the outcome of a construction contract cannot be estimated reliably, contract revenue is recognised only to the extent of contract costs incurred that are likely to be recoverable. An expected loss on a contract is recognised immediately in profit or loss.

RTI

Revenues from the long-term contracts are recognised by reference to the stage of completion of the contract activity at the statement of financial position date when the outcome of a contract can be estimated reliably. This is normally measured by the proportion that contract costs incurred for work performed to date relate to the estimated total contract costs, except where this would not be representative of the stage of completion. Variations in contract work, claims and incentive payments are included to the extent that they have been agreed with the customer. Where the outcome of a contract cannot be estimated reliably, contract revenue is recognised to the extent of contract costs incurred where it is probable that such costs will be recoverable. When it is probable that total contract costs will exceed total contract revenue, the expected loss is recognised immediately. The sales of software products and system integration services are generally multiple-element arrangements, involving the provision of related services, including customisation, implementation and integration services, as well as ongoing support and maintenance provided to customers. A multiple-element arrangement is separated into more than one unit of accounting if all of the following criteria are met: (a) the delivered items have value to the customer on a standalone basis; (b) there is objective and reliable evidence of the fair value of the undelivered items; and (c) the arrangement includes a general right of return relative to the delivered items, delivery or performance of the undelivered items is considered probable and substantially in our control.

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

In cases where extended payment terms exist, license and related customisation fees are recognised when payments are due, unless a history of collection, without providing concessions, has been established under comparable arrangements.

When sale agreements provide price protection to the dealer, the revenue is deferred until the dealer sells the merchandise to a third party due to the frequent sales price reductions and rapid technology obsolescence.

Certain products of this segment are generally sold with a limited warranty for product quality. The product return reserves and other post-contract support obligations are accrued at the time of sale. The segment accrues for estimated incurred but unidentified issues based on historical activity.

MTS Bank

Revenues from interest bearing assets are recognised on an accrual basis using the effective interest method. The effective interest method is a method of calculating the amortised cost of a financial asset or a financial liability (or group of financial assets or financial liabilities) and of allocating the interest income or interest expense over the relevant period.

The effective interest rate is the rate that exactly discounts estimated future cash receipts (including all fees on points paid or received that form an integral part of the effective interest rate, transaction costs and other premiums or discounts) through the expected life of the debt instrument, or (where appropriate) a shorter period, to the net carrying amount on initial recognition.

SSTL

Service revenues are recognised as services are rendered, net of discounts and waivers. Processing fees and activation revenues on recharge vouchers and start-up kits are recognised as revenues net of discounts, as and when they get activated.

Revenues from infrastructure services are recognised as services are rendered, in accordance with the terms of the related contracts. Indefeasible right of use contracts is accounted for as operating leases and revenues are recognised over the term of the lease.

Other

The companies that comprise our Other category recognise revenue generally when products are shipped or when services are rendered to customers. In cases where we act as an agent, only the net agency fee is recognised as revenue. With respect to Bashkirenergo, revenue from retail and wholesale electricity and heat sales is recognised upon delivery of the electricity and heat to the customer, and revenue from electricity transmission services is recognised upon receipt of customers' acceptance of the volume of electricity transmitted.

Licence Costs and Other Intangible Assets

We capitalise the cost of licences acquired in business combinations and directly from the government. Without consideration of possible future renewals, we amortise each licence on a straight-line basis over the term of the licence which is from three to 15 years. We review these licences and their remaining useful life and, if necessary, revise the useful lives based on our actual utilisation. The estimated useful lives of licences may vary depending on market or regulatory conditions, and any revision to the estimated useful lives may result in a write off or an increase in amortisation costs.

Other intangible assets represent acquired customer bases, trademarks, telephone numbering capacity, radio frequencies and various purchased software costs. Trademarks and telephone numbering capacity with unlimited contractual life are not amortised, but are reviewed, at least annually, for impairment.

Acquired customer bases are amortised over the estimate average subscriber life from one to eight years. Deferred telephone numbering capacity costs with a limited contractual life are being amortised over their contractual lives, which vary from two to 10 years. Acquired radio frequencies are amortised over the estimated average life of two to 15 months. Billing and telecommunication software is amortised over a 3-10 year estimated life. All finite-life intangible assets are amortised using the straight-line method.

Property, Plant and Equipment

Except with respect to the depletion expense of oil and gas properties, we calculate depreciation expense for property, plant and equipment on a straight-line basis over their estimated useful lives. We establish useful lives for each category of property, plant and equipment based on our assessment of the use of the assets and anticipated technology evolution. We review and revise if appropriate the assumptions used in the determination of useful lives of property, plant and equipment at least on an annual basis.

Depletion expense on oil and gas properties is calculated using the unit-of-production method based on total proved reserves. Depletion expense of other capitalised costs related to oil and gas production is calculated using the unit-of-production method based on proved developed reserves.

Impairment of Long-Lived Assets other than Goodwill and Indefinite Lived Intangible Assets

We periodically evaluate the recoverability of the carrying amount of our long-lived assets. Whenever events or changes in circumstances indicate that the carrying amounts of those assets may not be recoverable, we compare undiscounted net cash flows estimated to be generated by those assets to the carrying amount of those assets. When these undiscounted cash flows are less than the carrying amounts of the assets, we record impairment losses to write the asset down to fair value, measured by the estimated discounted net future cash flows expected to be generated from the use of the assets.

New Accounting Pronouncements

During the periods under review, the Financial Accounting Standards Board has issued certain new accounting pronouncements that were either adopted during the periods under review or are to be adopted in future periods. These pronouncements are described in Note 2 of the U.S. GAAP Financial Statements.

We do not expect the application of these pronouncements will have a material impact on our consolidated financial statements.

BUSINESS

Overview

We are the largest publicly-traded diversified investment company in the Russian Federation and the CIS in terms of market capitalisation, managing companies that collectively serve over 100 million customers. We are focused on delivering long-term growth to our shareholders through returns on our diversified portfolio of investments and identifying new and profitable investment opportunities. Our investment portfolio is currently largely composed of stakes in Russian businesses operating in a variety of sectors, including telecommunications, oil, utilities, consumer, high tech and others.

We were founded in 1993 by Vladimir Evtushenkov and his close associates as an operating holding company and developed through the 1990s and early 2000s through various acquisitions and the creation of several successful strategic partnerships. We completed an IPO in February 2005, when we conducted a standard listing of our GDRs on the London Stock Exchange. Our ordinary shares are listed on the MICEX-RTS Stock Exchange and on the Moscow Stock Exchange.

Since our founding, we primarily operated in the wireless communications, fixed line telecommunications, technology, insurance, real estate, media, banking, retail and travel sectors. In March 2009, we added the oil sector to our operations by acquiring a controlling interest in JSOC Bashneft and related companies. In October 2009, we sold our fixed line telecommunications operations to our wireless communication subsidiary, MTS OJSC, creating a leading supplier of integrated telecommunications solutions in the Russian Federation and the CIS.

In October 2010, we adopted a new strategy providing for our transition from an operating holding company to an investment company. In April 2011, in line with this strategy and to better allow us to identify and evaluate new investment opportunities and to manage our existing investments, we announced a new organisational and management structure which combines our investments into two units Core Assets and Developing Assets. We consider RussNeft, in which we hold a non-controlling 49% stake, to be one of our Developing Assets. See *“Management’s Discussion and Analysis of Financial Condition and Results of Operations—Acquisitions, Divestitures and Key Corporate Restructurings—Acquisitions—Acquisition of non-controlling stake in RussNeft.”*

Consolidated revenues, OIBDA and net income attributable to Sistema JSFC for the year ended 31 December 2011 were U.S.\$32,981.2 million, U.S.\$7,223.1 million and U.S.\$218.0 million, respectively. For the year ended 31 December 2011, MTS and Bashneft, two of our Core Assets, accounted for 88.6% of our consolidated revenues and RTI, MTS Bank and SSTL, three of our Developing Assets, accounted for 6.5% of our consolidated revenues. In 2011, MTS and Bashneft recorded an aggregate operating income of U.S.\$5,672.7 million and RTI, MTS Bank and SSTL recorded an aggregate operating loss of U.S.\$1,169.2 million.

Our businesses

Our portfolio of investments consists of two units: Core Assets, comprising mature, cash generative companies; and Developing Assets, consisting of companies with high potential for growth. Through this diversified approach to our portfolio, we are able to fund the early stages of development of our Developing Assets, as well as new acquisitions, with dividend payments from our Core Assets.

The following table sets forth our beneficial ownership interests in our principal subsidiaries and the sectors in which they operate as at 31 December 2011:

CORE ASSETS		
<i>Company</i>	<i>Beneficial Ownership</i>	<i>Industry</i>
MTS OJSC	53%	Telecommunications
JSOC Bashneft⁽¹⁾	69%	Oil
OJSC Bashkirenergo⁽²⁾	39%	Energy
DEVELOPING ASSETS⁽³⁾		
<i>Company</i>	<i>Beneficial Ownership</i>	<i>Industry</i>
SSTL	57%	Telecommunications
MTS Bank	99%	Banking
RTI	85%	High Technology
Detsky Mir	75%	Retail
SMM	75%	Media
Intourist	66%	Travel Services
Medsi Group	100%	Private Healthcare
Binnopharm	100%	Pharmaceuticals
NIS⁽⁴⁾	51%	High Technology

Notes:

- (1) Our voting interest in Bashneft is 86%. See “*Management’s Discussion and Analysis of Financial Condition and Results of Operations—Overview.*”
- (2) Bashkirenergo is currently being reorganised so that its power and heat generation assets and heat distribution assets will be controlled by one company, Bashenergoaktiv, and its power transmission and distribution assets are controlled by another company, BESK. See “*—Business Description—Core Assets—Bashkirenergo—History and Development*” for more discussion on the ongoing reorganisation.
- (3) We also consider RussNeft, in which we hold a 49% stake, to be one of our Developing Assets.
- (4) In February 2012, we increased our stake in NIS to 70%. See “*Management’s Discussion and Analysis of Financial Condition and Results of Operations—Recent Developments.*”

Below is the description of our businesses in different sectors:

Core Assets

Strategy

Our key objectives with respect to our Core Assets are to generate substantial dividend payments and achieve stable growth that outperforms the relevant market in each sector. We view our Core Assets as long-term investments. We have no current plans to sell them, except in relation to the reorganisation of Bashkirenergo, provided they continue to perform to our expectations. We would likely sell our Core Asset(s) only if we have alternative and more attractive uses for the proceeds of such sale(s).

Overview

MTS OJSC: MTS is a leading telecommunications provider in the Russian Federation and the CIS, offering mobile, fixed-line, broadband, pay-TV, as well as content and entertainment services. We own 52.8% (excluding treasury shares) of MTS OJSC.

JSOC Bashneft: JSOC Bashneft is a leading Russian vertically integrated oil company with upstream and downstream oil and energy assets mainly located in the Republic of Bashkortostan. Bashneft’s assets include upstream assets, a modern refining complex, a petrochemical plant and retail operations. We beneficially own 69% of JSOC Bashneft.

OJSC Bashkirenergo: OJSC Bashkirenergo is a mid-size, regional utility company in the Republic of Bashkortostan. We beneficially own 39% of OJSC Bashkirenergo. Bashkirenergo is currently undergoing a reorganisation, the purpose of which is to separate its generation assets from its power transmission and distribution assets. We expect this reorganisation to be completed by the end of 2012 and anticipate that we will hold a 75% stake in the transmission and distribution company and no stake in the generation company. See “*—Business Description—Core Assets—Bashkirenergo—History and Development.*”

Developing Assets

Strategy

When we consider new investments for our Developing Assets portfolio, we are most attracted to assets that exhibit substantial growth potential, possess a high-quality business model and have the potential to produce synergies with our existing portfolio companies. To support the growth potential of our Developing Assets, we may invest our own funds and/or seek potential partners that have the capacity to extend financing and/or relevant operational expertise. We aim to eventually either transfer each Developing Asset to our Core Assets portfolio or exit through an IPO, strategic sale or other means.

Overview

SSTL: SSTL is an Indian mobile and fixed telecommunications operator offering wireless, broadband and data services, together with value added services, to customers in 22 licence circles across India. We own a 56.7% stake in SSTL, the noncontrolling interest in which is owned by the Indian Shyam Group. See “*Risk Factors*” and “*—Material Litigation—SSTL*” for a discussion of the SSTL’s licence cancellation.

MTS Bank: MTS Bank is a retail bank ranked among the top 30 Russian banks by total assets, as measured under RAS. MTS Bank currently has a presence in over 45 cities and maintains nearly 140 points of sale in the Russian Federation. We own 99% of MTS Bank.

RTI: Our technology company, RTI, is our platform for implementing large-scale public-private partnerships in the technology and defence sectors. Through RTI, we own SITRONICS and RTI Systems Concern. SITRONICS is a high-tech company operating in the fields of telecommunications solutions, information technologies, systems integration and consulting and is a leading supplier of IT products in the CIS and Eastern Europe. RTI Systems Concern is a large, defence holding specialising in radio devices, rocket technology and integrated communications and defence systems. We own 84.6% of RTI, which, in turn, owns 63.1% of SITRONICS and 97% of RTI Systems Concern. See “—*Business Description—Developing Assets—RTI*” for a discussion of RTI’s acquisition of SITRONICS.

Detsky Mir: Detsky Mir is the leading retailer and wholesaler of children’s goods in the Russian Federation, with 154 outlets located across the Russian Federation. We own 75%-1 of OJSC Detsky Mir.

SMM: SMM manages assets in pay TV, TV content production and advertising. Its TV broadcast business is overseen by STREAM-TV, a leader in the Russian market for satellite TV products, and its production business is overseen by Russian World Studios, a leading producer of film and television content. We own 75%-1 of SMM.

Intourist: Our Moscow based tour operator is one of the leading Russian providers of travel and leisure services. We own 66% of Intourist. In 2011, Intourist established ITC Travel Investments, SL, a joint venture with Thomas Cook, one of the leaders in the international tourism market, in which Intourist holds a non-controlling 49% stake and Thomas Cook a 51% stake.

MEDSI Group: Medsi Group is a leading national network of private clinics, offering medical and healthcare services in Moscow and other regions of the Russian Federation. We own 100% of MEDSI Group.

Binnopharm: Binnopharm is a pharmaceutical company which operates a biopharmaceutical plant focused on the production of innovative medical aid for certain serious illnesses. We own 100% of Binnopharm.

NIS: NIS is the designated federal provider of navigation services based upon the GLONASS system, the global satellite navigation system developed by the Russian Federation and comparable to GPS. We own 51% of NIS. We increased our stake in NIS from 51% to 70% through the acquisition of an additional issuance of NIS shares. See “*Management’s Discussion and Analysis of Financial Condition and Results of Operations—Recent Developments.*”

RussNeft: RussNeft is a leading vertically-integrated oil company that is ranked in the top 10 oil companies in the Russian Federation in terms of production. RussNeft currently operates over 160 oil fields. We own 49% of RussNeft.

While our two Core Assets, MTS and Bashneft, comprise 88.6% of our consolidated revenues and SSTL, MTS Bank and RTI represent 6.5% of our consolidated revenues.

See “*Management’s Discussion and Analysis of Financial Condition and Results of Operations*” for the revenues generated by each of our businesses.

Investment Approach

We seek opportunities to create value through the management of our portfolio, including through the acquisition of new companies that offer synergies with our existing portfolio companies, the restructuring of existing portfolio companies and exits through either sales to strategic investors or through the public equity markets. We seek to establish partnerships with leading local and international companies in order to maximise the value of our portfolio companies.

The primary KPI that we use in assessing our investments is TSR. We compare this metric against internal hurdle rates for specific industries and investment types when making new investments or evaluating portfolio company performance. Depending on the particular asset, we target a TSR of at least 12% for our Core Assets and at least 15% for our Developing Assets. We and the senior management of our portfolio companies also monitor a number of other KPIs, including return on invested capital and certain operational metrics. The remuneration of our senior management and the management of our portfolio companies is linked to performance of these KPIs, particularly the TSR.

We seek to manage our portfolio companies primarily through board representation, with operational decisions taken by the management teams of each portfolio company. In certain circumstances, we may also assist our

portfolio companies, in particular Developing Assets, in relation to overall strategy, partnerships, risk management, corporate governance and internal controls, third party financing, management selection and identifying and implementing synergies with other portfolio companies.

Strengths

We have a number of key competitive strengths, which we believe have enabled us to become one of the largest publicly-traded diversified companies in the Russian Federation and the CIS in terms of market capitalisation and to provide a strong foundation for the implementation of our strategy.

- *Strong management track record in successfully developing our portfolio companies*

Our management has a proven ability to successfully develop companies from an early-growth stage to maturity, including MTS, which we developed from an early-stage business in 1996 to a company with over one hundred million subscribers in five countries through organic growth, acquisitions and restructurings of independent mobile service providers in the Russian Federation and leading telecommunications providers in CIS; and ROSNO, which we developed in partnership with Allianz into one of the leading insurance companies in the Russian Federation leveraging Allianz's technical know-how, risk management expertise, planning and controlling procedures. Allianz subsequently purchased our stake in ROSNO.

In addition, our management has significant experience in creating value through corporate restructurings. In previous years, our management has successfully restructured a diverse range of telecommunications assets, including the combination of MTS, Comstar and MGTS into one holding, MTS, thereby creating a leading integrated telecommunications company in the Russian Federation and the CIS. Currently, our management is overseeing the reorganisation of Bashneft and its various subsidiaries into a transparent, streamlined and vertically-integrated oil company.

- *Significant experience with identifying acquisitions, joint ventures and exits*

Since our creation in 1993, our management has accumulated significant experience in identifying acquisitions and executing M&A transactions, including acquisitions, divestitures and joint ventures. We monitor opportunities to create value by targeting investments, which are complementary to our existing portfolio. Having identified profitable investment opportunities with high returns, our management completed several M&A transactions in recent years. For example, we have successfully executed the acquisition of Bashneft in 2009 and a noncontrolling 49% stake in RussNeft in 2010 and have successfully created joint ventures, such as the venture between Thomas Cook and Intourist, and the Bashneft-LUKOIL joint venture for the development of the Trebs and Titov oil fields. The acquisition of Bashneft, in particular, demonstrates our management's ability to identify and execute attractive M&A opportunities, with Bashneft's stock having risen by over 900% since the time of the deal.

Furthermore, we have been able to crystallise gains on our investments through timely exits, including the sale of a controlling stake and later of our remaining position in ROSNO to Allianz.

- *Expertise in a wide range of sectors*

We have many years of experience in a wide range of the Russian Federation's most important and attractive sectors, including the telecommunications, oil, consumer and high tech sectors. We leverage this experience in evaluating potential investments and developing strategies for our portfolio companies. In addition, our management's industry expertise is instrumental in identifying opportunities for synergies between our existing portfolio companies as well as between our existing portfolio companies and potential acquisition targets. As an illustration of such activities, MTS Bank was rebranded in 2012 from MBRD (Moscow Bank for Reconstruction and Development) in order to facilitate the cross-selling of our telecommunications and banking products. MTS Bank markets itself under the MTS brand and leverages MTS' client database to promote its financial services.

- *Established and transparent public profile*

As a Russian company listed on the London Stock Exchange, we are subject to strong corporate governance and public disclosure standards.

We also have a well-established presence on the capital markets, having issued our first international Eurobond in 2004 and gone public in 2005. In addition, a number of our portfolio companies have publicly issued equity or

debt instruments, including MTS OJSC, which is listed on the New York Stock Exchange. As a result, we have a strong understanding of capital markets and are well-known to investors, which, in turn, facilitate our access to capital and increase our options with regard to financing and to potential exits.

Our public profile and our transparency are critical factors in our ability to attract industry-leading international and local partners as investors in our portfolio companies. Investments by Deutsche Telekom in MTS, Allianz in ROSNO and Thomas Cook in Intourist underscore that major international companies seek to partner with us.

- *Sound financial management*

We have historically adhered to a conservative financial strategy with respect to both our existing portfolio assets and potential new investments. Similarly, we target any newly-acquired companies to be able to cover their own financing costs within five to seven years after our acquisition of them. Furthermore, while cross-guarantees are given within Sistema, we guarantee subsidiary debt only in early-stage development situations. We maintain a low debt to OIBDA ratio, which reduces exposure to the potential negative performance of one of our portfolio companies or the macroeconomic environment as a whole. Low leverage also allows us to make timely investments and access the debt markets (both bank and public). See “*Risk Factors*” and “*Management’s Discussion and Analysis of Financial Condition and Results of Operations*.”

Strategy

Our strategic goal is to ensure sustained growth in the shareholder value of our business. We intend to achieve this goal by increasing the level of return on capital invested in our current assets and by reinvesting a larger portion of our non-committed cash in new investment projects with high returns.

The key elements of our strategy are:

- *Develop a balanced and diversified asset portfolio*

We aim to maintain a balanced portfolio, consisting of mature, dividend generative Core Assets and relatively smaller Developing Assets with high potential for growth. For the foreseeable future, we expect that the Core Assets will continue to generate the substantial majority of our revenues. We view our Core Assets as long-term investments, except in relation to the reorganisation of Bashkirenergo, and do not currently intend to sell them or reduce our stake below control, provided they continue to perform to our expectations. The stable dividend streams generated by the Core Assets can be used to finance investments in high growth Developing Assets and new acquisitions.

Additionally, we seek to diversify our portfolio across a wide range of sectors in order to reduce risk and volatility. In particular, we have established a target portfolio through 2015 that sets out the investments we intend to make by region and sector in the Russian Federation and we regularly evaluate and revise the target portfolio as necessary to adapt to economic and market conditions.

Furthermore, we may, in the future, diversify the geographic presence of our portfolio companies outside the Russian Federation, where we believe it is complementary to our existing businesses and an adequate level of return can be achieved.

- *Focus on sectors and geographies where we have a competitive advantage*

We have a long history of investing in the Russian Federation and the CIS and across a range of industry sectors. We intend to invest in regions and sectors where we either have an existing presence or which are complementary to our existing businesses.

We have identified the following sectors as potentially attractive areas for future investments, in addition to those where we are already present: agriculture, fertilisers, infrastructure, transportation and logistics as well as chemicals and petrochemicals. Moreover, certain of our portfolio companies are considering international expansion complementary to their existing businesses.

In all cases, potential investments will be evaluated in light of our returns criteria, including TSR.

- *Pursue an active portfolio management approach*

We seek to actively manage our portfolio of investments by making value-accretive acquisitions and disposals where such decisions lead to the maximisation of returns. When considering an investment, we target a TSR above our internal hurdle rates for the applicable industry.

- *Attract leading international and local companies as partners in portfolio companies*

We will continue to seek to create partnerships with leading international and local companies as joint investors in our portfolio companies, which will allow us to benefit from the industry expertise and international best practices of our partners. We believe that such partnerships will also help us diversify our portfolio and free up capital for new investments.

Business Description—Core Assets

OVERVIEW

The Core Assets consist of our holdings in MTS, Bashneft and Bashkirenergo. Each of these companies is a leader in its respective industry and provides us with stable cash flows in the form of dividends. These companies are able to service their liabilities independently and their operations and business development are managed fully by their respective management teams. We are the majority shareholder in each of our Core Assets.

MTS

Overview

MTS is a leading telecommunications provider in the Russian Federation and the CIS, offering a wide range of mobile and fixed line voice and data communications services, including transmission, broadband, pay-TV and various value-added services, as well as selling equipment and accessories. MTS is the largest mobile operator in the Russian Federation, Uzbekistan and Armenia and the second largest in Ukraine in terms of mobile subscribers. As at 31 December 2011, MTS had a mobile subscriber base of approximately 101.1 million (approximately 70.0 million in the Russian Federation, 19.2 million in Ukraine, 9.3 million in Uzbekistan and 2.4 million in Armenia), which is a decrease of 2.4% compared to 31 December 2010. MTS is also one of the largest operators in the Moscow residential broadband market in terms of subscribers, with a 28.5% market share as at 31 December 2011, according to Direct INFO. MTS' revenues for the year ended 31 December 2011 were U.S.\$12,319 million, an increase of 9.1% from the year ended 31 December 2010. MTS' net income for the year ended 31 December 2011 was U.S.\$1,568 million, an increase of 1.2% from the year ended 31 December 2010.

We own 52.8% of MTS (excluding treasury shares). In 2009, 2010 and 2011, MTS accounted for 54.4%, 42.1% and 37.4%, respectively, of our total revenues. In 2012, MTS' capital expenditures are estimated to be U.S.\$2,494.5 million, all of which are expected to be financed from internally generated cash flow. Capital expenditure budgets are confirmed on an annual basis based upon both MTS' cash requirements and dividend policy.

The Russian Federation is MTS' principal market, both in terms of subscribers and revenues. For the years ended 31 December 2009, 2010 and 2011, approximately 81%, 83% and 86%, respectively, of MTS' revenues came from operations in the Russian Federation; approximately 11%, 9% and 9%, respectively, of MTS' revenues came from operations in Ukraine; and approximately 8%, 8% and 5%, respectively, of MTS' revenues came from operations in its other countries.

The table below sets forth MTS' total mobile subscribers as at the end of the last five years:

<u>Period</u>	<u>Subscribers⁽¹⁾</u> <u>(in millions)</u>
2007	82.0
2008	91.3
2009	97.8
2010	103.3
2011	101.1 ⁽²⁾

- (1) Excludes Mobile Telesystems LLC (“**MTS Belarus**”) subscribers. MTS defines a subscriber as an individual or organisation whose account shows chargeable activity within 61 days (or 183 days in the case of MTS' prepaid brand tariffs) or whose account does not have a negative balance for more than this period.
- (2) Excludes Turkmenistan subscribers.

According to MTS' estimates, mobile cellular penetration (the number of active mobile phone numbers as a percentage of a given population) in the Russian Federation and Ukraine was 156.8% and 117.6%, respectively, as at 31 December 2011, which represented an increase from 151% and a decrease from 118.1%, respectively, compared with year-end 2010. According to MTS' estimates, mobile cellular penetration in Uzbekistan and Armenia was approximately 82.2% and 116.4%, respectively, as at 31 December 2011, compared to approximately 73.3% and 115.5%, respectively, as at 31 December 2010.

As at 31 December 2011, MTS had licences for commercial mobile operations in the entire territory of the Russian Federation, with a population of approximately 143 million people; in the entire territory of Ukraine, with a population of approximately 46 million people; in the entire territory of Uzbekistan, with a population of approximately 27 million people; and in the entire territory of Armenia, with a population of approximately 3 million people. In Turkmenistan, MTS' operating licence was suspended on 21 December 2010, and we ceased providing mobile telecommunications services in that country since that date. See "*—Material Litigation—MTS—BCTI*" for a discussion of the recent suspension of MTS' primary operating licence in Turkmenistan. MTS Belarus had approximately 4.9 million subscribers and a leading market share of 43% as at 31 December 2011 and approximately 4.7 million subscribers and a leading market share of 45.1%, according to MTS' estimates. Belarus, a country with a population of approximately 9.5 million, had a mobile cellular penetration rate of approximately 121% as at 31 December 2011. Belarus entered hyperinflation in 2011.

In 2009, 2010 and 2011, MTS significantly expanded its operations in an effort to meet the challenges of MTS' evolving markets and further the goals of its new "3i" strategy. Through MTS' acquisition of a controlling stake in Comstar in October 2009, MTS has become a leading integrated fixed line services provider in the Russian Federation. MTS also continued to aggressively develop its proprietary sales and distribution network both organically and through the acquisition of national and regional retail chains. MTS additionally focused on the development of online platforms and content, launching Omlet.ru in September 2009. Omlet.ru is an online and mobile content portal offering a large selection of videos, music and games for sale and a high degree of interoperability between mobile devices and computers as well as network flexibility (e.g. EDGE and 3G). In 2011, MTS also launched the 3G network in the 900MHz range in the Moscow metropolitan area. In 2011, MTS received the first licence in the Russian Federation to provide wireless communication services in the LTE time-division duplexing ("**TDD**") standard in the 2595-2620 MHz range in the Moscow metropolitan area.

To maintain and increase its market share and brand awareness, MTS uses a combination of print media, radio, television, direct mail and outdoor advertising, focusing on brand and image advertising, as well as promotion of particular tariff plans.

History and Development

Mobile TeleSystems CJSC ("**MTS CJSC**"), MTS OJSC' predecessor, was formed in 1993. The founding shareholders included MGTS and three other Russian telecommunications companies, which collectively held 53% of the original share capital, and two German companies, Siemens AG and T-Mobile Deutschland GmbH, an affiliate of Deutsche Telekom AG, which collectively held the remaining 47%. In late 1996, we acquired a majority stake in MTS OJSC and have remained the majority shareholder ever since. We currently own 52.8% of MTS OJSC share capital (excluding treasury shares).

MTS CJSC inaugurated service in the Moscow licence area in 1994 and began expanding into nearby regions in 1997. Since that time, MTS has continued to grow by applying for GSM licences in new regions, investing in new GSM licensees, increasing its ownership percentage in these licensees and acquiring existing GSM licence holders and operators in the Russian Federation and the CIS. MTS expanded into the fixed line communications market in 2009 with the acquisition of Comstar from Sistema JSFC.

MTS OJSC was created on 1 March 2000, through the merger of MTS CJSC and RTC CJSC, a wholly-owned subsidiary of MTS CJSC. MTS OJSC completed its IPO on 6 July 2000, and listed its shares of common stock, represented by ADSs, on the New York Stock Exchange, or NYSE, under the symbol "MBT." In April 2003 and December 2004, T-Mobile completed offerings of approximately 5.0% and 15.1%, respectively, of MTS OJSC's shares in the form of GDRs through an unsponsored GDR programme. In September 2005, T-Mobile sold its remaining 10.1% stake in MTS OJSC on the open market.

Since 2002, MTS has operated a joint venture in Belarus, MTS Belarus, in which MTS holds a 49% stake and the Belarusian state-owned monopoly Beltelekom owns a 51% stake. In 2003, MTS expanded into Ukraine and since 2007 has been operating there under the MTS brand. In August 2004, MTS acquired a 74% stake in Uzdurobta,

the largest wireless operator in Uzbekistan. MTS consolidated its ownership of Uzdurobita in 2007 when it acquired the remaining 26% stake. MTS has operated under the MTS brand in Uzbekistan since May 2006. In 2005, MTS acquired Barash Communication Technologies, Inc. (“**BCTI**”), the leading wireless operator in Turkmenistan, and between October 2006 and December 2010, operated under the MTS brand in Turkmenistan. On 21 December 2010, the Ministry of Communication of Turkmenistan suspended MTS’ primary operating licence, and MTS has since ceased providing mobile telecommunications services in Turkmenistan since that time. See “—*Material Litigation—MTS—BCTI*.” In 2007, MTS entered the Armenian market, acquiring an 80% stake in International Cell Holding Ltd., a 100% indirect owner of K-Telecom CJSC (“**K-Telecom**” or “**VivaCell-MTS**”), the leading wireless operator in Armenia. K-Telecom operates in the GSM-900/1800 standard, covering the entire territory of Armenia. It historically operated under the VivaCell brand, and was re-branded as VivaCell-MTS in September 2008.

In October 2009, MTS acquired a 50.9% stake in Comstar, a leading fixed line operator in the Russian Federation, from us, and subsequently increased its ownership interest to 62.0% in December 2009 and to 71.0% in September 2010 through a voluntary tender offer. On 23 December 2010, the extraordinary general meetings of shareholders of Comstar and MTS OJSC approved a merger of Comstar and MTS, which was completed on 1 April 2011. As a result, Comstar ceased to exist as a separate legal entity, and MTS became the legal successor of Comstar in respect of all its rights and obligations.

Prior to 1 April 2011, Comstar operated in both the alternative and traditional fixed line communications markets. After 1 April 2011, MTS continued, and still continues to provide these services. Among MTS’ subsidiaries is MGTS, Moscow’s incumbent fixed line operator with “last mile” access (the final leg of delivering connectivity from a communications provider to a customer) to approximately 96% of the households in Moscow. In 2011, MTS completed the re-branding of Comstar with its main MTS brand and MTS is gradually completing this process in major Russian cities.

Strategy

MTS’ primary strategic goal is to be the leading communications operator in the territories where it is present, providing its customers with mobile and fixed telephony, high-speed Internet access at home and on the move, cable TV and the widest choice of licensed content on the market. MTS strives to maintain and strengthen its market position by investing in network and product development, new technologies and customer service.

From October 2009, MTS has adopted a new “3i” strategy, which MTS believes represents a logical development of its strategic principles. Consistent with this new strategy, MTS moved beyond simple mobile access, both horizontally and vertically, through its acquisition of Comstar, the rapid build-out of MTS’ proprietary distribution network and the launch of its first online content platform, Omlet.ru. MTS’ development beyond mobile access is the intrinsic part of MTS’ new “3i” strategy, which is focused on the following key directions:

- **Integration:** developing new pipelines and customer touch points. MTS aims to provide a comprehensive integrated service portfolio for all of its customers’ communication needs, through both fixed line and wireless access. Through the networks and platforms MTS develops, it will seek to create a seamless and unsurpassed user experience.
- **Internet:** offering universal connectivity. MTS’ customers increasingly expect faster and broader connectivity as more devices and services depend on integrated mobile and fixed networks. MTS’ goal is to create smarter pipelines so customers can realise the full benefits of today’s technologies, while creating additional value for MTS. Through so-called “smart pipes,” MTS will strive to offer best-in-class content applications and market-leading services, enabling transactions and bringing it closer to its customers.
- **Innovation:** differentiating itself from MTS’ competitors by offering a unique mix of products and services. MTS will offer exclusive devices, distinct packages of services catering to all customer segments and a market-leading end-to-end user experience at home, work and on the move.

MTS may also continue to expand its footprint as attractive opportunities arise. In July 2010, MTS acquired Multiregion, a cable operator, thus strengthening its position in the rapidly expanding market of broadband Internet access and cable TV. The transaction is in line with the “3i” strategy of MTS as it broadens its portfolio of integrated services and improves the company’s competitive position.

Current Operations

MTS is a provider of mobile cellular communications services in the Russian Federation, Ukraine, Uzbekistan, Belarus and Armenia. MTS describes its mobile and fixed line business operations below.

MTS Subsidiaries

The table below sets forth MTS' significant subsidiaries, their places of incorporation and MTS' ownership interests therein as at 31 December 2011.

<u>MTS Subsidiary</u>	<u>Ownership Interest</u>	<u>Place of Incorporation/ Organisation</u>
Sibintertelecom CJSC	100.0%	The Russian Federation
Russian Telephone Company CJSC (“ RTC ”)	100.0%	The Russian Federation
Comstar Regions CJSC (“ Comstar-Regions ”)	100.0%	The Russian Federation
Sistema Telecom	100.0%	The Russian Federation
Infocentr	100.0%	The Russian Federation
Inteleca Group	100.0%	The Russian Federation
Altair	100.0%	The Russian Federation
TVT	100.0%	The Russian Federation
TS-Retail OJSC	100.0%	The Russian Federation
Metro-Telecom CJSC	95.0%	The Russian Federation
MGTS	94.1%	The Russian Federation
MTS Ukraine	100.0%	Ukraine
MTS Finance S.A. ⁽¹⁾	100.0%	Luxembourg
Uzdunrobita (“ MTS-Uzbekistan ”)	100.0%	Uzbekistan
BCTI	100.0%	USA
MTS Bermuda Ltd ⁽²⁾	100.0%	Bermuda
MTS International Funding Limited ⁽³⁾	VIE	Ireland
K-Telecom	80.0%	Armenia
MTS Belarus	49.0%	Belarus
IntellectTelecom	47.0%	The Russian Federation

(1) Represents beneficial ownership interest.

(2) A wholly owned subsidiary established to repurchase MTS OJSC's ADSs.

(3) A private limited company organised and existing under the laws of Ireland for the sole purpose of financing a loan to MTS OJSC. The company is a variable interest entity (“**VIE**”) of the MTS.

Mobile Operations

Services Offered

Network Access

MTS primarily offers mobile cellular voice and data communication services to its subscribers on the basis of various tariff plans designed for different market segments. In general, most of MTS' tariff plans combine per minute usage charges, value-added services and, in some cases, monthly network access fees.

Automatic Roaming

Roaming allows MTS' customers, both subscribers and guest roamers, to receive and make international, local and long-distance calls while travelling outside of their home network. Roaming is provided through individual agreements between MTS and other GSM operators. Unlike many non-GSM providers that require additional equipment or prior notification, MTS' roaming service is instantaneous, automatic and requires no additional equipment.

As at 31 December 2011, MTS had bilateral roaming contracts with 711 wireless operators in 228 countries, including with regional operators in the Russian Federation. MTS continually seeks to expand its roaming capability and is currently in negotiations with additional operators. In the Russian Federation, as at 31 December 2011, in addition to MTS' network coverage area in 82 of the 83 regions of the Russian Federation, GSM service was available to MTS subscribers in the Penza region of the Russian Federation where MTS operated through its roaming agreements with 11 regional operators. On 19 April 2011, MTS won a public tender held by the State

Radio Frequencies Commission and obtained radio frequencies that allow MTS to provide GSM services in the Penza region, where MTS did not previously have a GSM licence. MTS plans to start the construction of a GSM network in the Penza region in 2012. As a result, MTS is now able to expand its GSM network coverage throughout the entire territory of the Russian Federation.

Value-Added Services

MTS offers various value-added services to its customers. These services may be included in the tariff plan selected by the subscriber or subscribers may pay additional monthly charges and, in some cases, usage charges. Some basic value-added services that MTS offers include: call divert/forwarding, wi-fi, caller ID display and anti-caller ID display, e-shop, SMS, voicemail, mobile TV, missed call alerts, WEB and WAP portal, etc. MTS also provides many voice and SMS-based value-added services in cooperation with various content providers.

GPRS and Internet Access

MTS offers General Packet Radio Service (“GPRS”) services, enabling its subscribers to access the Internet, WAP and MMS in all of the countries where MTS operates. MTS also provides international GPRS roaming to its subscribers, enabling them to use various GPRS-based services while travelling abroad.

In 2005, MTS launched EDGE services in the Moscow metropolitan area. Further, MTS extended its data transmission network to expand EDGE services to cover the most developed markets where MTS operates. EDGE is a high-speed, high-quality data transfer technology capable of transmitting streamline video and TV programs onto mobile phones. At present, EDGE services are available to MTS’ subscribers in the Russian Federation, Ukraine, Armenia, Uzbekistan and Belarus. Prior to the suspension of BCTI’s primary operating licence on 21 December 2010, MTS also provided its subscribers in Turkmenistan with EDGE services.

MTS also offers the “MTS-Connect” service, which allows its subscribers to get mobile Internet access through a GPRS/EDGE/3G/High Speed Downlink Packet Access (“HSDPA”)/High Speed Packet Access (“HSPA”) connection, using a computer, PC-card and USB-modem. This service is available to MTS’ subscribers in the Russian Federation and Ukraine and in more than 181 countries where MTS has GPRS roaming.

MTS was the first mobile operator to offer Blackberry services in the CIS after signing an agreement with Research In Motion in September 2005 to offer BlackBerry services to its subscribers. Following its receipt of the required regulatory approvals, MTS began providing BlackBerry services to corporate users in Ukraine in October 2007 and to corporate users in the Russian Federation in June 2008. In addition to corporate users, MTS also provides BlackBerry services to individual subscribers in Ukraine and in the Moscow metropolitan area in the Russian Federation. In May 2009, MTS launched Blackberry Internet Service in the Moscow metropolitan area, and in October 2009, MTS launched commercial operations of BlackBerry Enterprise Server (BES) and BlackBerry Internet Service (BIS) in 39 regions of the Russian Federation, and expanded such services to 81 regions by the end of 2011.

3G Technology

The key benefit of a 3G network, based on R99/HSDPA/HSPA technologies using UMTS technology, is the ability to provide subscribers with faster data download and upload speeds with top download capacity using HSPA technology up to 21 Mbit per second in the Russian Federation and Armenia. This is over 50 times faster than the currently available 2G EDGE technology.

In April 2007, MTS was one of three companies, along with Vimpelcom and MegaFon, who received a nationwide 3G/UMTS licence in the Russian Federation. The licence is valid through 2017 and covers the entire territory of the Russian Federation. The conditions set forth in the tender documentation required MTS, Vimpelcom and MegaFon to begin undertaking the construction of a 3G network over a period of two years from the time the licence was received. MTS currently has commercial 3G networks launched in all regions of the Russian Federation.

In May 2009, MTS, along with Vimpelcom and MegaFon, was allocated 3G/UMTS frequencies to begin testing its 3G network in the Moscow metropolitan area. As at 31 December 2011, MTS’ 3G indoor network operates in 96 trade and business centres in Moscow and in various metro stations. MTS also provides 3G services to large companies within Moscow.

In December 2009, MTS obtained a permit to install 783 base stations in the UMTS standard in Moscow and commercially launched its 3G network in Moscow. MTS' 3G network uses 1950-1965 MHz, 2015-2020 MHz and 2140-2155 MHz frequencies and complements its existing GSM network. By the end of 2011, MTS had installed 21,670 3G base stations throughout the Russian Federation. In order to expand its coverage in the Moscow region's countryside, MTS launched a 3G network in the 900 MHz frequency band.

In 2010, MTS began to implement an upgraded version of the HSPA technology known as HSPA+. This technology allows the MTS to provide its subscribers with faster data transmission speeds. MTS has launched HSPA+ technology in Moscow which supports 42 Mbit per second data transmission speed.

In 2011, MTS began to develop a 3G femtocell network. Femtocells are small low-power wireless base stations in the licensed 2100 MHz spectrum. They connect to a mobile operator's network using residential DSL or cable broadband connections and can support multiple standard mobile devices. Femtocells deliver a strong signal and high-quality voice service to standard mobile devices in homes, small and large offices, outdoor public spaces, metro hotspots and rural areas. They allow for strong signal performance even in areas where MTS cellular coverage is limited or unavailable. A femtocell network also provides for high speed of data upload and download. In 2011, MTS installed 66 femtocells in Moscow and 60 femtocells in Saint Petersburg.

In July 2006, MTS Ukraine was licensed to provide telecommunications services using CDMA 450 technology. CDMA 450 is a 3G telecommunication standard ratified by the International Telecommunication Union. MTS commenced commercial services using CDMA 450 technology in Ukraine in November 2007 and currently offers high-speed mobile Internet access to its subscribers.

During April 2007, the Communications and Information Agency of Uzbekistan allocated a 3G/UMTS licence to MTS covering Uzbekistan. The licence is valid through 2016 and covers the entire territory of the country. In December 2008, MTS commercially launched its 3G network in Uzbekistan, and, in 2011, MTS completed its 3G network expansion into all regional centres of Uzbekistan. MTS also plans to further develop its 3G network in Uzbekistan in 2012.

In January 2010, the Communications and Information Agency of Uzbekistan granted MTS an LTE licence covering Uzbekistan. In July 2010, MTS started to construct a 4G network based on the LTE technology in Uzbekistan. Currently, the 4G network is accessible only in the central part of Tashkent; however, MTS plans to expand it in the future to cover all of Uzbekistan.

In Armenia, MTS' subsidiary K-Telecom is licensed to offer 3G services in the UMTS standard throughout Armenia pursuant to its wireless services licence. In October 2007, K-Telecom was allocated frequencies to offer 3G services throughout the entire territory of Armenia. The frequencies were allocated for a 10-year period. In 2009, MTS commercially launched its 3G network in Armenia. In 2010, MTS further expanded its 3G network to cover all towns and villages with a population of more than 2,000 people, and, as a result, the 3G outdoor coverage currently covers more than 91% of inhabited areas. In 2011, K-Telecom started to provide telecommunications services based on HSPA+ technology in Yerevan, Gyumri and Vanadzor. MTS plans to extend HSPA+ technology to all regions of the country. In Yerevan, capital of Armenia, in December 2010, MTS commenced a commercial test of the first 4G/LTE network. MTS plans to start providing LTE services in Gyumri and Vanadzor in 2012.

Other Services

In addition to cellular communication services, MTS offers corporate clients a number of telecommunications services such as design, construction and installation of local voice and data networks capable of interconnecting with fixed line operators, installation and maintenance of cellular payphones, lease of digital communication channels, access to open computer databases and data networks, including the Internet, and provision of fixed, local and long-distance telecommunications services, as well as video conferencing.

Strategic Partnership with Vodafone

In October 2008, MTS announced a strategic partnership agreement with Vodafone aimed at drawing on Vodafone's expertise in building and developing 3G networks and mobile broadband products, cooperating with leading global equipment providers and deploying innovative client relationship management ("CRM") practices to enhance quality and further improve the efficiency of MTS' operations. In addition, the agreement allows MTS exclusive access to a range of products, services and devices from Vodafone for its markets of operation in the Russian Federation, Ukraine, Uzbekistan and Armenia.

Other Mobile products

Handsets

Nearly all of MTS' handset sales in 2009 consisted of dual-band GSM 900/GSM 1800 handsets. These dual-band handsets are currently in widespread use on networks in Western Europe and, because they send and receive communications on both GSM 900 and GSM 1800 frequencies, they can relieve possible congestion on MTS' network and increase the ability of its customers to roam.

In 2010 and 2011, nearly all of MTS' handset sales consisted of tri-band GSM 900/1800/1900 and dual-band UMTS 900/2100 handsets, except for certain models in the low cost segment and touch-phones. These handsets, which function in the GSM 900, GSM 1800 and PCS-1900 standards, provide users with greater automatic roaming possibilities in the Russian Federation, Europe, the United States and Canada. MTS generally does not offer handset subsidies in the Russian Federation but does offer them in Ukraine to a limited number of contract subscribers as well as modem subsidies for GSM and CDMA users. For the years ended 31 December 2009, 2010 and 2011, MTS provided net handset subsidies of U.S.\$15.6 million, U.S.\$12.8 million and U.S.\$8.6 million, respectively, in Ukraine.

In August 2008, MTS signed an agreement with Apple Sales International and launched iPhone 3G™ sales in October 2008. Under the agreement, MTS committed to purchasing a certain quantity of iPhone 3G™ headsets over 2009, 2010 and 2011. In 2011, MTS negotiated an extension of the agreement until 2012 and launched iPhone 4s sales in December 2011. In 2012, the agreement was further extended.

In line with its strategy to expand its proprietary distribution network, MTS' handset sales increased by 303% in 2010 and by 25.6% in 2011, and MTS expects moderate growth in 2012.

Sales and Marketing

Target Customers

MTS' target customers historically included companies, professionals, high-income individuals, reporters, government organisations, businesspersons and diplomats. However, with mobile cellular penetration in these segments becoming saturated, MTS began to more aggressively promote its mobile cellular services to a much wider and diverse population. Over time, as customer demands have developed, MTS has adjusted its service model to provide differentiated levels of service to meet the needs of distinctive customer segments. Today, MTS is considered a mass-market mobile network operator with a wide range of subscribers in all customer segments. As part of MTS' business, MTS provides a wide range of products and services to these customer segments.

To promote subscriber loyalty, MTS offers discounts with respect to its tariff plans for customers willing to enter into extended contracts with MTS. This strategy also helps to mitigate churn rates among MTS' subscribers in a highly competitive market.

Advertising and Marketing

MTS' advertising and public relations initiatives include:

- brand and image advertising to position MTS as the leading mobile cellular operator in the Russian Federation, Ukraine, Belarus, Uzbekistan and Armenia;
- information advertising and promotion to inform potential customers of the advantages of the high quality and variety of MTS' services and the extensive coverage MTS offers; and
- product- and tariff-related advertising and promotion for specific marketing campaigns, new tariff plans for various target audiences and pricing discounts.

MTS uses a combination of newspaper, magazine, radio, television and outdoor advertising, including billboards and signs on buses and kiosks, and exhibitions to build brand awareness and stimulate demand. As MTS has expanded its network, MTS has concentrated a greater part of its advertising and marketing effort on international and cross market offers with other companies, positioning the MTS brand as a truly national brand.

In 2010 and 2011, MTS made enhancements to the MTS Bonus loyalty program, including better opportunities for participants both in terms of points accumulation and points exchange. The MTS Bonus loyalty program is aimed at retaining subscribers within the MTS network and stimulating their further use of MTS' mobile

services. It is also designed to enhance brand loyalty and create overall positive brand perception. In April 2010, MTS signed an agreement with Sberbank, one of the leading Russian banks, to launch co-branded credit cards. The holders of such credit cards receive MTS Bonus programme points when they make payments using the credit card. The bonus points can be used to pay for MTS' services, make purchases in MTS-branded stores and pay for other goods and services with a co-branded MTS credit card. In 2011, MTS took several steps to increase its subscribers' loyalty with successful enhancements to the MTS Bonus loyalty programme, such as the launch of the advertising campaign "Which MTS Bonus prize is yours?" and the creation of the financial product "MTS Dengi." The main purpose of the advertising campaign was to inform the customers that they can obtain various gifts in exchange for accumulated bonus points. MTS also promoted the use of the "MTS Dengi" credit card, as it allows customers to receive more bonus points.

Renewed Brand

In December 2008, MTS reached an agreement with SSTL allowing SSTL to use the MTS brand in India. Under the terms of the agreement, SSTL has had the right to use the MTS brand in India starting in March 2009, while MTS started receiving royalties of 0.16% of SSTL's revenues in April 2009. The agreement is limited to SSTL using the MTS brand in India and does not contemplate MTS' participation in SSTL's operations. The terms also stipulate that MTS will act as the brand guardian to ensure brand usage and marketing communications adhere to MTS' brand guidelines. The term of agreement expires on 31 December 2012.

On 1 October 2010, MTS announced the launch of a refreshed logo which MTS believes better emphasises the ideas of innovation and dynamism reflected in MTS' recently introduced new slogan "a step ahead." Its logo and brand style refreshment are among the goals of MTS' new brand positioning. The refreshed logo retains the same egg shape, but transforms the former logo into a 3D image of a white egg against a red background, which gives the logo a more dynamic and modern look and perception. This new logo is aimed at graphically enhancing and modernising the egg-shaped logo MTS has been using since 2006. In addition, MTS believes that the new logo better symbolises MTS' dynamic and innovative approach to doing business and MTS' stated mission of "creating the best client experience," and MTS' slogan "a step ahead."

In December 2010, MTS acquired Sistema Telecom from us, which gave it control over the universal brand featuring the egg-shaped symbol against backgrounds of various colours used by MTS and its affiliates operating in the telecommunications sphere.

In furtherance of MTS' effort to integrate Comstar within MTS, develop and offer integrated communications services and create a unified platform for subscribers, MTS completed the process of re-branding Comstar with its main MTS brand. Specifically, MTS carries out advertising campaigns aimed at promoting each of its mobile network, fixed TV and Internet broadband services under the MTS brand name across all media channels.

In February 2012, MBRD, our subsidiary, announced that it was to be renamed MTS Bank having taken the MTS brand owned by MTS as a basis for further development.

Global recognition

In May 2011, MTS was ranked 80 in the BRANDZ™ Top 100 Most Powerful Brands, an independent ranking published by the Financial Times and Millward Brown, a leading global market research and consulting firm. MTS was the first Russian company to join the ranks of the most powerful brands in the world in 2008 and remains the highest-ranked brand in the Russian Federation. In December 2010, MTS was named the Best Russian Brand 2010, according to Interbrand, an international brand consulting agency. In June 2010, MTS was recognised as the winner of the V International Competition "The Best Risk Management in the Russian Federation and CIS—2010" organised by the Russian Risk Management Society. At the 4th CIS-EU Legal Forum: Eurolawyer 2011, MTS was awarded The CIS Legal Department of the Year: Best Work in Obtaining Financing on Capital Markets. The award recognises the contribution of the company's legal department in securing financing on the capital markets through credit agreements and issuance of bonds in 2010.

Sales and Distribution

MTS has historically enrolled a vast majority of its subscribers through a network of independent dealers that operate numerous points-of-sale in places with high consumer activity, such as supermarkets, shopping centres, air terminals and markets. However, according to press reports, the financial downturn and tightening of the

credit markets resulted in many large national and regional mobile handset retailers in the Russian Federation facing liquidity issues. In addition, as at 1 April 2009, MTS ceased working with Euroset, the largest mobile handset retailer in the Russian Federation, following Vimpelcom's indirect acquisition of a 49.9% stake. As a result of these factors, the share of MTS' subscribers enrolled through these retailers dropped dramatically during the last quarter of 2008 and continued to drop in 2009. In the second half of 2010, MTS focused on improving its cooperation with certain of the large national and regional mobile handset retailers such as AltTelekom. In addition, MTS restored its cooperation and resumed working with Euroset in November 2010. MTS intends to continue developing a diversified range of distribution channels by entering into cooperation agreements with major national retailers of electronics and household appliances.

In 2009, MTS changed the structure of its retail operations by significantly expanding its proprietary sales and distribution network both organically and through the acquisition of several national and regional retail chains. Over the course of 2009, MTS acquired 100% of handset retailer Telefon.Ru, which at the date of acquisition operated 512 stores in 180 cities in the Russian Federation; 100% of the Eldorado handset retail chain, which operated 383 stores in 153 cities in the Russian Federation; and 100% of handset retailer Teleforum, which operated 180 stores in St. Petersburg and several other regions of the Russian Federation.

In addition, MTS organised its retail operations under a wholly owned subsidiary, RTC. RTC handles all functions relating to MTS' retail operations, including the management of points-of-sale, the purchase and sale of handsets and accessories and subscriber enrolment at MTS' retail outlets. It also endeavours to secure optimal locations for MTS' points-of-sale and monitors the effectiveness of their operations. In 2011, MTS continued to implement its strategy in retail operations by significantly expanding its proprietary sales and distribution network organically. The number of MTS' retail outlets (including MTS' partners, operating under the MTS brand), increased by 17% in 2011 compared to 2010.

MTS' proprietary distribution network consists of MTS-branded franchise points-of-sale (third-party dealers operating under the MTS brand) and MTS-branded points-of-sale owned by MTS. As at 31 December 2010, MTS' proprietary distribution network in the Russian Federation consisted of 3,539 points-of-sale, including 1,206 franchise points-of-sale and 2,333 points-of-sale owned by MTS.

In 2011, MTS has focused on the further development of its proprietary network in the Russian Federation. As at 31 December 2011, MTS operated 4,146 points-of-sale, including 1,686 franchise points-of-sale and 2,460 points-of-sale owned by MTS.

Of the retail outlets acquired by MTS, 411 were re-branded as MTS monobrand outlets in 2010, and 308 outlets in 2011.

As a result of MTS' new strategy, the number of subscribers in the Russian Federation who were enrolled directly by MTS increased by 16% during the year ended 31 December 2011 as compared to the year ended 31 December 2010. In 2011, the share of subscribers enrolled through MTS' own distribution network reached 35%.

MTS' proprietary distribution network outside of the Russian Federation as at 31 December 2011 consisted of 41 points-of-sale in Ukraine, 26 points-of-sale in Uzbekistan and 99 points-of-sale in Armenia.

For newly acquired mobile subscribers in the Russian Federation, MTS links commissions payable to a dealer on a monthly basis to the amount of revenues MTS receives during the six-month period from the date a subscriber is activated by such dealer. In addition, MTS has established caps, or a maximum commission amount payable to its dealers. The dealer commissions in the Russian Federation currently range between RUB 100 and RUB 2,800 (U.S.\$3 and U.S.\$87) per subscription. In Ukraine, MTS links dealer commissions to the tariff package sold, category of subscriber, subscriber revenue, the duration of a subscriber being active, city of subscription and status of the specific dealer. MTS has different commission structures based on whether the subscriber is prepaid, postpaid or a CDMA-only subscriber, i.e., subscribers using only mobile Internet services.

MTS believes that its method for paying commissions provides dealers with greater incentives to add new subscribers, reduces the risk of dealer fraud and improves MTS' cash-flow management.

Market and Competition

The Russian wireless telecommunications market

Demand for wireless communications services in the Russian Federation has grown rapidly over the last 10 years due to technological development, rising disposable incomes, increased business activity and declining prices resulting from intensified competition among wireless communications providers. As at 31 December 2011, overall wireless penetration in the Russian Federation was approximately 156.8%, or approximately 227.6 million subscribers, according to AC&M-Consulting.

In Moscow and St. Petersburg, where penetration reached approximately 212.1% and 215.6%, respectively, as at 31 December 2011, according to AC&M-Consulting. The average penetration rate in regional markets reached approximately 146% as at 31 December 2011, according to AC&M-Consulting.

The following table sets forth key data on the Russian Federation's wireless telecommunications market as at the dates indicated:

	As at 31 December				
	2007	2008	2009	2010	2011
	<i>(amounts in millions, except for percentages)</i>				
Subscribers ⁽¹⁾	172.9	187.8	207.9	219.2	227.6
Subscriber penetration	119%	129%	143%	151%	157%

Source: AC&M Consulting.

(1) Based on registered subscribers (SIM cards only). There is no uniform definition of active subscribers in the Russian wireless market, which may result in variances in reported numbers from that which would result from the use of a uniform methodology.

According to AC&M-Consulting, MTS accounted for 38.6% and 36.2% of subscribers in Moscow, 31% and 28.0% of subscribers in St. Petersburg and 32.6% and 30.7% of total Russian subscribers as at 31 December 2010 and 2011, respectively. MTS believes that the decrease in its market share in the Russian Federation, particularly in Moscow, is the result of its effort to restructure its subscriber base to minimise the number of subscribers who have a positive balance but are infrequent users of MTS' mobile services. MTS believes that this restructuring will increase the overall rate of usage and ultimately have a positive influence on average revenue per user in the future.

The primary mobile competitors in the Russian Federation include MTS, MegaFon and Vimpelcom, each of which has national coverage in the Russian Federation. Competition today is based largely on local tariff prices and secondarily on network coverage and quality, the level of customer service provided, roaming and international tariffs and the range of services offered.

The following table sets forth the number of wireless subscribers for each network operator in the Russian Federation as at 31 December 2009, 2010 and 2011:

Operator	As at 31 December		
	2009	2010	2011
	<i>(Amounts in millions)</i>		
MTS	69.3	71.4	70.0
MegaFon	50.2	56.6	61.6
Vimpelcom	50.9	52.0	57.2
Others	37.5	39.3	38.8

Source: AC&M-Consulting.

- *MegaFon.* MegaFon, which operates GSM 900/1800/UMTS (3G) networks, is one of MTS' primary competitors in the Russian Federation, and it is the second largest GSM wireless operator in the Russian Federation in terms of subscribers. The MegaFon group holds GSM 900/1800/UMTS (3G) licences to operate in all 83 regions of the Russian Federation.

According to AC&M-Consulting, MegaFon had a subscriber base of approximately 61.6 million subscribers in the Russian Federation as at 31 December 2011, including 9.4 million subscribers in the Moscow licence area. At 31 December 2011, according to AC&M-Consulting, MegaFon had a 26.1% market share in Moscow, a 34.0% market share in St. Petersburg and a 27.1% market share of total wireless subscribers in the Russian Federation.

- *Vimpelcom*. In addition to MegaFon, MTS also competes with Vimpelcom, which is the third largest GSM 900/1800/UMTS (3G) wireless operator in the Russian Federation in terms of subscribers.

According to AC&M-Consulting, it had a subscriber base of approximately 57.2 million in the Russian Federation at 31 December 2011, including 12.9 million subscribers in the Moscow licence area. At 31 December 2011, according to AC&M-Consulting, Vimpelcom had a 35.7% market share in Moscow, a 20.0% market share in St. Petersburg and a 25.1% market share of total wireless subscribers in the Russian Federation.

- *Other Operators*. In addition to its principal competitors, MegaFon and Vimpelcom, MTS also competes with local GSM operators in several Russian regions.

In certain areas of the Russian Federation, MTS competes with Tele2, which had approximately 20.6 million subscribers as at 31 December 2011. Also, MTS competes with Rostelecom (through its subsidiaries CenterTelecom, SibirTelecom, Dalsvyaz, Uralsvyazinform, Volga Telecom, North-West Telecom, Southern Telecommunications Company and Dagsvyazinform), which had approximately 12.6 million customers as at 31 December 2011.

The Ukrainian wireless telecommunications market

Overall wireless penetration in Ukraine in 2011 increased to 117.6%, or approximately 51 million subscribers, as compared to 113.0% or approximately 48.7 million subscribers, in 2010, according to MTS' estimates.

The following table sets forth the number of subscribers of the top mobile operators in Ukraine as at the dates indicated and the coverage area of MTS Ukraine and MTS' competitors in Ukraine:

<u>Operator</u>	<u>As at 31 December 2009</u>	<u>As at 31 December 2010</u>	<u>As at 31 December 2011</u>
	(amounts in millions)		
Kyivstar	22.0	24.4 ⁽¹⁾	24.8
MTS Ukraine	17.6	18.2 ⁽²⁾	19.5 ⁽²⁾
Astelit	7.8 ⁽³⁾	6.1 ⁽³⁾	7.0 ⁽³⁾
URS (Vimpelcom) ⁽¹⁾	2.0	—	—

(1) In October 2010, Kyivstar and URS each announced that they would be integrating their operating activities in Ukraine. The number of subscribers of Kyivstar has been adjusted to reflect this integration.

(2) Number of GSM subscribers. CDMA customer base reached approximately 0.3 million subscribers as at 31 December 2011.

(3) Number of three-month active subscribers.

Source: Subscriber information based on AC&M-Consulting data and operators' official financial and operational reports.

The two largest wireless telecommunications providers in Ukraine are MTS Ukraine and Kyivstar who share 82.0% of the market, with 36.0% and 46.0%, respectively, as at 31 December 2011, according to AC&M-Consulting. In Ukraine, MTS competes primarily with Kyivstar, a GSM operator with approximately 24.8 million subscribers as at 31 December 2011. Kyivstar offers wireless services using GSM 900/1800 technologies. Kyivstar is also licensed to provide fixed line services by the fibre-to-the-building technology, or FTTB, under the brand "Kyivstar Home Internet." FTTB technology allows provision of services using a fibre-optic cable. Astelit is owned by Turkcell Iletisim Hizmetleri A.S., or Turkcell, and 13.2% of Turkcell is owned by Alfa Group. Astelit offers services in GSM 900/1800 standards under the brand "life:)" brand.

The Uzbekistan wireless telecommunications market

The Uzbekistan wireless telecommunications market is characterised by increasing penetration rates. In 2011, overall wireless penetration in Uzbekistan increased from approximately 73.3% in 2010 to 82.2% in 2011, or by approximately 2.9 million subscribers, according to MTS' estimates and data from the websites of Vimpelcom and TeliaSonera.

The following table sets forth the number of subscribers as at the dates indicated and the coverage area of MTS-Uzbekistan and MTS' competitors in Uzbekistan:

<u>Operator</u>	<u>31 December</u>	<u>31 December</u>	<u>31 December</u>
	<u>2009</u>	<u>2010</u>	<u>2011</u>
	(amounts in millions)		
MTS-Uzbekistan ⁽¹⁾	7.1	8.8	9.3
Unitel (Vimpelcom) ⁽²⁾	3.5	4.8	6.4
Ucell (Coscom) ⁽³⁾	5.1	6.8	7.7
Others ⁽¹⁾	0.3	0.3	0.3

(1) Subscriber information based on our estimates.

(2) Subscriber information based on Vimpelcom's estimates.

(3) Subscriber information based on TeliaSonera's estimates.

MTS-Uzbekistan offers wireless services in Uzbekistan using GSM, UMTS and LTE (4G) technologies. As at 31 December 2011, it had approximately 9.3 million subscribers and a 39.2% market share according to MTS' estimates. MTS-Uzbekistan competes primarily with Ucell (Coscom), a GSM operator beneficially owned by TeliaSonera with approximately 7.7 million subscribers and a 32.4% market share as at 31 December 2011. MTS also competes with Beeline (Unitel), a GSM and UMTS operator owned by Vimpelcom with approximately 6.3 million subscribers and a 26.8% market share as at 31 December 2011.

The Armenian wireless telecommunications market

As at 31 December 2011, overall wireless penetration in Armenia was approximately 114.2%, or approximately 3.7 million subscribers, according to MTS' estimates.

The following table sets forth the number of subscribers as at the dates indicated and the coverage area of VivaCell-MTS and MTS' competitors in Armenia:

<u>Operator</u>	<u>31 December</u>	<u>31 December</u>	<u>31 December</u>
	<u>2009</u>	<u>2010</u>	<u>2011</u>
	(amounts in millions)		
VivaCell-MTS	2.1	2.5	2.4
ArmenTel (Vimpelcom)	0.5	0.7	0.8
Orange (France Telecom)	0.1	0.6	0.6

Source: Subscriber information based on our estimates.

As at 31 December 2011, VivaCell-MTS had approximately 2.4 million subscribers and a 63.9% market share, according to AC&M-Consulting and MTS' estimates. In Armenia, MTS competes with ArmenTel, a fixed line and mobile operator wholly owned by Vimpelcom. ArmenTel holds a licence in the GSM 900 standard for the entire territory of Armenia and a radio frequency permit for fixed line communications with CDMA equipment. Starting from 2009, MTS also competes with Orange (France Telecom), which was granted a GSM-900/1800 network licence in October 2008.

Tariffs

MTS customises its marketing efforts and pricing policies in each region of the Russian Federation and its other countries of operation by considering such factors as average income levels, the competitive environment and subscriber needs, all of which vary from region to region. Consistent with its marketing strategy, MTS has developed tariff plans to appeal to a broader market. The following table sets forth the mix between prepaid and other subscribers, such as contract and corporate customers, for the Russian Federation and Ukraine, MTS' two major revenue generating countries, for the periods indicated:

	<u>As at 31 December</u>		
	<u>2009</u>	<u>2010</u>	<u>2011</u>
The Russian Federation			
Prepaid	79%	81%	77%
Contract and Corporate	21%	19%	23%
Ukraine			
Prepaid	92%	92%	92%
Other	8%	8%	8%

MTS is actively seeking to migrate its customers from advance payment plans to credit payment plans in an effort to stimulate average revenue per user (“ARPU”) and reduce churn. MTS endeavours to mitigate the risk of bad debt through the implementation of credit scoring algorithms that assess and help manage the risk of potential bad debt.

Currently, each of MTS’ tariff plans in the Russian Federation combines per minute usage charges, value-added services in packages and different monthly network access fees (with the exception of the prepaid tariff plans) designed for different market segments. MTS’ tariff plans are designed to be simple and appeal to particular segments of the market, taking into account such factors as customer needs and consumption levels. MTS’ tariff plans are currently divided into five categories—“Prepaid,” “Maxi,” “Unlimited,” “Data” and “Corporate.”

MTS’ tariffs vary from plan to plan. The following description of tariffs and charges are, in each case, exclusive of VAT. As at 31 December 2011, the per-minute tariff for local calls within the MTS network varied from U.S.\$0.041 per minute to U.S.\$0.060 per minute. Different rates apply to local calls to other networks and vary from U.S.\$0.052 per minute to U.S.\$0.082 per minute. Higher rates apply to domestic long distance calls, and rates for international calls vary from U.S.\$0.12 per minute for calls to MTS subscribers within the CIS to U.S.\$1.91 per minute for calls to other parts of the world. Certain value-added services are included in all current tariff plans at no additional charge (other than for subscribers using old tariff plans that MTS no longer offers, some of which carry a charge of up to U.S.\$1.87 per month for these services). Periodically, MTS runs various promotional campaigns, either on the federal or regional level, in which MTS provides temporary discounts to its regular prices.

MTS’ tariff plans in Ukraine are oriented towards the following three main segments: (i) Business Postpaid, (ii) Private Postpaid and (iii) Private Prepaid. Private Prepaid tariffs are further divided into national mass market tariffs, youth market tariffs, regional tariffs, and segmented tariffs.

As at 31 December 2011, the standard per minute tariff for calls in Ukraine varied from U.S.\$0.03 per minute to U.S.\$0.13 per minute (based on the hryvnia/U.S. dollar exchange rate as at 31 December 2011). The standard per minute tariff for calls made within the MTS Ukraine network ranged from U.S.\$0 per minute with limitations in minutes to U.S.\$0.08 per minute. Higher rates applied to international calls ranging from U.S.\$0.13 per minute for calls using special tariffs to U.S.\$9.2 per minute for standard international tariffs. All tariffs for MTS Ukraine subscribers are quoted in hryvnias.

Customer Payments and Billing

MTS enrolls new subscribers, except for certain corporate and exclusive clients, in an advance payment programme, under which the subscriber prepays a specific amount of money to use MTS’ services. As at 31 December 2011, approximately 80% of MTS’ consolidated subscriber base was enrolled in the advance payment programme and 20% used the credit system.

MTS’ advance payment system monitors each subscriber account and sends an advance warning on the subscriber’s mobile telephone when the balance on the subscriber’s account decreases below a certain threshold.

Under the credit payment system, customers are billed monthly in arrears for their network access and usage. MTS limits the amount of credit extended to customers based on the customer’s payment history, type of account and past usage. As at 31 December 2011, subscribers using the credit system of payment had credit limits of up to U.S.\$1.6 million for key corporate customers in the Russian Federation. When a credit limit is reached, MTS blocks the telephone number until the balance is settled. There are no credit limits established for certain exceptional, high loyalty level customers.

Implementation of the “Foris” billing system was completed in the Russian Federation in 2008, and MTS has already begun to experience increases in MTS’ overall efficiency and reductions in MTS’ expenses. MTS is planning to complete the transfer of its individual subscribers in Ukraine to a new billing system by the end of 2012, and is approaching the final stage of transferring its individual subscribers in Uzbekistan to the “Foris” billing system. In Armenia, MTS uses the “Eskadenia” billing system which is currently being upgraded. The new billing system allows MTS to offer all of its subscribers a uniform and consistently high level of service. It also supports the monitoring of account usage in real time. In addition, the system provides MTS with the ability to offer flexible tariff plans with various usage discounts and subscriber loyalty bonuses. Furthermore, MTS is able to provide its corporate subscribers with more sophisticated customised billing solutions. For example, the corporate subscribers who use multiple phone numbers in different regions of the Russian Federation now receive a single invoice, whereas MTS’ old billing system could not support such a service.

In the Russian Federation and Ukraine, MTS offers its subscribers various ways to pay for MTS' services, including by cash or credit card, wire transfer, on account, prepaid cards and express payment cards.

Customer Service

MTS believes that to attract and retain customers, it must provide a high level of service in the key areas of customer assistance, care and billing. In each of the markets where MTS operates, MTS has contact centres that provide customer service 24 hours a day, seven days a week. Contact centres provide services to MTS' customers through various channels, i.e., telephony, e-mail, SMS/MMS and fax. Customer service representatives answer inquiries regarding disconnection due to lack of payment, handset operation, roaming capabilities, service coverage and billing. A special group of customer service representatives handle customer claims and assists customers who wish to change their services. MTS regularly uses automatic systems and independent analysis to monitor the contact centres' accessibility and customer satisfaction with the service level offered at such centres. To improve customer loyalty, reduce churn rate and promote its services, MTS conducts outbound calling campaigns using MTS staff, including the outbound contacts centre and the CRM laboratory, a system for managing MTS' interaction with customers, clients and sales prospects.

In order to reduce operating expenses, the contact centres were relocated from regions where property ownership was expensive to other Russian regions where such costs are lower. To further increase operating efficiencies, in 2011, MTS completed the consolidation of its contact centres into three key locations. MTS continuously works to improve customer satisfaction by providing its subscribers with convenient and functional self-service systems, e.g., Internet-Helper, interactive voice response ("IVR") and Mobile Helper. For instance, Internet-Helper is a service that, among other things, provides the customer with an opportunity to view information about his contract and personal information as well as manage certain account data. Similarly, Mobile Helper, among other things, allows a customer to receive information about his current balance, tariff plan details, as well as change service language and view bills for previous months.

In 2010 and 2011, MTS also continued expanding its retail chain and began providing customer support in its retail stores. Currently, customer assistance is offered in over 3,000 monobrand retail stores in the Russian Federation. In order to support customer assistance in MTS' monobrand outlets, in 2011, MTS established a special centre for processing delayed customers' claims and requests from all over the Russian Federation.

In 2012, MTS plans to make the customer assistance process in Ukraine more personalised by anticipating customer needs. MTS plans to maintain a history of subscriber requests and personalise the IVR for each customer profile, which will depend on individual ARPU, region and other parameters. Based on these parameters, MTS calculates a customer lifetime value index and provides its priority customers with a wider range of assistance services. MTS also aims to offer personal agents to its premium customers, establish an operational CRM system and renew the technical platform of its contact centre.

Network

Network Technology

MTS believes that geographic coverage, capacity and reliability of its network are key competitive factors in the sale of mobile cellular telecommunications services. MTS' 2G network is based primarily on GSM 900 infrastructure, augmented by GSM 1800 equipment. MTS uses GSM 1800 equipment in high-use areas, because 1800 MHz base stations are more efficient in relieving capacity constraints in high traffic areas. Although there is no difference in quality between GSM 900 and GSM 1800 services, the higher frequency 1800 MHz signals do not propagate as far as 900 MHz signals. As a result, more 1800 MHz base stations are typically required to achieve the same geographic coverage. Accordingly, in regions where geographic coverage, rather than capacity, is a limiting factor, networks based on GSM 900 infrastructure are typically superior to those based on GSM 1800, because they require fewer base stations to achieve coverage and, therefore, cost less. In most markets, including the Russian Federation and Ukraine, the most efficient application of GSM technology is to combine GSM 900 and GSM 1800 infrastructure in a unified network, which is commonly referred to as a dual-band GSM network.

MTS' 3G network is based on UMTS 2100, and MTS' existing GSM infrastructure is actively used for its 3G rollout. MTS is combining its UMTS and GSM infrastructures in a unified network based on the Single RAN concept introduced by its vendors. In 2012, MTS will continue to develop UMTS 2100 networks in the Russian Federation, Belarus, Uzbekistan and Armenia in order to provide its subscribers with high-quality services. In

2011, MTS launched UMTS 900 in the Moscow region. The double-band 2100/900 UMTS network in the Moscow region gives MTS a significant advantage on the wireless broadband market of the Moscow region in terms of coverage area. MTS is planning to launch UMTS 900 in the Far East (Khabarovsk region) because of the regulatory limitations on the use of UMTS 2100. All mobile GSM and UMTS networks are being developed towards IP interfaces in accordance with the ALL (full set) IP concept which is the basic concept in future LTE networks.

MTS has been implementing the latest cutting-edge technologies such as LTE. MTS launched LTE frequency division duplexing (“**FDD**”) 2600 in Uzbekistan and Armenia in 2010. MTS is planning to launch LTE TDD 2600 in Moscow in 2012. MTS also plans to participate in the LTE frequency band tender that the Federal Service for Supervision in the Area of Communications, Information Technologies and Mass Media is going to arrange in 2012.

Network Infrastructure and Frequency Allocation

MTS uses switching and other network equipment supplied by Motorola, Nokia Siemens Networks, Ericsson, Huawei, Alcatel-Lucent and other major network equipment manufacturers.

In the Moscow licence area, MTS has allocated frequencies spanning 2 x 11.4 MHz of spectrum in the GSM 900 frequency band and 2 x 24.6 MHz of spectrum in the GSM 1800 frequency band for operation of a dual GSM 900/1800 network.

In 2011, MTS has allocated frequencies 2596-2610 MHz spanning 25 MHz for LTE TDD network deployment in the Moscow metropolitan area.

MTS has submitted applications for 873 LTE TDD base stations in the Moscow metropolitan area to the State Radio Frequencies Commission.

In St. Petersburg and the Leningrad region, MTS has allocated frequencies spanning 2 x 9.6 MHz of spectrum in the GSM 900 frequency band (including 2 x 1.6 MHz in the E-GSM band) and 2 x 18.2 MHz of spectrum in the GSM 1800 frequency band for operation of a dual GSM 900/1800 network.

MTS has allocated frequencies 1950-1965 MHz, 2010-2015 MHz and 2140-2155 MHz in the UMTS core frequency bands spanning 2 x 15 MHz (for FDD mode) and 5 MHz (for TDD mode) for UMTS network deployment for the entire territory of the Russian Federation.

MTS has frequencies allocated to it for the operation of GSM 900 and GSM 1800 frequency bands in all regions of Ukraine. The radio frequencies allocated to MTS for the operation of GSM 900 span from 2 x 4.0 MHz of spectrum in the Crimea Autonomous Republic to 2 x 5.8 MHz in the Nikolaev, Lugansk, Chernovtsy and Kirovograd regions and in Kiev. MTS also has been allocated frequencies spanning from 2 x 20.0 MHz in the Kiev region to 2 x 26.6 MHz in the Dnepropetrovsk region for operation of GSM 1800 base stations. In addition, MTS has been allocated frequencies spanning from 453.35-457.1 MHz and 463.35-467.1 MHz in the CDMA-450 core frequency and bands spanning 3 x 1.25 MHz for CDMA-450 network deployment for the entire territory of the Ukraine.

MTS believes that it has been allocated adequate spectrum in each of the licence areas.

Base Station Site Procurement and Maintenance

The process of obtaining appropriate sites requires that MTS’ personnel coordinate, among other things, site-specific requirements for engineering and design, leasing of the required space, obtaining all necessary governmental permits, construction of the facility and equipment installation. In the Russian Federation, MTS uses site development software supplied mainly by Aircom International to assess new sites so that the network design and site development are coordinated. MTS’ software in the Russian Federation and Ukraine can create digital cellular coverage maps of its licence areas, taking into account the peculiarities of the urban landscape, including the reflection of radio waves from buildings and moving automobiles. Used together, these software tools enable MTS to plan base station sites without the need for numerous field trips and on-site testing, saving MTS considerable time and money in its network build-out.

Base station site contracts are essentially cooperation agreements that allow MTS to use space for its base stations and other network equipment. The terms of these agreements range from one to 49 years, with the term of a majority of agreements being one to five years. Under these agreements, MTS has the right to use premises located in attics or on top floors of buildings for base stations and space on roofs for antennas. In areas where a suitable base station site is unavailable, MTS constructs towers to accommodate base station antennas, mainly on leased plots of land. MTS anticipates that it will be able to continue to use its existing GSM 900 base station sites and to co-locate GSM 1800, UMTS 2100 and UMTS 900 base stations at some of the same sites.

To provide quality service to subscribers, MTS' maintenance department, staffed 24 hours per day, performs daily network integrity checks and responds to reported problems. MTS' technicians inspect base stations and carry out preventative maintenance at least once every six months.

Network Monitoring Equipment

MTS has operation and maintenance centres in major cities throughout the Russian Federation. MTS controls and monitors the performance of MTS' network, call completion rate and other major key technical performance indicators. MTS uses monitoring systems to optimise MTS' network and to locate and identify the cause of failures or problems, and also to analyse MTS' network performance and obtain network statistics. MTS has agreements with different suppliers for technical support services that allow MTS to obtain their assistance in trouble shooting and correcting problems with MTS' network within the warranty period.

MTS' networks in Ukraine, Uzbekistan, Armenia and Belarus are monitored by its local operations and maintenance centres in each country. In addition to monitoring performance of the network, these operations and maintenance centres analyse network quality parameters and provide reports and recommendations to management.

The handling of any significant network problems and outages are monitored and coordinated at MTS' corporate headquarters in Moscow, which also manages the cross-functional coordination of MTS' networks in all of its countries of operation.

Fixed Line Operations

Overview

In addition to its mobile operations, MTS also currently operates in both the alternative and traditional fixed line communications markets. On 1 April 2011, MTS completed a merger with Comstar, the leading supplier of integrated fixed line telecommunications solutions in the Russian Federation. MTS now offers alternative and traditional communications services in over 150 cities across the Russian Federation, covering a population of over 53 million people.

MTS' alternative fixed line communications services include voice, data and Internet and pay-TV services for corporate and residential subscribers, as well as the provision of interconnect services to other communications operators and numbering capacity to their subscribers. According to Direct INFO, as at 31 December 2011, MTS was the largest operator in the Moscow residential broadband market in terms of subscribers, with a 28.5% market share. MTS also operates in Ukraine and Armenia, where MTS provides digital telephony communications services, data transmission, Internet access and the renting of channels.

MTS' traditional fixed line communications services are provided through incumbent operator MGTS. Through MGTS, MTS owns "last mile" access to approximately 4.1 million households in Moscow, representing approximately 96% of the city's total households who are active users of fixed line voice telephony, according to Direct INFO. MGTS provides regulated and unregulated services, including local telephony services at tariffs regulated by the Russian government, DLD/ILD voice telephony through licensed operators, interconnect to other operators, Internet and data transmission services and numbering capacity to subscribers of other communications operators through agency agreements concluded with such operators.

In November 2009, Sistema JSFC, Comstar and Svyazinvest signed a non-binding memorandum of understanding, contemplating an exchange of certain telecommunications assets. The transaction was completed in October 2010 and included, among other things, the entry by Sistema and Svyazinvest into an exchange transaction pursuant to which Svyazinvest obtained control over 100% of the share capital of Sky Link and Sistema JSFC acquired a 23.3% stake in MGTS from Svyazinvest. In addition, Comstar transferred its 25% plus

1 share ownership stake in Svyazinvest to Rostelecom for cash consideration of RUB 26 billion (U.S.\$839.2 million as at 23 September 2010). The proceeds of the sale were used by Comstar to pay down its outstanding debt to Sberbank in the amount of RUB 26 billion (U.S.\$839.2 million as at 23 September 2010). Sky Link is a Moscow-based CDMA operator holding GSM licences for a majority of the Russian regions.

Comstar's shares of common stock, represented by GDRs, were listed on the London Stock Exchange under the symbol "CMST" from February 2006 until 25 March 2011. On 25 March 2011, the U.K. Listing Authority cancelled the listing of Comstar's GDRs from the Official List following Comstar's announcements regarding its intention to seek cancellation of its listing of GDRs. As a result, Comstar's GDRs are no longer admitted to trade on the London Stock Exchange.

Customers and Services Offered—Alternative Fixed Line Business

MTS provides alternative fixed line communications services to corporate, operator and residential subscribers in over 150 cities throughout the Russian Federation. Specifically, MTS offers local voice, DLD/ILD voice, data and Internet and pay-TV services to its subscribers. The interconnect tariffs MTS charges to other telecommunications operators in Moscow and certain other cities are regulated by the Russian government. MTS believes its alternative fixed line subscribers typically evaluate its service and product offerings based on such factors as price, technology, security, reliability and customer service.

The following table sets forth certain operating data for MTS' alternative fixed line business in the Moscow market and in the Russian regions and the CIS as at and for the years ended 31 December 2010 and 2011.

<u>Alternative fixed line business</u>	<u>31 December 2010</u>	<u>31 December 2011</u>
Moscow market		
Installed telephone lines (000s)	659	659
Residential		
Number of subscribers (000s) ⁽¹⁾	541	620
ARPU (RUB)	566	554
ARPU (U.S.\$)	18.6	18.9
Corporate ⁽²⁾		
Number of subscribers (000s)	29	30
ARPU (RUB) ⁽⁴⁾	17,447	16,375
ARPU (U.S.\$) ⁽⁴⁾	575.7	557.9
Operators		
Number of active lines (000s)	438	438
of which, used by mobile operators (000s)	307	85
Russian regions and CIS (excluding Moscow market)⁽³⁾		
Residential		
Number of subscribers (000s) ⁽¹⁾	3,661	4,392
ARPU (RUB)	188	178
ARPU (U.S.\$)	6.2	6.1
Corporate ⁽²⁾		
Number of subscribers (000s)	73	117
ARPU (RUB)	3,302	2,614
ARPU (U.S.\$)	108.6	89.0
Operators		
Number of active lines (000s)	5	9

(1) Subscribers to broadband Internet, pay-TV, voice and other services. MTS calculates its subscribers based on the number of active lines in service. A line is considered "active" if the subscriber has used and paid for the service within the last six months.

(2) Includes state-owned enterprises and government agencies.

(3) No reliable data is available on installed lines outside of the Moscow market.

(4) The calculation changed starting in 2011. Pay-TV and data transmission revenue are now included in the calculation of ARPU.

Corporate subscribers

MTS targets corporate subscribers covering a range of industries, such as business centres, hotels, financial institutions, professional services firms, consumer goods companies, manufacturers and companies involved in

extractive industries, among others. These subscribers vary in size, ranging from large multinational and Russian corporations with thousands of employees to small- and medium-sized enterprises with up to several hundred employees. As at 31 December 2011, MTS had approximately 51,000 voice and 73,000 Internet corporate subscribers.

MTS offers voice, data transmission and Internet and various value-added services to its corporate subscribers.

Operators

MTS is the largest mobile operator in the Russian Federation, according to AC&M-Consulting. MTS also operates fixed-line local networks in Moscow and other cities mostly for provision of local numbers to mobile subscribers. In order to lower the costs of intercity and international traffic transition, MTS has put into operation an intercity international network in December 2008.

According to Direct INFO, together with MGTS, MTS had approximately 77% of the total active numbering capacity in Moscow as at 31 December 2011. MTS now has approximately 78 local fixed networks in 51 regions of the Russian Federation, including Moscow, and 21 zonal fixed networks to provide telephony services to subscribers. MTS' integrated intercity/international network is interconnected to more than 45 international operators. As at 31 December 2011, MTS had more than 1100 interconnect agreements with national and international operators for interconnection of its fixed networks.

Residential subscribers

MTS offers voice, Internet and pay-TV services to residential subscribers.

MTS' pricing structure is designed to appeal to large numbers of consumers with various interests and purchasing power, and varies significantly between regions. MTS charges a subscription fee of RUB 110 to RUB 450 (U.S.\$3.40 to U.S.\$14) per month in Moscow and a subscription fee of up to RUB 99 to RUB 365 (U.S.\$ 3.10 to U.S.\$11.30) in other regions of the Russian Federation, depending on the number of channels included in the package. There is a connection fee in some regions of the Russian Federation. MTS also offers bundled Internet and pay-TV services for RUB 260 to RUB 1,480 (U.S.\$8.10 to U.S.\$46) per month in Moscow and RUB 299 to RUB 2,350 (U.S.\$9.30 to U.S.\$73) in certain other regions of the Russian Federation, depending on the speed of the Internet connection, the number of pay-TV channels being provided and level of competition in a particular region.

Customers and Services Offered—Traditional Fixed Line Business

MTS provides traditional fixed line communications services through its subsidiary, MGTS, which is the incumbent fixed line PSTN operator in Moscow. MGTS owns Moscow's PSTN infrastructure, including switches, a transmission network and underground ducts, and owns or holds leases to properties housing its offices and equipment. As at 31 December 2011, MGTS had approximately 4.42 million active lines in service, a cable network of over 110,217 km, a fibre-optic network of over 8,896 km and 2,997 payphones. Although MGTS' core backbone network is fully digital and is based on state-of-the-art synchronous digital hierarchy ("SDH") technology, only around 69% of installed lines were digital as at 31 December 2010. As a result, those subscribers who connect to MTS' network using analogue automatic test equipment are currently not able to receive MTS' value-added services. In 2011, MGTS completed the digitalisation of its network using the Mediator Private Network special range of equipment, which allowed MGTS to replace its existing analogue equipment and complete the digitalisation of its network two years ahead of schedule. The total installed capacity of MGTS' telephone network reached 4.9 million numbers as at 31 December 2011.

Residential subscribers accounted for approximately 81.7% of MGTS' total lines, corporate clients for 11.2% and public sector subscribers for 7.1%, as at 31 December 2011.

MGTS holds licences and regulatory approvals to provide, among others, the following services: local telephony; DLD/ILD voice telephony through licensed DLD/ILD operators, including MTS; interconnect to other operators; Internet and data transmission, including leased DLD/ILD services; inquiry and information, including telephone directories; use of payphones; and numbering capacity provided to the subscribers of other communications operators through agency agreements concluded with such operators.

As the only licensed PSTN operator in Moscow, MGTS is considered a natural monopoly under Russian antimonopoly regulations. Consequently, most of the services provided by MGTS are subject to governmental regulation. The FTS regulates MGTS' tariffs for voice telephony services provided to its PSTN subscribers, including monthly subscription fees, installation fees and local call charges. Operating revenues from regulated services accounted for approximately 69% of service operating revenues of MTS' traditional fixed line business in 2009, 2010 and 2011.

The FTS sets the tariffs MGTS can charge taking into account cost of services, network investment and a certain profit margin, and the current tariffs fully compensate MGTS for the cost of services provided to residential and government subscribers. According to Russian legislation, MGTS is allowed to petition the FTS for tariff increases upon certain conditions, such as inflation or increases in the cost of services. Historically, MGTS has petitioned the relevant Russian government agency for tariff increases once or twice per year. The FTS has permitted MGTS to increase its tariffs several times.

MGTS also provides a number of unregulated services. According to the Russian legislation, DLD/ILD services provided by licensed non-monopoly operators, public payphones, data transmission services, value-added services and a number of other services are not subject to tariff regulation. Among others, MGTS provides the following unregulated services:

- various value-added services, including call forwarding, call waiting, call holding, caller ID, provision of second direct inward dialling (DID) number;
- Internet access for residential subscribers and corporate entities; and
- rent of space for telecommunications equipment of other operators connected to MGTS' network.

MGTS is not licensed to provide DLD/ILD communications services directly to its subscribers but must route such traffic through a licensed DLD/ILD operator. As a result, DLD/ILD traffic originated by MGTS subscribers is carried either by MTS, with these services included in MGTS' monthly bill, or by other providers of DLD/ILD services, who bill MGTS subscribers directly or pay MGTS an agency fee for processing their bills.

The following table sets forth certain operating data for MTS' traditional fixed line business as at and for the years ended 31 December 2010 and 2011:

<u>Traditional fixed line business</u>	<u>2010</u>	<u>2011</u>
Installed telephone lines (000s)	4,903	5,100
Residential		
Number of subscribers (000s) ⁽¹⁾	3,615	3,610
CPP traffic (millions of minutes)	1,993	1,832
ARPU (RUB)	352	371
ARPU (U.S.\$)	11.6	12.7
Corporate ⁽²⁾		
Number of active lines (000s)	785	809
Number of subscribers (000s)	66	66
CPP traffic (millions of minutes)	924	883
ARPU (excl. revenue from points of interconnect) (RUB)	7,016	8,047
ARPU (excl. revenue from points of interconnect) (U.S.\$)	231.1	274.7
Number of points of interconnect (000s)	20	10
Average monthly revenue per point of interconnect (RUB)	6,714	9,932
Average monthly revenue per point of interconnect (U.S.\$)	221.3	341.6
Operators		
Number of interconnected operators	195	200
Number of points of interconnect (000s)	235	244
Average monthly revenue per point of interconnect (RUB)	1,194	1,247
Average monthly revenue per point of interconnect (U.S.\$)	39.3	42.5

(1) MTS calculates its subscribers based on the number of active lines in service. A line is considered "active" if the subscriber has used and paid for the service within the last six months.

(2) Includes state-owned enterprises and government agencies.

MGTS' subscriber segments and the services provided to each subscriber segment are further described below.

Residential and corporate subscribers

MGTS provides basic regulated voice services to residential and corporate subscribers using its PSTN facilities and copper "last mile" access. Tariffs for these services are established by the FTS.

In addition to basic services to basic voice services, MGTS also provides corporate customers with digital telecommunication, Internet and virtual private network ("VPN") deployment services, rental of high-speed communication channels and various other services.

Operators

MGTS provides interconnection, traffic transmission and leased line services to other communications operators. Interconnection is carried out on the local and zonal levels in accordance with terms and conditions that are publicly disclosed. MGTS also provides additional services to operators interconnecting to MGTS' network, including access to emergency service, information and customer care numbers.

MGTS has also established an active presence in the data transmission market. Through its public data transmission network ("PDTN"), MGTS can establish VPNs for other operators as well as provide other data network services. Operators can also rent space and utility systems from MGTS to house their network equipment.

Sales and Marketing

Alternative fixed line business

MTS' target customers include corporate, operator and residential subscribers.

MTS also actively promotes its services to existing subscribers with special bundled product offerings aimed at servicing their communications requirements and enhancing subscriber loyalty. MTS' advertising and information materials are aimed primarily at the promotion of the MTS brand. Since the beginning of 2011, MTS promotes only the MTS. All fixed-line products are offered and marketed under this brand. However, in new markets, where the introduction of a new brand soon after the introduction of the older brand may strain customer loyalty, MTS can still use two brands to decrease churn. In addition to promoting the MTS brand, MTS also promotes specific product and service offerings such as Wi-Fi and Wi-Max. MTS' advertising and marketing efforts are designed to convey a positive image of MTS to the market as a leading communications operator focused on customer satisfaction.

Traditional fixed line business

As the incumbent PSTN, MGTS has not invested significantly in sales and marketing. In connection with the long term modernisation program of MTS' network based on passive optical network ("PON") technology, MTS expects to increase its investments in sales and marketing of convergent products, including double and triple-play products. In 2010, MTS launched several pilot projects based on PON technology, which allows MTS to provide higher quality services than its competitors. In addition, PON technology allows MTS to provide services that generate a high volume of traffic, such as video security, video social networking and other similar services.

MGTS is replacing the old networks used by Moscow educational institutions for PON, a modern and high-quality fibre-optic communication technology. MGTS will also provide schools with fire-alarm systems and safety monitoring.

Market and Competition

MTS competes with a number of fixed line telecommunications operators servicing Moscow, St. Petersburg and other major Russian cities. Moscow is the largest and most competitive of these markets. MTS' primary competitors include:

- *Vimpelcom*, which is also one of MTS' primary competitors in the Russian mobile communications market. Vimpelcom acquired alternative operators Golden Telecom and Corbina Telecom in 2008, and offers voice, data and Internet services to corporate entities, operators and residential subscribers in major cities throughout the Russian Federation, Ukraine, Kazakhstan and Uzbekistan using intercity fibre-optic and satellite-based networks. MTS competes with Vimpelcom in the corporate, operator and

residential fixed line telecommunications markets in Moscow and in certain other regions of the Russian Federation where MTS is present, including, among others, Rostov, Nizhny Novgorod, St. Petersburg, Ekaterinburg and Krasnodar.

- *Rostelecom*, the Russian Federation's primary DLD/ILD operator. MTS competes with Rostelecom in the corporate, operator and residential fixed line telecommunications markets in all regions where MTS operates in the Russian Federation (including the Moscow region). MTS also competes with Rostelecom in the mobile telecommunications market in certain parts of Siberia.
- *Akado Group* (formerly Renova Media) is comprised of AKADO Stolitsa, a leading provider of pay-TV, broadband Internet and digital telephony in Moscow; Comcor, a Moscow-based fibre-optic network operator providing services under the AKADO Telecom brand; and several Internet and pay-TV providers in St. Petersburg, Ekaterinburg and Minsk (Belarus). MTS competes with the Akado Group primarily in the residential fixed line telecommunications markets in Moscow and Ekaterinburg.
- *MegaFon*, which acquired operators Synterra and Net-by-Net, and offers services in the operator, corporate and residential fixed line telecommunications markets in Moscow, St.-Petersburg, and other regions.
- *Er-Telecom*, voice telephony, broadband and TV operator. MTS competes with Er-Telecom in the residential fixed line telecommunications market in St.-Petersburg, Novosibirsk, Omsk, Nizhny Novgorod, Ekaterinburg, Kazan, Rostov, Chelyabinsk and other regions.

Corporate subscribers

The following table sets forth the corporate subscriber market shares of the primary fixed line operators (including both alternative and incumbent operators) in Moscow as at 31 December 2011:

<u>Company</u>	<u>The Russian Federation</u>
MTS	9%
MGTS	11%
Vimpelcom	21%
Synterra	6%
Company TransTeleCom (TTK)	5%
Orange	3%
Akado	10%
Rostelecom (incl. RTCOMM)	9%
Other	26%
Total	<u>100%</u>

Source: Direct INFO

In the corporate subscriber segment, MTS generally competes on the basis of network quality, individual and bundled service offerings, customer service, installation time, geographical presence and pricing.

Residential Subscribers

Voice Services

The following table sets forth the market shares of the primary fixed line operators (including both alternative and incumbent operators) for voice services in the Russian Federation as at 31 December 2011:

<u>Company</u>	<u>The Russian Federation</u>
MGTS	12%
Rostelecom	76%
Other	12%
Total	<u>100%</u>

Source: Direct INFO

As Moscow's only PSTN operator, MGTS faces limited competition in the market for residential local telephony services in Moscow. As at 31 December 2011, it provided local voice telephony services for approximately 97% of all residential subscribers in Moscow, according to Direct INFO.

In the alternative voice services market, MTS generally competes based on the availability of bundled packages comprising broadband Internet access and pay-TV services, value-added services, network quality, installation time and customer service.

Internet

According to Direct INFO, as at 31 December 2011, computer penetration of households was 67% in the Russian Federation, with 94% of these households having Internet access. The following table sets forth the market shares of the primary operators in the residential broadband Internet market in the Russian Federation as at 31 December 2011:

<u>Company</u>	<u>The Russian Federation</u>
MTS	8%
MGTS	2%
Akado	4%
Vimpelcom	9%
Er-Telecom	9%
Rostelecom (including OJSC "National Cable Networks")	37%
Other	<u>31%</u>
Total	<u>100%</u>

Source: Direct INFO

Pay-TV

According to Direct INFO, as at 31 December 2011, TV penetration was 74% in the Russian Federation. The following table sets forth the market shares of the primary operators in the TV market in the Russian Federation as at 31 December 2011:

<u>Company</u>	<u>The Russian Federation</u>
MTS	11%
Akado	4%
Rostelecom	20%
Tricolor TV	29%
Vimpelcom	1%
Er-Telecom	7%
Other	<u>28%</u>
Total	<u>100%</u>

Source: Direct INFO

In the TV market, MTS generally competes on the basis of pricing, channel selection and content, individual and bundled service offerings, customer service and installation time.

Tariffs

MTS establishes prices for its unregulated services and different subscriber segments based on certain common considerations, policies and goals. For example, MTS generally seeks to establish competitive prices based on market rates for the services MTS offers and below market prices when MTS' lower-than-average costs or economies of scale allow the group to do so. MTS also offers subscribers bundled service packages with several services offered together at a discount to the cost of ordering each individual service separately and to promote

additional services to MTS' existing subscribers. In addition, MTS often offers promotions to its various subscriber segments waiving or discounting installation fees in order to attract new subscribers or promote new services.

With regard to corporate clients, MTS generally aims to derive the bulk of its operating revenues from monthly payments. Thus, depending on the scale and type of services ordered, MTS will often discount or waive installation fees.

For services offered to other communications service providers, MTS aims to generate most of its operating revenues from monthly payments and by offering an array of value-added services.

MTS develops tariffs for service offerings to residential subscribers with the aim of attracting new subscribers, as well as expanding the services used by existing subscribers in order to generate higher ARPU. In particular, MTS offers several flexible tariff plans customised for various types of residential subscribers, as well as various promotions, such as free installation and bundled service packages offered at a discount.

Network

Long-haul backbone network

As a result of MTS' acquisitions of Comstar and Evrotel OJSC, it became one of the largest operators of the Internet long-haul backbone networks in the Russian Federation. MTS continues to develop its long-haul backbone network through the build-out of a fibre-optic infrastructure and acquisitions of other Internet backbone service providers. MTS currently has a fibre-optic network of approximately 65,000 km, which also allows it to operate an optical transport network using dense wavelength division multiplexing technology.

In addition, MTS has its own internet protocol ("IP") multi protocol label switching ("MPLS") network, which is capable of providing Internet and L2/L3 VPN services and delivering other media products, such as digital television and IP television, to regional networks for use in its fixed line and mobile operations, as well as for its wholesale customers. MTS' IP MPLS backbone network covers most of the Russian Federation and Ukraine and is present in most of the European and U.S. Internet exchange points, such as DE-CIX in Frankfurt, NETNOD in Stockholm, AMS-IX in Amsterdam, PARIX in Paris, LINX in London, Equinix in Ashburn and New York, NIIX in New York and Any2 in Los-Angeles. In 2011, MTS also established connection to FICIX in Helsinki. More than 75% of MTS' international Internet traffic is delivered through settlement-free peering with other large networks. The remaining international Internet traffic is delivered through direct connections with certain of the largest networks. All internet traffic in the Russian Federation is delivered through settlement-free peering with the largest ISPs in the Russian Federation.

Alternative fixed line business

The network infrastructure MTS maintains in Moscow is substantially different from the infrastructures MTS uses in the regions. In Moscow, MTS has primarily grown organically, while MTS' regional development has largely been through the acquisition of companies with different business models and a focus on different services. As a result, the network infrastructures in the other Russian regions and the technologies used to support such infrastructures are different from the network infrastructure established in Moscow and which MTS currently owns.

Moscow Metropolitan Area

The Moscow telephone network consists of 15 switching nodes (13 time division multiplexing switches and 2 soft switches) with total capacity of over 700,000 subscribers.

The Moscow region telephone network consists of 10 soft switches with total capacity of around 15,000 subscribers.

All of MTS' PSTN switching centres are connected to a digital transport network, which uses SDH technology and covers the entire territory of Moscow and most of the Moscow region.

For the provision of Internet access, IP-telephony and other services, MTS has its own IP MPLS network, the core of which is constructed as IP MPLS rings with routers connected to each other by means of 10 GE channels. In addition, separate routers are used for inter-carrier connections and are connected to the core routers by means of 10 GE interfaces.

As at 31 December 2011, MTS' wireless broadband network in the Moscow metropolitan area included 51 base stations in the 5 GHz frequency band. During 2011 in the 2.4-2.5 GHz frequency band, MTS continued the construction of the Wi-Max network started by Comstar, which consisted of over 210 base stations as at 31 December 2011. MTS' radio-relay communication lines included 25 links, in addition to 115 Internet hot-spots using Wi-Fi technology as at 31 December 2011.

Russian Regions

As at 31 December 2011, MTS provides cable Internet access to 6.5 million households and cable TV access to 7.7 million households, excluding the Moscow metropolitan area. Among the access equipment used are Ethernet switches, IP digital subscriber line access multiplexer ("DSLAM") and PON. MTS mainly uses the FTTB technology for internet access, which can provide speeds up to 1 Gb/sec. In 2011, MTS started to roll-out DVB-C technology for cable TV service.

Traditional fixed line business

Public Switch Telephone Network (PSTN)

MTS' traditional fixed line communications network has an installed capacity of more than 5.0 million numbers, of which 2.2 million is digital exchange, 0.3 million is analogue exchange and 2.6 million is NGN exchange capacity. The digital portion of the network is based on the SDH backbone and the transport level of the PDTN. The total length of the fibre-optic network is more than 8,648 km.

The SDH network, which uses Lucent Technologies equipment, is configured as follows: 29 rings STM-4/STM-16, based on DACS cross-switches, located in the buildings with switches ATC 316 and ATC 201. There are a total of 159 multiplexers in the network, including ISM2000, ADM16/1, ADM16/1c, ADM4/1 and ADM4/1c. The SDH network allows for traffic transmission between exchanges and traffic exchange with interconnected carriers 1676 E1. The ECI SDH network topology (SDM 1/4/16, XDM500 and XDM1000) is multi-layered, with each network layer designed to carry a certain type of traffic: 19139E1, 168 rings STM-4/STM-16, 457 multiplexers.

Monitoring of the digital network and management of switching equipment is centralised and carried out from MGTS' control centres.

Public Data Transmission Network

MTS' PDTN is a hierarchical 3-layer IP/MPLS network. The first level is the transport level for high rate traffic throughput over the PDTN. The second level is used for terminating subscriber sessions and, at the same time, to backhaul traffic from access nodes ("PoPs") to the transport level. The third level allows subscribers to access the PDTN.

As PoPs the PDTN uses MGTS' switching centres connected with at least 4,000 subscribers. MTS currently has over 250 PoPs in service. The coupling of two or more DSLAMs within one PoP is through Catalyst 2970G GE switches or similar switches having a minimum of 12 GE ports. Each PoP is connected to an individual GE port of the nearest Cisco 7606 router.

Principal suppliers

MTS' principal suppliers are Sitronics Telecom Solutions, Huawei, Nokia Siemens Networks and NEC for switching equipment; ECI Telecom and Alcatel Lucent for transport network equipment; Cisco Systems, Huawei and Alcatel Lucent for Internet and data network equipment; Secure Media for crypto-protection conditional access software; and Tandberg TV for broadcasting equipment. All of MTS' equipment is supplied directly through authorised dealers.

Seasonality

MTS' results of operations are impacted by certain seasonal trends. Generally, revenue is higher during the second and third quarter due to increased mobile phone use by subscribers who travel in the summer from urban areas to more rural areas where fixed line penetration is relatively low, as well as an increase in roaming revenues and guest roaming revenues during these quarters. Quarterly trends can also be influenced by a number of factors, including new marketing campaigns and promotions, and may not be consistent from year to year.

Property, Plant and Equipment

MTS owns and leases premises in Moscow, in some of its regional licence areas and in Ukraine, including approximately 238 buildings through MGTS. MTS believes that its properties are adequate for its current needs and additional space is available to MTS if and when it is needed.

Mobile Operations

The primary elements of MTS' network are base stations, base station controllers, transcoders and mobile switching centres. GSM and 3G technologies are based on an "open architecture," which means that equipment from one supplier can be combined with that of another supplier to expand the network. Thus, there are no technical limitations to using equipment from other suppliers. The table below sets forth certain information on MTS' network equipment as at 31 December 2011:

	<u>Base stations GSM-900</u>	<u>Base stations GSM-1800</u>	<u>Base stations UMTS-2100</u>	<u>Base station controllers*</u>	<u>Switches*</u>	<u>Media gateways</u>
The Russian Federation	20951	13991	21670	908	175	124
Ukraine	5376	8745	—	352	43	4
Uzbekistan	770	1960	805	67	35	53
Turkmenistan	630	521	42	15	3	8
Armenia	819	82	743	32	6	6

(*) Includes 3G equipment.

Interconnect Arrangements and Telephone Numbering Capacity

MTS operates various types of communications networks, including mobile cellular, DLD/ILD (domestic long-distance/international long-distance) and local fixed line and zonal fixed line networks.

Cellular operators must interconnect with fixed zonal, wireless, long distance and international telephone operators to obtain access to their networks and, via these operators, to the networks of other operators around the world. Cellular and fixed line operators must also obtain telephone numbering capacity to allocate to their subscribers. There are two categories of telephone numbers: "federal" 11-digit numbers (non-geographical numbering plan for cellular operators) and "local" seven-digit numbers (geographical numbering plan for fixed-line operators, which can also be used as additional numbering capacity for mobile operators). In Moscow, both "federal" and "local" numbers have been used in the 11-digit format since the beginning of 2011. MTS has entered into various agreements for the provision of local telephone numbering capacity with several local telecommunications operators in Moscow and in other regions of the Russian Federation and in Ukraine. MTS has also built its own local networks in certain cities within the Russian Federation (including Moscow) to provide local telephone numbering capacity to MTS' subscribers. MTS is allocated federal telephone numbering capacity by the government, and MTS provides interconnect services to other operators on the zonal level in all regions of the Russian Federation. Zonal/local interconnect typically entails payment of a one-time connection fee per point of interconnect ("EI") and a usage charge based on minutes of traffic.

To provide its subscribers in the Russian Federation with DLD/ILD services, MTS has interconnect agreements with national operators Rostelecom, MTT (an affiliate of Sistema until 18 March 2009), Vimpelcom and other national transit operators. MTS has also built and operates its own DLD/ILD network, which allows MTS to interconnect directly to foreign operators and thereby decrease the interconnect costs.

In Ukraine, mobile operators are allocated numbering capacity by the National Commission for the State Regulation of Communications and Informatisation. MTS believes that it has been allocated sufficient numbering capacity in Ukraine for the development of its mobile network. MTS also believes that it has been allocated sufficient fixed line numbering capacity with respect to the cities in which MTS is developing its fixed line network.

BASHNEFT

Overview

Bashneft is a vertically integrated oil business with upstream and downstream assets mainly located in the Republic of Bashkortostan. In 2011, according to information provided by the Russian Ministry of Energy, Bashneft was the eighth largest Russian producer of crude oil and the sixth largest Russian refiner in terms of volume of oil products produced. Bashneft's business portfolio also includes the production of petrochemicals and the sale of oil products.

Our acquisition of a controlling stake in Bashneft in 2009 expanded our activities into the oil and gas sector. Bashneft became one of our Core Assets. Bashneft's current reorganisation of its corporate structure is an example of our efficient management of Bashneft. The reorganisation is aimed at reducing operating costs and improving operating efficiency and transparency. See "*—Organisational Structure.*"

We currently own 69.0% of Bashneft. In 2009, 2010 and 2011, Bashneft accounted for 26.8%, 43.7% and 50.2%, respectively, of our total revenues.

Bashneft currently holds exploration and production licences for more than 190 fields located in the Republics of Bashkortostan, Tatarstan and Komi, the Orenburg region, the Khanty-Mansiysk Autonomous District and the Nenets Autonomous District. According to Miller and Lents, Bashneft's total proved reserves without taking into account licence expiration dates (excluding Trebs and Titov fields) as at 31 December 2011 were approximately 276.1 million tonnes (1,966.6 mmbbl), which provides for an equivalent of 18.3 years of production. In 2009, 2010 and 2011, Bashneft produced 12.2 million tonnes, 14.1 million tonnes and 15.1 million tonnes, respectively, of crude oil.

Bashneft's refinery complex consists of three interconnected refining facilities, Ufa Oil Refinery, Novoil and Ufaneftekhim, and one petrochemical plant, Ufaorgsintez, with a total capacity of 24.1 million tonnes a year. These facilities together are usually referred to as the "**Ufa Refinery Group.**" In December 2009, Bashneft discontinued providing fee-based refining services to third party suppliers of crude oil. As a result, in 2010 and 2011, Bashneft was the owner of all oil products it produced. Bashneft produces a wide range of refined oil products, the principal ones being diesel fuel, gasoline, fuel oil and vacuum gasoil. Total primary refinery capacity as at 31 December 2011 was 24.1 million metric tonnes a year. In 2010 and 2011, Bashneft's refinery complex refined 21.2 million metric tonnes and 21.1 million metric tonnes, respectively. Approximately 90% of Bashneft's refined oil products are delivered to wholesale customers.

Bashneft also has an extensive retail network of petrol stations. As at 31 December 2011, this network consisted of 724 owned and franchised stations.

Bashneft derives a significant share of its revenues from the sale of oil products, and it also generates revenues from the sale of crude oil. In 2010, Bashneft generated U.S.\$11.7 billion of total revenues, including U.S.\$9.4 billion from the sale of petroleum products and U.S.\$2.0 billion from the sale of crude oil. In 2011, Bashneft generated U.S.\$16.5 billion of total revenues, including U.S.\$13.0 billion from the sale of petroleum products and U.S.\$3.1 billion from the sale of crude oil. In 2010 and 2011, Bashneft's domestic sales accounted for 45.5% and 40.3%, respectively, and export sales accounted for 51.5% and 57.3%, respectively, of Bashneft's overall revenue.

History and Development

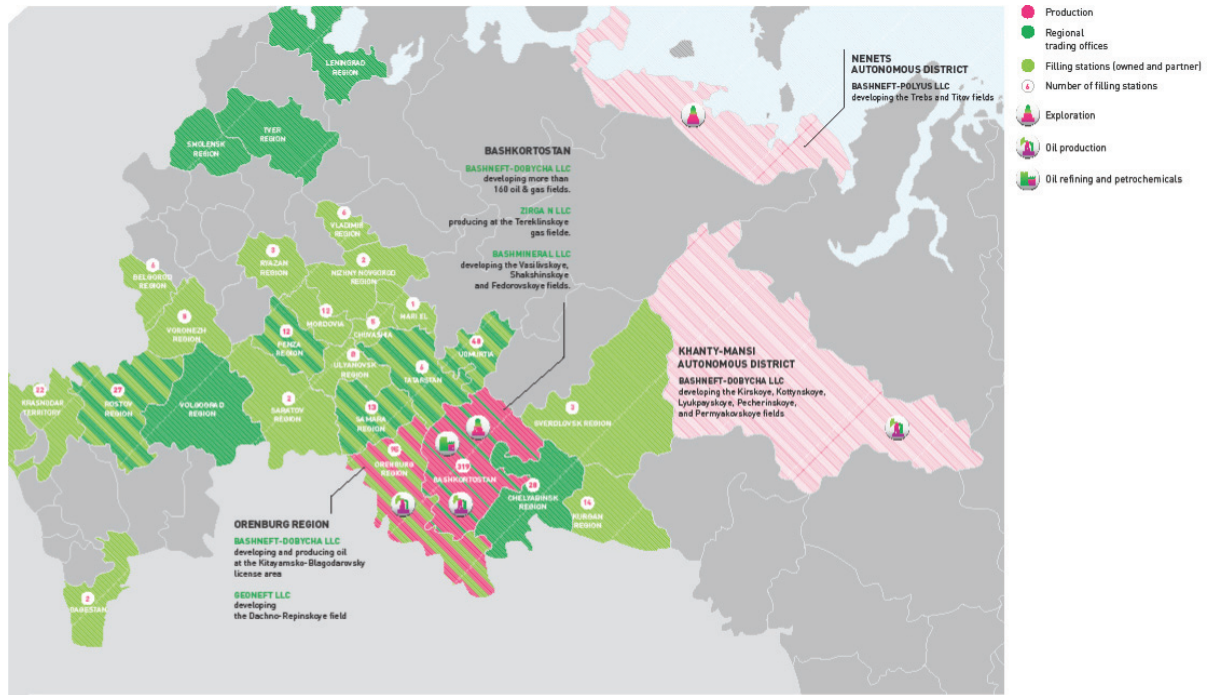
Bashneft's history dates back to 1935, when an independent trust was established consisting of the Ishimbayskoye oil field, the Sterlitamak oil exploration unit and various other assets. In 1995, JSOC Bashneft was incorporated as an open joint stock company.

A key milestone for Bashneft occurred at the end of 2009, when it acquired a controlling stake in Ufaneftekhim, Novoil, Ufa Oil Refinery, Ufaorgsintez and Bashkirnefteprodukt from us and became a vertically-integrated oil company, with both upstream and downstream assets.

In 2011, Bashneft was awarded at auction a subsoil licence, valid for 25 years, to explore and develop the Trebs and Titov oil deposits in the Nenets Autonomous Deposit, which are estimated to contain 140.1 million tonnes of C1 + C2 reserves under Russian classification, according to Rosnedra. The consideration paid for the licence amounted to U.S.\$629 million. In December 2011, Bashneft and LUKOIL created a joint venture for the joint development of the fields. In December 2011, the licence was transferred to Bashneft's wholly-owned subsidiary, Bashneft Polus, in which LUKOIL subsequently acquired a 25.1% interest for RUB 4.8 billion. In 2012, a minority shareholder in JSOC Bashneft brought a claim in the Russian courts, challenging the validity of this licence transfer. Work at the fields is ongoing pending resolution of the dispute. See "*—Material Litigation—Bashneft*" for a discussion of the dispute surrounding the Trebs and Titov licence.

In 2011, Bashneft made significant progress in expanding its commercial activities and establishing its own sales network with the acquisitions of Orenburgnefteprodukt, ASPEC Group and SKON. Following these acquisitions, Bashneft currently has a retail network with 724 petrol stations.

The following map shows the location of Bashneft's activities across the Russian Federation:



Strategy

The overall strategic goal of Bashneft is to create a large scale, vertically-integrated oil company with high-growth in crude oil production, highly developed refining operations and an extensive retail distribution network. To reach this goal, Bashneft has adopted a strategic development programme for 2012 through 2016 and has set forth specific objectives:

- *Growth of the upstream sector.* Bashneft aims to expand its upstream assets through organic growth and acquisitions.
- *Improvement of corporate governance.* Bashneft aims to improve its corporate governance and organisational structures, including by simplifying its structure and implementing an integrated planning system for internal controls and managerial reporting.
- *Maximisation of production and cost control.* Bashneft aims to sustain its current level of crude oil production from existing oil fields and to launch commercial production at Trebs and Titov oil fields in 2013. Bashneft expects to reach peak production output at Trebs and Titov in 2018 to 2023. At the same time, Bashneft is focused on optimising operations so as to control costs and also plans to maintain its reserve base in Bashkortostan as well as seek new development opportunities, particularly in Bashkortostan.
- *Increase of the refining depth and supplies of own crude oil provided to own refining facilities.* Bashneft has taken the strategic decision to focus on refining its own crude, rather than enter into tolling agreements for the refining of crude oil produced by third parties. In connection with this, it is the aim of Bashneft that in the mid-term 80% to 100% of its refining demand be met by its own supply of crude. Bashneft also intends to upgrade its refinery complex, so that 100% of its oil products are Euro 4 or Euro 5 compliant by 2015. In particular, it aims to increase the average refining depth of its refinery complex from 86% to 94.4% and increase the yield of light oil products from 59.9% to 73.4% by 2016, in part through the construction of a delayed coking unit, a vacuum gas oil hydrocracking unit, a hydrogen production unit, a sulphuric acid alkylation unit and a sulphuric acid regeneration unit and a hydrotreating catalytic gasoline cracking unit, reducing its production of vacuum gas oil and fuel oil.
- *Development of the distribution network.* It is a key priority of Bashneft to develop its distribution network and oil storage facilities. To this end, it aims to expand its retail network to 1,200 petrol stations by 2016 and to sell up to 80% of its gasoline output on the retail market at its own petrol stations or those of its partners. Bashneft plans to continue developing the Bashneft brand on both the wholesale and retail markets.

- *Reduction of health, safety and environmental hazards.* Bashneft is committed to protecting the health and safety of its employees, and others who are impacted by its operations, and to reducing its environmental footprint. For this reason, all of Bashneft's projects are evaluated in light of their safety and environmental consequences, and certain of its projects are designed specifically to reduce the company's environmental impact. For example, Bashneft is currently constructing an oil sludge recycling and decontamination unit and is involved in other bio-decontamination projects.

The board of directors of Bashneft also approved the Business Plan of Bashneft for 2012. As part of realising its development strategy through 2016, in 2012 Bashneft plans oil production of 15.2 million tons and oil refining of 20 million tons. Bashneft aims to increase the number of its filling stations and to sell more petroleum products through its own and franchised stations.

Organisational Structure

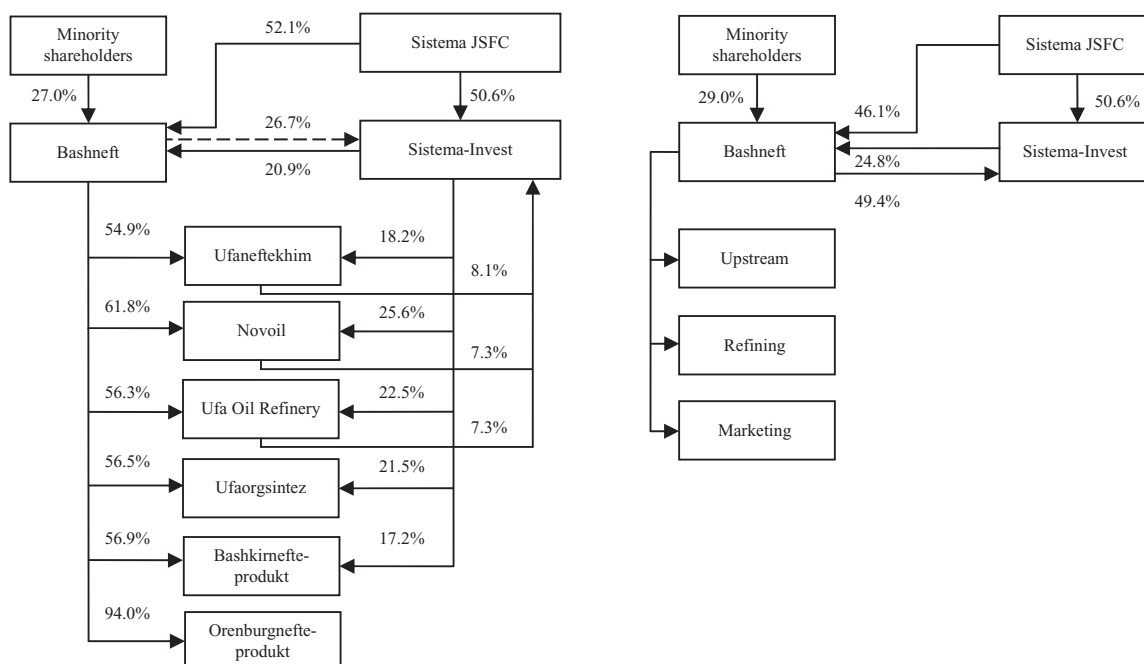
Bashneft's operations are currently divided into the following main segments:

- Exploration and Production;
- Refining and Petrochemicals; and
- Sales and Marketing.

Bashneft has seven principal exploration and production subsidiaries, four principal refining and petrochemical subsidiaries, five principal sales and marketing subsidiaries and one subsidiary responsible for managing its rail business.

In order to reduce operating costs and improve operating efficiency and transparency, Bashneft has commenced the reorganisation of its corporate structure through the merger of the Merger Subsidiaries (Ufa Oil Refinery, Novoil, Ufaneftekhim, Bashkirnefteprodukt and Orenburgnefteprodukt) into JSOC Bashneft. The merger procedure contemplates two steps: (i) the conversion of ordinary and preferred shares in the Merger Subsidiaries into ordinary and preferred shares, respectively, in JSOC Bashneft, at the conversion ratios determined by the boards of directors of JSOC Bashneft and the Merger Subsidiaries; and (ii) a cash buyback by JSOC Bashneft and the Merger Subsidiaries of the shares of those shareholders who did not vote or who voted against the merger. In March 2012, each of the boards approved the proposed terms of the consolidation, including the conversion ratios, and, at the end of April, the shareholder meetings of JSOC Bashneft and each of the Merger Subsidiaries approved the merger, and FAS approved the merger on 13 April 2012. The share buyback is scheduled to be completed in July 2012, and the share conversion is expected to be completed by the end of 2012. At that point, the Merger Subsidiaries will cease to exist as separate legal entities.

The table below sets forth the existing and target corporate structure of Bashneft:



Investment Programme

Bashneft has adopted an investment programme through 2016. According to current estimates, Bashneft anticipates overall organic capital expenditures to equal approximately U.S.\$1.0 to U.S.\$1.2 billion per year.

Of this total amount, approximately 50% is expected to be allocated to the exploration and production segment, 30% to the refining and petrochemicals segment and 20% to the marketing segment.

Capital expenditures in each of the upstream and downstream segments are estimated to be allocated in roughly equal proportion between maintenance and development. Approximately 95% of the planned capital expenditures in the marketing segment are expected to be spent on development as well as additional acquisitions of petrol stations.

Exploration and Production

Licences

As at 1 January 2012, Bashneft has licences for exploration and production of 190 oil fields, 180 of which are located in Bashkortostan, five in the Khanty-Mansiysk Autonomous District, three in the Orenburg Region, and two in the Nenets Autonomous District. While most of Bashneft's production licences expire between 2013 and 2030, the licences for certain fields, such as the Abdullovskeye, Alkinskeye and Kuzbaevskoye fields, expire beyond 2041. The licences for Bashneft's ten largest oil fields, accounting for approximately 55% of Bashneft's proved reserves, without taking into account licence expiration, expire between 2014 and 2021. The licences for Bashneft's largest field, Arlanskeye, expire in 2016. The licences for the Yugomashevskoe, Tuimazinskoe, Znamenskoye, Chetyrmanskoye, Burayevskoye and Illishevskoe fields expire in 2018. The licences for the Igrovskoye and Tatyshlinskoye fields expire in 2014 and 2021, respectively. The licence for the Mancharovskoye field expires in 2016. Bashneft's current production plans are based on the assumption that it will be able to extend all of its existing licences upon their expiration and produce crude oil through the full economic lives of its fields, and not only until the current expiration date of the relevant licences.

As at 31 December 2011, Bashneft held 309 licences for subsoil use, of which 197 are oil and gas Production Licences; 22 Exploration and Production Licences; 2 licences for geological subsoil study. The large majority of these licences pertain to oil fields in the Republic of Bashkortostan.

In 2011, Bashneft was awarded at auction a subsoil licence, valid for 25 years, to explore and develop the Trebs and Titov oil fields in the Nenets Autonomous District, which are estimated to contain 140.1 million tonnes of C1 + C2 reserves under Russian classification (explored and preliminary estimated reserves). In December 2011, the licence was transferred to Bashneft's wholly-owned subsidiary at that time, Bashneft Polus, in which LUKOIL subsequently acquired a 25.1% interest for RUB 4.8 billion. In 2012, a minority shareholder in JSOC Bashneft brought a claim in the Russian courts, challenging the validity of this licence transfer. While Bashneft-Polus may not have met the licence requirements, Bashneft itself (as a major shareholder) has done so, according to Bashneft. Work at the fields is ongoing pending resolution of the dispute. See "*—Material Litigation—Bashneft.*"

In 2011, Bashneft acquired licences for the geological study, exploration, prospecting and production of hydrocarbon deposits at subsoil areas in the Nenets Autonomous District for the following blocks: Vostochno-Padimeisky, Savatinsky, Nyarioyakhsky and Priiskiy. In 2012, Bashneft acquired licences for the geological exploration, surveying and production of hydrocarbons for Yangareiskiy and Sabriyaginskiy subsoil blocks in the Nenets Autonomous District.

Production Licences give Bashneft the exclusive right to exploit fields in a defined area. In 2000, new legislation was passed that requires Production, and Combined Exploration and Production Licences issued from January 2000 to be granted for a period of time coterminous with the economic viability of the applicable field based on a feasibility study. This requirement does not apply retroactively to licences issued prior to this legislation. However, it does apply in circumstances where pre-existing licences expire and need to be renewed following enactment of this legislation. Bashneft believes that, upon their expiration, it will be successful in renewing those licences issued before this legislation came into effect. Since 2003, 26 of its licences have been extended in accordance with this legislation. In fact, to date, Bashneft has been successful in renewing all licences it has sought to renew. Most of Bashneft's Production, and Combined Production and Exploration Licences expire between 2014 and 2030.

In order to comply with the terms of its Exploration and Production Licences, and to meet certain environmental requirements, Bashneft pays certain local and federal taxes. In addition, Exploration and Production Licences typically require a licence holder to make certain commitments, such as extracting an agreed target amount of reserves annually, conducting agreed minimum drilling levels and other exploration and development activities, protecting the environment in the licence area from damage, providing progress reports and geological data to the relevant authorities, and paying royalties and other obligations when due. Licences may be revoked if Bashneft fails to comply with their terms or fail to heed warnings given by regulatory authorities. See *“Risk Factors—Risks Relating to Our Business and Industry—General Risks—The licences and permits that we require for our business may be invalidated, suspended or may not be issued or renewed, or may contain onerous terms and conditions that restrict our ability to conduct our operations or could result in substantial compliance costs or administrative penalties.”*

To date, no Production Licences or Exploration Licences held by Bashneft have been revoked. However, a minority shareholder in JSOC Bashneft has challenged the validity of the licence transfer granted to Bashneft Polus to develop the Trebs and Titov oil fields. See *“—Material Litigation—Bashneft.”* Bashneft actively monitors the potential profitability of each licence and surrenders those licences for areas whose development it deems uneconomic. In 2011, Bashneft surrendered its subsoil rights at the West Vesolvsky licence area and chose not to renew its licence for the Aksenovsky area.

Reserves and Resources

At Bashneft’s request, Miller and Lents, its independent reservoir engineers, has carried out an independent evaluation of certain of Bashneft’s reserves as at 31 December 2011. The properties evaluated are located in the Volga-Ural Region and West Siberian Basin in the Russian Federation. Miller and Lents evaluated 154 of Bashneft’s fields, or approximately 81% of Bashneft’s total fields. Trebs and Titov oil fields were not evaluated by Miller and Lents. Unless otherwise specified, any information in this Prospectus relating to Bashneft’s estimated crude oil reserves is primarily extracted or derived from the Reserves Report prepared by Miller and Lents as at 31 December 2011. The information concerning certain of Bashneft’s estimated crude oil reserves has been prepared in accordance with the definitions contained in SEC Regulation S-X Rule 4.10(a) at that time and has been primarily derived or extracted from the 31 December 2011 report of Miller and Lents. For further information on the SEC Reserves Definitions, see *“Annex A—SEC Reserves Definitions.”*

The process of estimating oil reserves is complex and inherently uncertain. Bashneft is required to project production rates and timing of development as well as to analyse available geological, geophysical, production, engineering and economic data for each reservoir. The extent, quality, and reliability of this data can vary. Furthermore, in 2011, Miller and Lents evaluated more of Bashneft’s fields than in 2010, which may affect the comparability between 2010 and 2011 reserve evaluations. The accuracy of reserves data is also a function of the quality and quantity of other available data, engineering and geological interpretation, and judgment. The Reserves Report was prepared on the basis that Bashneft owns 100% of the reserves discussed therein and was not prepared on the basis of Sistema JSFC’s ownership stake in the reserves, which is less than 100%, given that Sistema JSFC beneficially owns a 69% stake in Bashneft. See also *“Risk Factors—Risks Relating to Our Oil and Energy Business—The crude oil reserves data in this Prospectus are only estimates and Bashneft’s actual production, revenues and expenditures with respect to its reserves may differ materially from these estimates.”*

The tables below include proved reserves that otherwise meet the standards for being characterised as “proved” and that Bashneft estimates it can produce through the economic lives of its licensed fields. However, to follow the SEC guidance, in understanding the proved oil reserves that will be produced during the existing licence periods and those that will be produced during the period of the expected licence extension, the reserves information in this Prospectus is presented for each of these two periods. According to Miller and Lents, the licence expiration dates cause SEC case reserves to be reduced for two reasons. First, production projections are stopped at the licence expiration date. Second, development work scheduled prior to the licence expiration date is excluded as uneconomic if payout does not occur before the expiration date.

The following table sets forth Bashneft's total net proved reserves up to and past the existing licence expiration dates as at 31 December 2011:

Reserves Category	As at 31 December 2011					
	Net Reserves, To Licence Expiration Date		Additional Net Reserves, Beyond Licence Expiration Date		Total Net Reserves to Field Economic Life	
	Oil, MMbbls	Oil, MMTonnes	Oil, MMbbls	Oil, MMTonnes	Oil, MMbbls	Oil, MMTonnes
Proved Developed Producing	537.1	75.5	680.2	95.5	1,217.4	171.0
Proved Developed Nonproducing	106.1	14.9	476.4	66.8	582.5	81.7
Proved Undeveloped	29.8	4.1	136.9	19.3	166.7	23.4
TOTAL PROVED	673.0	94.5	1,293.6	181.6	1,966.6	276.1

According to appraisals of Bashneft's reserves performed by Miller and Lents, as at 31 December 2011, the total proved developed and undeveloped reserves were 276.1 MMTonnes (1,966.6 MMbbls), without taking into account licence expiration dates, an increase of 4.7% compared to the reserves amount as at 31 December 2010. Bashneft's total proved reserves have a reserve life of 18.3 years without taking into account licence expiration dates, based on 2011 production.

The table below sets forth the future net revenues associated with Bashneft's total proved reserves:

Reserves Category	As at 31 December 2011					
	Future Net Revenues ⁽¹⁾⁽²⁾ , To Licence Expiration Date		Additional Future Net Revenues ⁽¹⁾⁽²⁾ , Beyond Licence Expiration Date		Total Future Net Revenues ⁽¹⁾⁽²⁾ to Field Economic Life ⁽³⁾	
	Undisc., MM\$	Discounted at 10% Per Year, MM\$	Undisc., MM\$	Discounted at 10% Per Year, MM\$	Undisc., MM\$	Discounted at 10% Per Year, MM\$
Proved Developed Producing	11,099.4	7,847.2	15,497.8	4,615.7	26,597.2	12,462.9
Proved Developed Nonproducing	1,824.3	936.7	11,935.4	1,767.8	13,759.7	2,704.6
Proved Undeveloped	233.0	45.9	1,814.5	217.9	2,047.5	263.8
Other Capital and Property Taxes	(427.2)	(248.7)	(1,354.9)	(334.6)	(1,782.2)	(583.2)
Total Proved	12,729.4	8,581.1	27,892.8	6,266.9	40,622.2	14,848.0

- (1) Future net revenues as used in this Prospectus are defined as the total gross revenues (total revenues after deduction of transportation costs, export and customs duties, value added tax and other special taxes) less mineral tax extraction taxes, operating costs and capital expenditures. Bashneft's estimates of future net revenues and discounted future net revenues are not intended and should not be interpreted to represent fair market values for the estimated reserves. The operating expenses employed in estimating future net revenues are based on the prospective operating expenses (reduced by total depreciation and mineral extraction taxes) of Bashneft.
- (2) Future net revenues for total proved reserves include deductions for other capital and property taxes, but they do not include deductions for either federal or local taxes on net profit. As at 31 December 2011, Bashneft's capital and property taxes deductions without taking into account licence expiration dates were U.S.\$0.6 billion, discounted at 10% per annum, and U.S.\$1.8 billion, undiscounted.
- (3) These estimates assume that Bashneft's Production licences will be renewed through the economic lives of its fields.

As at 31 December 2011, Bashneft's estimated undiscounted future net revenues attributable to its total fields without taking into account licence expiration dates were U.S.\$40.6 billion, approximately 33.7% higher compared to 2010 year-end assessment completed by Miller and Lents, and the before-tax net present value of the future net revenues without taking into account licence expiration dates, discounted at 10% per annum, in accordance with SEC guidelines, was U.S.\$14.8 billion, an increase of 30.6% compared to 2010 forecasts.

Improved oil prices contributed in part to the increase of future net revenues compared to 2010. As at 31 December 2011, the average oil price employed in computations of revenues by Miller and Lents was U.S.\$45.6 per barrel (converted into barrels at the rate of 7.25 barrels per tonne) compared with U.S.\$35.49 per barrel as at 31 December 2010. This price represents the 12-month average of the first day of the month pricing for 2011. The average net oil price was calculated based on the net export oil price, net oil price and net domestic oil price. According to Bashneft, as at 31 December 2011, 24.2% of oil was exported to non-CIS countries, 68.9% of oil was destined for refining and 6.9% of oil was sold on the domestic market.

However, according to Bashneft, the primary value driver was Bashneft's focus on its core oil properties. In 2011, the volume of Bashneft's oil reserves increased by 4.7% by volume compared to 2010. More importantly, according to Bashneft, its oil reserves increased principally as a result of successful geological studies, revisions to previous estimates, as well as its exploration and development programme in 2011. According to the Reserves Report prepared by Miller and Lents, Bashneft's net total proved volumes of oil and future net revenues are estimated to decrease. According to Bashneft, the rate at which net total proved volumes of oil may decrease depends on each field's production and development plan, depletion rates and natural declines in production, and the rate at which future net revenues may decrease depends on each field's production and development plan, oil prices as well as capital and operating expenditures for each oil field.

See also *“Risk Factors—Risks Relating to Our Oil and Energy Business—The crude oil reserves data in this Prospectus are only estimates and Bashneft's actual production, revenues and expenditures with respect to its reserves may differ materially from these estimates.”*

The Reserves Report evaluates the mineral extraction tax based on Russian tax regulations, and the formula for mineral extraction tax contains an adjustment based on the depletion of Bashneft's fields. According to Bashneft, its average depletion rate was more than 80% as at 31 December 2011, and the mineral extraction tax increased by 50.3% compared to 2010. The increase is primarily based on the increased oil price. Bashneft estimates that it will have sufficient funds to finance its capital expenditures.

In 2011, Bashneft achieved significant growth of its asset base due to its acquisition of a subsoil licence to explore and develop the Trebs and Titov oil deposits in the Nenets Autonomous District. Commercial production is expected to begin in 2013 and reach peak output in 2018 to 2023. For the avoidance of doubt, the Reserves Report does not contain the evaluation of the Trebs and Titov oil fields. See *“—Business Description—Core Assets—Bashneft—History and Development”* for further discussion of Bashneft's acquisition of this licence and *“—Material Litigation”* for a discussion of the dispute concerning this licence.

As at 31 December 2011, ten major producing fields accounted for more than half of Bashneft's proved crude oil reserves (without consideration of licence expiration dates). The Arlanskoye fields (including Arlanskaya, Novo-Khazinskaya, Nikolo-Berezovskaya and Yusupovskaya licence areas) represented the largest constituents of these proved crude oil reserves. While Tuimazinskoye field is the next largest field in terms of proved crude oil reserves, it represents a substantially smaller portion of such reserves. The remaining crude oil reserves from Bashneft's top ten fields are widely dispersed across the third through tenth largest fields. The licences for Bashneft's ten largest oil fields expire between 2014 and 2021. See *“—Licences.”*

Ten major fields are expected to contribute a significant portion to Bashneft's discounted estimated future net revenues (without consideration of licence expiration dates), of which the Arlanskoye fields are expected to contribute the largest amount.

Production

Overview

The table below sets forth Bashneft's production levels for the years ended 31 December 2009, 2010 and 2011:

As at 31 December					
2009		2010		2011	
Tonnes	Barrels	Tonnes	Barrels	Tonnes	Barrels
(in millions)					
12.2	87.1	14.1	100.7	15.1	107.6

In 2011, Bashneft produced 15.1 million tonnes of crude oil, an increase of 6.8% compared to 2010. This growth was mainly due to the introduction of new secondary and tertiary recovery techniques designed to increase average flow rates per well and effective use of modern extraction technologies, such as water injection, hydrofracturing and side-tracking, as well as intensification activities. Oil recovery intensification activities contributed an additional 1.9 million tonnes of production in 2011. Bashneft does not believe it is materially dependent on any single field.

Bashneft's production activities are mainly concentrated in the Republic of Bashkortostan, where its five largest fields—the Arlanskoye, Tuimazinskoye, Yugomashevskoye, Chetyrmanskoye and Ilishevskoye fields—are located. In 2011, production at these five fields accounted for approximately 43.7% of Bashneft's overall

production. In 2011, Bashneft's fields in Bashkortostan produced 14.3 million tonnes of oil, an increase of 9% compared to 2010. In 2011, production in Bashkortostan accounted for 95% of Bashneft's total production.

In Khanty-Mansiysk Autonomous District, Bashneft is developing five fields. In 2011, production in Khanty-Mansiysk Autonomous District accounted for 2.8% of Bashneft's total production.

In the Orenburg Region, Bashneft produces oil in two licensed areas. In 2011, production in the Orenburg Region accounted for 0.9% of Bashneft's total production.

In the Republic of Tatarstan, Bashneft produces oil in one field. In 2011, production at this field accounted for 1.4% of Bashneft's total production volume.

Drilling Services

Bashneft maintains its own in-house drilling company, Bashneft-Drilling, which provides a full range of drilling services not only to Bashneft, but also to external customers. Bashneft-Drilling constructs and reconstructs wells and underground utility pipelines, as well as other drilling services. In addition, Bashneft-Drilling's operational support facility is used by factories and research institutes for testing new types of drilling equipment. Bashneft-Drilling is developing its third-party business. Among its largest external customers are Slavneft-Megionneftegaz, TNK-BP and Rosneft. The company has also carried out a number of international projects including in Mongolia, Vietnam, India, Algeria, Mauritania and Kazakhstan.

Bashneft drilled 171, 122 and 73 new production wells in 2009, 2010 and 2011, respectively.

In 2011, Bashneft drilled 13 exploration wells, compared to 1 in 2010 and 18 in 2009. The decline in drilling in 2010 was mainly driven by the adoption of a more selective approach to drilling and by greater focus on increasing the flow rates at new wells, which, in turn, led to a surge in the flow rates at new wells. See "—Wells," below. Bashneft's drilling success ratio was 62% in 2009, 100% in 2010 and 69% in 2011.

Wells

Bashneft had 19,703 wells as at 31 December 2011, including 15,656 active production wells and 4,047 active injection wells, which are used to pump water or other agents into the reservoir in order to maintain pressure and to enhance crude oil recovery. In 2009, 2010 and 2011, the average daily flow rate was 2.0, 2.6 and 2.8 tonnes, respectively, compared to the average daily flow rate for new wells of 5.9, 13.4 and 14.5 tonnes, respectively.

The table below sets forth information on Bashneft's wells in the years ended 31 December 2009, 2010 and 2011:

	Year ended 31 December		
	2009	2010	2011
Production wells	17,398	16,470	15,656
Injection wells	4,104	4,056	4,047
Total production and injection wells	21,502	20,526	19,703

The table below sets forth Bashneft's drilling activity in the years ended 31 December 2009, 2010 and 2011, which includes drilling performed for Bashneft's own production purposes and for third parties:

Type of Drilling	Year ended 31 December		
	2009	2010	2011
	(thousand metres)		
Production	262	241	160
Exploration	10.5	6.8	30.9

The increase in exploration drilling during 2011 was a result of acquiring the Trebs and Titov licence acquisition as well as more efficient planning.

Well Stimulation Techniques

Four of Bashneft's oil fields have a relatively high depletion level (more than 80% in 2011). Bashneft has designed and successfully implemented a well stimulation programme including a range of measures aimed at

maintaining or increasing production volumes from its fields. Bashneft produced 1,295 thousand tonnes, 1,911 thousand tonnes and 1,610 thousand tonnes of crude oil in 2009, 2010 and 2011, respectively, using various well stimulation techniques. Bashneft intends to continue to use various enhanced recovery techniques to optimise its production of crude oil. Well rehabilitation primarily involves replacing or reconditioning pumps, replacing corroded pipes, and clearing well bores in order to bring wells back into production or increase production. These advanced techniques include flow rate and water injection pattern management, horizontal drilling, hydraulic fracturing and chemical, microbiological and thermal recovery techniques. Bashneft continues to explore technologies that will enhance these methods.

Refining and Petrochemicals

Overview

Bashneft's oil refining complex consists of three interconnected refineries—Ufaneftekhim, Ufa Oil Refinery and Novoil—and one petrochemical facility, Ufaorgsintez, which are closely located to one another. Bashneft believes that the operation of its refining and petrochemical facilities as a single production chain, together with their close proximity to most of Bashneft's oil fields, enhances overall economic efficiency.

Bashneft produces a wide range of refined oil products that include diesel fuel, gasoline (including stable natural gasoline), fuel oil, vacuum gasoil, liquefied gas, bitumen, industrial lubricants and sulphur. Total primary refinery capacity as at 31 December 2011 was 24.1 million metric tonnes a year. In 2010 and 2011, Bashneft's refinery complex refined 21.2 million metric tonnes and 21.1 million metric tonnes, respectively. In 2011, according to the Ministry of Energy, Bashneft refined 8.3% of all oil refined in the Russian Federation and accounted for 12.5% of gasoline produced in the Russian Federation. In December 2009, Bashneft discontinued providing fee-based refining services to third party suppliers of crude oil. As a result, in 2010 and 2011, Bashneft was the owner of all oil products it produced.

Bashneft believes it is one of the leading Russian oil companies in terms of refining efficiency, complexity and quality. Its Nelson Index, which measures a refinery's complexity, is 8.3, comparable to average European levels and among the best in the Russian Federation. Its refining depth, calculated as a weighted average of its three refineries, was 83.4% in 2009, 86.3% in 2010 and 85.9% in 2011. Its light products yield, i.e., light products as a share of overall production, was 60.4% in 2009, 61.8% in 2010 and 59.9% in 2011. The slight decline in 2011 was the result of scheduled maintenance and repairs of certain refining units. As at 31 December 2011, there were no major work stoppages due to unplanned repairs. Average capacity utilisation rates for Bashneft's refinery complex was 86% in 2009, 88% in 2010 and 87% in 2011.

Facilities and Products

Bashneft maintains three oil refining facilities and one petrochemical facility, all located in close proximity to one another and integrated into a single production chain.

Ufaneftekhim

Ufaneftekhim began operations in 1957. Ufaneftekhim specialises in refining West-Siberian crude oil, a mixture of Arlan sour crude oils and gas condensate into a production slate of 30 products, including high-octane motor gasoline, low-sulphur diesel fuel, fuel oil, bitumen, coke, limp and granular sulphur, liquefied gases, benzene, toluene, orthoxylene and paraxylene. Ufaneftekhim is one of the Russian Federation's largest producers of aromatic hydrocarbons.

Ufaneftekhim's capacity is 9.5 million tonnes per year, and, as at 31 December 2011, its refining depth was 94.8% and its light yield was 67.9%. In 2010 and 2011, Ufaneftekhim's throughput was 7.8 million metric tonnes and 8.4 million metric tonnes, respectively.

Ufaneftekhim's key facilities include hydrocracking, hydrotreating, catalytic cracking, deasphalting, visbreaking and bitumen production units. In 2009, Bashneft commissioned a delayed coking unit with an initial capacity of 1.2 million tonnes per year, enabling it to increase its refining depth, and a hydrogen production unit. Other recently completed capex projects at Ufaneftekhim include the reconstruction of its hydrocracking facility and the installation of a hard waste utiliser. The refinery is also implementing a project to improve the productivity of its delayed coking unit, which is expected to be completed in 2012.

Ufa Oil Refinery

Ufa Oil Refinery first launched operations in the 1930s. Ufa Oil Refinery specialises in the production of high-octane gasoline, diesel fuel, fuel oil, LPG and sulphur and uses phenol and acetone, produced at Ufaorgsintez, to manufacture diphenylolpropane, a raw material used to make epoxy resins and polycarbonates.

Ufa Oil Refinery's capacity is 7.5 million tonnes per year, and, as at 31 December 2011, its refining depth was 76.2% and its light yield was 56.6%. In 2010 and 2011, Ufa Oil Refinery's throughput was 6.7 million metric tonnes and 6.1 million metric tonnes, respectively.

Ufa Oil Refinery's key facilities include a catalytic cracking unit and a vacuum gasoil hydrotreater, which was reconstructed in 2009. Bashneft plans to construct a gasoline hydro distiller catalytic cracking unit with a capacity of 1.3 million metric tonnes per year. The purpose of this project is to enable the refinery to produce 100% of its gasoline output in accordance with Euro-4 and Euro-5 standards. To increase refining depth, Bashneft also plans to construct a delayed coking unit at Ufa Oil Refinery with a capacity of 1.6 million metric tonnes per year. This project is expected to be completed in 2016. There are also plans to build a hydrotreating cat-cracked gasoline unit, in order to improve fuel quality, and modernise the refinery's sulphur production facility. The new gasoline unit is expected to come on line in 2013.

Novoil

Novoil first launched its operations in 1951 and is one of the Russian Federation's largest producers of high quality petroleum products as well as one of its leaders in terms of refining depth. Novoil has the capacity to refine sweet and sour crude oil, various gas condensates and medium and heavy oils into a production slate of approximately 100 products, including motor gasoline, jet fuel, diesel fuel, motor oil, transmission and special lubricants, vacuum gas oil, paraffin-wax products, petroleum bitumen, fuel oil, coke and lump sulphur.

Novoil's capacity is 7.1 million tonnes per year, and, as at 31 December 2011, its refining depth was 86.4% and its light yield was 59.8%. In 2010 and 2011, Novoil's throughput was 6.7 million metric tonnes and 6.6 million metric tones, respectively.

Novoil's key facilities include units for hydrotreating, reforming and isomerisation, sulphuric acid alkylation, thermo-cracking, visbreaking, coking, gas fractionation, selective clearing and dewaxing of oil distillates, deasphalting of tar and bitumen, gas desulphurisation and sulphur recovery. In 2009 and 2010, Bashneft undertook a number of measures to improve product quality, including replacing the catalytic system and installing an additional reactor in one of Novoil's diesel hydrotreating blocks and replacing reactors and equipment at Novoil's LP-24-7 unit. Bashneft plans to introduce low temperature isomerisation technology in order to increase production of high-octane gasoline components and construct a sulphuric acid alkylation complex (expected to be completed in 2013), hydrogen unit (expected to be completed in 2013) and hydrocracking complex (expected to be completed in 2016), all of which is designed to improve fuel quality.

Ufaorgsintez

Ufaorgsintez is one of the Russian Federation's largest producers of petrochemicals. Ufaorgsintez was founded in 1994 with assets from the Ufa Synthetic Spirits Plant, which was commissioned in 1956 as the first petrochemical company in Bashkortostan. Ufaorgsintez is integrated technologically with the Ufa Oil Refinery and therefore with Bashneft's refinery complex as a whole. Ufaorgsintez uses petroleum gas, light gasoline (gaseous waste) and benzene from Bashneft's refinery complex to produce approximately 30 types of petrochemical products, including Balen, high-density polyethylene, acetone, phenol, alpha-methylstyrene, isopropyl and synthetic rubber.

Ufaorgsintez's throughput is approximately 500 thousand tonnes per year. In both 2010 and 2011, Ufaorgsintez's throughput was less than 400 thousand tonnes a year of petrochemical products. Ufaorgsintez manufactures approximately 40% of phenol, 20% of polypropylene and 13% of low-density polyethylene produced in the Russian Federation.

Key customers of Ufaorgsintez's products include various chemical companies, which use its petrochemical products to manufacture plexiglass, diphenylolpropane, phenol resins, alkylphenol, oil additives, plastic film, technical and agricultural items and various rubber products. Many of Ufaorgsintez's products are used in the manufacture of electrical and electronic equipment, including as insulation for pipes and cables in electrical appliances, and as a corrosion-resistant coating.

Feedstock Supply Arrangements

Crude oil is Bashneft's principal feedstock, although Bashneft also requires small amounts of other feedstock, including gas condensate, as well as a regular supply of electricity, heat, water and natural gas.

In 2010 and 2011, crude oil and gas condensate purchased from third-party suppliers equalled 11.0 million tonnes and 10.7 million tonnes, respectively, which accounted for 52% and 51%, respectively, of Bashneft's feedstock supplies. The remainder, or 10.0 million tonnes in 2010 and 10.2 million tonnes in 2011, came from Bashneft's own hydrocarbon supplies. Bashneft sells on the domestic market and exports the balance between the amount of crude oil it produces and consumes.

In December 2009, Bashneft discontinued providing fee-based refining services to third party suppliers of crude oil. As a result, in 2010 and 2011, Bashneft was the owner of all oil products it produced.

Third-party purchases of oil constitute a significant share of Bashneft's operating costs. Key suppliers include LUKOIL, TNK-BP, Shell and Surgutneftegaz, which together accounted for 77.5% of Bashneft's third-party oil purchases in the year ended 31 December 2011. Bashneft is not dependent on one particular supplier and third-party oil purchases are made in approximately proportional quantities.

Bashneft purchases most of its third-party oil supplies pursuant to one-year contracts with the option to extend. Volumes and prices are set under monthly supplemental agreements. The contracts stipulate guaranteed monthly volumes, which, subject to certain conditions, can be increased upon agreement between Bashneft and the supplier. Prices are denominated in roubles, but linked to international prices for crude, which are denominated in U.S. dollars. Some agreements determine prices pursuant to specific formulas, and some agreements contain fixed prices stipulated in supplemental agreements.

The majority of Bashneft's crude oil supplies are delivered to Bashneft's refinery complex by the Transneft pipeline network. Transneft is a state-controlled monopoly that operates the Russian Federation's crude oil pipeline network. The Russian government regulates access to the pipeline and is required by law to provide such access on a non-discriminatory basis. The FTS sets pipeline tariffs, which are set in roubles and are dependent on transport destination, delivery volume, distance of transportation and several other factors. They are revised by the FTS. Bashneft is responsible for paying the transportation costs of third party oil supplies. Bashneft has not experienced any material disruptions in the supply of its own and third party oil to its refinery complex.

Sales and Marketing

Overview

Bashneft sells crude oil and oil products on both the export and domestic markets. In 2010 and 2011, crude oil sales accounted for 17% and 19%, respectively, and oil products sales accounted for 80% and 79%, respectively, of Bashneft's overall sales. Bashneft's key priority in sales and marketing is to increase the share of domestic retail sales of oil products, in part through the expansion of its own proprietary sales network.

Crude oil

Bashneft refines most of its crude oil production and only sells to third parties the difference between own production volumes and own refining requirements. As at 31 December 2011, 24.2% of Bashneft's crude oil was exported to non-CIS countries, 68.9% of oil was destined for refining and 6.9% of oil was sold on the domestic market. In 2010, Bashneft produced 14.1 million tonnes of crude oil, of which 10.1 million tonnes were delivered to Bashneft's refinery complex and 3.1 million tonnes were sold on the export markets. In 2010, Bashneft sold 0.9 million tonnes of crude oil on the domestic market. In 2011, Bashneft produced 15.1 million tonnes of crude oil, 10.5 million tonnes of which was delivered to Bashneft's refinery complex and the remaining balance was sold on the domestic and international markets. In 2011, Bashneft sold 1.02 million tonnes of crude oil on the domestic market.

Bashneft's crude oil exports are dispatched by pipeline to the entry point of the Druzhba pipeline and to the Primorsk and Gdansk ports for onward delivery by ship. Key export destinations include Poland, Germany and the Czech Republic. In 2010, in terms of volume, 37% of Bashneft's crude oil exports were shipped to the Czech Republic, 34% to the Primorsk Port for onward delivery, 19% to Poland, 6% to the Gdansk Port for onward delivery and 4% to Germany. In 2011, in terms of volume, 40% of Bashneft's crude oil exports were shipped to the Czech Republic, 14% to the Primorsk Port for onward delivery, 38% to Poland, 4% to the Gdansk Port for onward delivery and 4% to Novorossiysk for onward delivery.

Generally, Bashneft enters into framework agreements with its export customers. The agreements are not automatically extended, but they can be prolonged upon mutual consent of the parties by signing an additional agreement. Price, product specifications and volumes are set pursuant to supplemental agreements with respect to each delivery.

Bashneft's export agreements provide that crude oil may be shipped either through the destination points of Poland, Slovakia, Hungary or Ukraine or through southern Russian and Ukrainian sea ports. The pipeline deliveries to these destination points should be arranged by Bashneft.

For crude oil shipped overland, the price is determined as an average number based on the highest and lowest "Brent Dated"/"Brent (Dtd)" quotations as published in "Platts Crude Oil Assessments"/"Platts Crude Oil Marketwire," for all available quotations published during the month of delivery minus a discount to be mutually agreed by the parties for each cargo in a supplemental agreement. The payment has to be made within 5 business days after presentation by the seller of its commercial invoice and copies of acts of delivery and acceptance.

For crude oil shipped through the sea ports, the price is determined as an average number based on the highest and lowest "Brent Dated"/"Brent (Dtd)" quotations as published in "Platts Crude Oil Assessments"/"Platts Crude Oil Marketwire," for the five consecutive quotations published after the respective bill of lading date or other quotations agreed upon between the parties minus a discount to be mutually agreed by the parties for each cargo in a supplemental agreement. The payment has to be made within 5 business days after presentation by the seller of seller's commercial invoice.

Oil products

In 2010, Bashneft sold 18.9 million metric tonnes of oil products, of which 11.1 million metric tonnes were sold on the domestic market and 7.8 million metric tonnes were sold on the export market. In 2011, Bashneft sold 19.3 million metric tonnes of oil products, of which 10.2 million metric tonnes were sold on the domestic market and 9.2 million metric tonnes were sold on the export market. Bashneft adjusts its export/domestic sales balance on a monthly basis in response to changes in market dynamics or export duty rates. While export sales may from time to time command a premium over domestic sales of Bashneft's oil products, the domestic market is becoming equally important to Bashneft's oil products sales.

An effective quality control strategy is a significant part of Bashneft's business. Bashneft has developed a comprehensive quality control procedure, whereby audits are conducted throughout the production process to ensure that raw materials, technological processes, management systems, production processes and products comply with Russian technical regulations. The quality control procedure also ensures that Bashneft adheres to best practices in occupational health and safety and environmental protection. All fuel produced by Bashneft is at least compliant with the Euro-3 standard (a European emission standard that defines acceptable limits for exhaust emissions).

The following table sets forth Bashneft's sales of refined oil products in terms of volume for the periods indicated:

	For the year ended 31 December		
	2009	2010	2011
Volume			
Domestic wholesale market	53.1%	55.5%	47.3%
Domestic retail market	7.6%	3.2%	5.3%
Export market	39.3%	41.3%	47.4%

Domestic sales

Most of Bashneft's sales of oil products are on the domestic market. In 2009, 2010 and 2011, Bashneft sold 4.2 million metric tonnes, 11.1 million metric tonnes and 10.2 million metric tonnes, respectively, of oil products on the domestic market. Gasoline, diesel, fuel oil and vacuum gas oil constitute Bashneft's principal domestic oil products sales. From the second half of 2009 through 2011, over 80% of Bashneft's domestic sales occurred on the wholesale market in contrast to the retail market. Nevertheless, it is a strategic priority of Bashneft to sell a greater share of products directly to retail customers through the expansion of its retail network. See "*Retail Network*."

In 2011, Bashneft's main customers accounted for approximately 50% of its domestic oil products sales, a substantial share of which was sold through Bashneft subsidiaries, including CJSC Bashneft-Region ("**Bashneft-Region**"), Bashkirnefteprodukt and Orenburgnefteprodukt, which are involved in small wholesale and retail operations.

The key sales area for Bashneft's domestic sales of oil products is Bashkortostan and the neighbouring regions. In 2011, oil products have been delivered to the Russian Federation's Central region, North-Western region, Ural region and Volga region, including Bashkortostan.

Bashneft also sells its oil products on commodity exchanges, and believes such sales will become increasingly important in the future. Bashneft is accredited to trade on the Interregional Stock Exchange for the Oil and Gas Complex and the St. Petersburg International Mercantile Exchange.

Bashneft's domestic sales of oil products are delivered by pipeline and railroad. In 2011, in terms of volume, the majority of Bashneft's domestic fuel oil sales were delivered by rail and the remaining balance by pipeline.

Retail network

Retail sales have been a highly profitable and relatively stable segment, and, as a result, one of Bashneft's key priorities is to rapidly expand its distribution network and increase the share of its retail sales conducted through its own network. To reach this goal, Bashneft will endeavour to expand its network of petrol stations through acquisitions and through partnership arrangements.

In 2009, 2010 and 2011, Bashneft sold 526 thousand tonnes, 616 thousand tonnes and 1023 thousand tonnes, respectively, of oil products at its owned petrol stations. Bashneft's retail sales amounted to 616 thousand tonnes in 2010 and 1,023 thousand tonnes in 2011. Motor fuels represent Bashneft's key retail product.

By year-end 2009, Bashneft managed 319 petrol stations, all of which were Bashneft's own stations. In 2010, Bashneft established its partnership programme, whereby Bashneft enters into franchise agreements with partners, who, in turn, sell oil products under the Bashneft brand. By year-end 2010, Bashneft expanded its retail network to 547 stations, 318 of which were owned stations and 229 were partner stations. In 2011, Bashneft made a number of acquisitions to expand its retail network: Orenburgnefteprodukt, which owned 95 petrol stations and 16 storage facilities, in April 2011; finished consolidation of the ASPEC Group, which owned 44 petrol stations and two oil depots in Udmurtia, in July 2011; and SKON, the third largest retail chain in Sverdlovsk region with 25 petrol stations, in December 2011. By year-end 2011, Bashneft owned 460 petrol stations (including 20 leased petrol stations), and operated more than 200 stations through its partnership programme. In April 2012, Bashneft announced its acquisition of 12 additional petrol stations in the Kurgan Region of the Russian Federation.

As at 31 December 2011, approximately 45% of Bashneft's petrol stations were located in Bashkortostan, and 14% and 7%, respectively, in the neighbouring regions of Orenburg and Udmurtia. Bashneft expects to continue focusing its expansion plans on these regions, as well as other neighbouring regions within 1,000 km of Ufa and the growing markets of Moscow and St. Petersburg.

By 2016, Bashneft aims to expand its retail chain of owned stations to approximately 1,200 stations and to sell up to 80% of its gasoline production through its own retail network.

Export sales

Bashneft entered the petroleum product export market in the second half of 2009. In 2009, 2010 and 2011, Bashneft exported 2.7 million metric tonnes, 7.8 million metric tonnes and 9.2 million metric tonnes, respectively, of oil products, mainly to countries outside the CIS. Bashneft's principal oil products exports are gasoline, diesel, fuel oil and vacuum gas oil.

The following table sets forth the sales of Bashneft's principal oil products exports, by volume, for the periods indicated:

<u>Oil Product</u>	<u>Total Sales</u>		
	<u>2010</u>	<u>Year ended 31 December 2011</u>	
	<i>(in thousand tonnes, except for percentages showing change)</i>		
			<i>%</i>
Diesel fuel	4,308	5,327	23.7
Vacuum gas oil	1,686	1,896	12.5
Fuel oil	732	961	31.3
Naphtha	403	370	-8.2
Gasoline	526	425	-19.2
Other	84	115	36.9
Total	7,739	9,094	17.5

Bashneft has the capacity to adjust its export product mix in response to changes in market dynamics or tax policies. For example, the 60-66-90 Scheme for calculating the marginal export duty rates on crude oil and oil products, which came into effect on 1 October 2011, has prompted Bashneft to reduce its gasoline exports, a percentage of which has been redirected to domestic sales, and increase its fuel oil and vacuum gas oil exports. See "*Regulatory Overview—Regulation of the Oil Industry in the Russian Federation.*"

Exports are typically made through trading companies pursuant to both long-term and short-term contracts. Principal export customers include Baltic International Trading LLC, Glencore Energy UK Ltd., Limited Liability Company Triple, Litasco S.A., Mercuria Energy Trading S.A., Minco Enterprises Ltd., Septo Trading Inc., Somitekno Ltd., Souz Petroleum SA (oil export), Star Oil (FZE) (oil export), TNK Trade Ltd. And Vitol SA.

Bashneft exports various petroleum products, including, but not limited to, bitumen, diesel fuel, naphtha residual, stable natural gasoline and diphenylolpropane. Petroleum products are delivered by rail or pipeline in accordance with additional agreements and supplements with respect to each cargo or period of delivery. During the month preceding the month of shipment a buyer usually sends to the seller, within a deadline specified in the framework agreement, a preliminary delivery request with the indication of quantity of products to be shipped. Following the preliminary delivery request, the seller makes initial transportation arrangements. Upon receiving the final delivery request, the seller ships the products. The price procedure is stipulated by a respective supplemental agreement that can provide for prepayment with subsequent reconciliation or payment after delivery.

Bashneft's oil products are delivered to export ports through the Transnefteprodukt network of pipelines and by rail. In 2011, in terms of volume, most of fuel oil exports were delivered by rail; most of diesel exports were delivered by pipeline, with the remaining balance delivered by rail; and most of gasoline exports were delivered by rail, with the remaining balance delivered by pipeline.

Transportation and Logistics

Crude oil

Bashneft transports substantially all of its crude oil through the pipeline system operated by Transneft, the Russian Federation's monopoly pipeline operator. Transneft is a state-controlled company and the Russian government is expected to retain control over Transneft for the foreseeable future. Russian governmental authorities regulate access to Transneft's pipeline network both for delivery to international destinations and for delivery to port terminals. Pipeline capacity is allocated quarterly. If the capacity requested by oil producers exceeds the total available export capacity, which it has since the 1990s, it is allocated in proportion to the amount of oil produced and delivered to the Transneft pipeline system in the prior quarter and planned oil production in the following quarter. Russian governmental authorities require that the maintenance of a steady supply to the Russian domestic market take priority, which serves to restrict the allocation of export pipeline capacity. Generally, a Russian oil company, such as Bashneft, is given an allocation for export to non-CIS countries equal to approximately 24% of its total crude oil produced and delivered to Transneft. These constraints have subsided in recent years as a result of the further development of the Transneft pipeline network and a shift to the production and export of refined products by vertically integrated Russian oil companies. In addition, Bashneft often acquires additional export pipeline capacity from other Russian oil companies.

Transportation Costs

The FTS, which regulates the activities of natural monopolies in petroleum and energy transportation networks, sets the tariff rates for the use of Transneft's pipelines for domestic shipments and auxiliary services related to the acceptance and delivery of crude oil. The FTS is authorised to periodically review and set the tariff rates applicable to each segment of the pipeline and for the entire pipeline. The tariffs are dependent on transport destination, delivery volume, distance of transportation and several other factors, and are revised by the FTS at least annually. Historically, Transneft's tariffs have tended to increase. Fees for transportation taking place outside the Russian Federation are not subject to the FTS regulation. In 2011, the Transneft tariff (exclusive of VAT) was approximately RUB 600 per tonne to Primorsk and RUB 550 per tonne to the Czech Republic. Transportation costs within the Russian Federation are paid in roubles, and the costs for transportation outside the Russian Federation are commonly paid in U.S. dollars. Transneft charges Bashneft both the applicable FTS tariff for the Russian segment of Bashneft's crude oil transportation and an additional fee for non-Russian segments (including transportation in Ukraine and Belarus), in its capacity as an agent for non-Russian transportation providers. The cost of transportation is reflected in the sales price in the majority of Bashneft's crude oil sales contracts.

Oil Products

Bashneft's Transport Infrastructure

Bashneft maintains its own transport infrastructure, including a fleet of 4,500 rail tank wagons. In 2011, Bashneft's rail tank fleet transported more than 6.7 million tonnes of oil products, accounting for approximately 60% of the total volume of Bashneft products shipped by rail.

Market and Competition

Bashneft competes with a number of oil production companies in the Russian Federation. Bashneft's primary competitors include: Tatneft, LUKOIL, Udmurtneft and Belkamneft. Some of Bashneft's main competitors in the petroleum products production and sales area are TNK-BP, LUKOIL, Surgutneftegas and Rosneft.

The key activities in which Bashneft faces competition include:

- the acquisition of exploration and production licences at auctions or tenders by Russian governmental authorities;
- the acquisition of other companies already owning licences or existing hydrocarbon producing assets;
- domestic, retail and export sales;
- the engagement of leading third party service providers whose capacity to provide key services may be limited;
- the purchase of capital equipment, which may be scarce;
- the employment of the qualified and experienced staff; and
- the availability of sufficient transportation capacity.

As a result of numerous factors, Bashneft expects competition in the oil industry to intensify. A number of other Russian oil companies, as well as foreign companies, are able to compete for licences and offer services in the Russian Federation, increasing the domestic competition. Bashneft also expects domestic competition to increase due to the limited quantities of unexploited and unallocated hydrocarbon reserves remaining in the Russian Federation and the effects of, and financial resources provided by, increasing levels of foreign investment in Russian projects. Internationally, Bashneft competes with oil companies outside of the Russian Federation. In some cases, Bashneft may be at a significant disadvantage because foreign-domiciled companies may have access to greater financial, technical and other resources, giving them a competitive advantage on the specific projects and markets in which Bashneft competes.

Health, Safety and Environment

In 2010, Bashneft adopted a health, safety and environment strategy (the "HSE Strategy").

Health and Safety Management

In the sphere of health and safety management, the HSE Strategy includes the following main objectives:

- Protecting the life and health of Bashneft's employees;
- Maximising safety provisions for Bashneft's employees in case of accident;
- Achieving industry-leading levels of worker health and safety;
- Ensuring all Bashneft's subsidiaries and affiliates have certificates confirming conformity of their health and safety provisions to established Government norms.

Bashneft aims to ensure that industrial safety requirements are met during implementation of all technical projects. Bashneft has introduced a multi-level system of production control at hazardous production facilities to manage risk, prevent accidents and ensure overall industrial safety.

Bashneft has collaborated with a leading international consulting company, Ernst & Young, for the design and implementation of a risk control system to reduce the probability of accidents and to organise a risk management system that addresses various issues, including matters of industrial and environmental safety. Bashneft has also set up a permanent Risk Committee and Risk Management Department to monitor risks and develop responses to accidents. Bashneft carries out regular inspections of its facilities, trains its employees in safe work practices and provides its workforce with all necessary protective gear.

In 2010, there were four production accidents at Bashneft, including one fatality resulting from a motor vehicle accident. In 2011, there were three production accidents. So far in 2012, there have been three production accidents, including six fatalities resulting from negligence and violation of safety measures.

Environment

Environmental risks are inherent in the oil business, and environmental protection has been and will remain an important concern for Bashneft.

In April 2012, an oil spill at the Trebs and Titov field leaked approximately 600 tonnes of oil. According to Bashneft, the accident was most likely caused by breakage of an old well's corroded plug. See *"Risk Factors—Risks Relating to Our Oil and Energy Business—We may be subject to claims and liabilities under health, safety and environmental laws and regulations, and future changes to such regulations may materially increase the cost of compliance."*

In recent years, Bashneft has taken a number of concrete steps to reduce its impact on the environment. Processing and detoxifying legacy oil sludge is one of Bashneft's principal environmental challenges. In response to this challenge, Bashneft's in-house R&D unit developed a new agent that breaks down the biological components of sludge, thereby removing harmful pollutants and toxins. To date, Bashneft has built two sites for the application of this agent and plans to install six more sites in the future.

Minimising air pollution is another important objective for Bashneft. Atmospheric pollutant emissions at Bashneft's production facilities are within permissible limits, and they are on a steadily declining trend thanks to the implementation of new organisational and technological measures.

All of Bashneft's main storage facilities have up-to-date hermetic systems for control of light hydrocarbon fractions. Units installed at Bashneft's refineries capture the fractions for recuperation of hydrocarbon fumes and subsequent hermetic loading into rail tanks.

A unit for removing sulphur from straight-run gases has been installed on a distillation tower at the Ufa Oil Refinery in order to further reduce atmospheric emissions. The unit fully cleanses fuel gases before their use, significantly reducing the emission of sulphurous gases into the atmosphere.

The transition to Euro-4 and Euro-5 compliant fuel products is an essential step in reducing Bashneft's atmospheric pollutant emissions. Vehicle exhaust emissions account for more than 60% of all atmospheric pollutants in large Russian cities, and the use of Euro-4 and Euro-5 products are expected to significantly lower overall exhaust emissions. Bashneft aims to produce only Euro-5 compliant products by 2015.

Flare equipment at Bashneft's refineries is fitted with systems for capturing emergency gas releases, which are compressed and returned to the fuel system for repeat use. Bashneft has approved a corporate programme for the period 2010 to 2013 to increase productive use of secondary gas. This programme, for which Bashneft has allocated RUB 1.57 billion, is projected to increase productive use of associated gas from 83.1% in 2010 to 95% in 2013. Bashneft uses associated gas in multiple capacities. Using multi-phase booster pumps, associated gas is injected, together with water, into strata at the Ilishevskoye field, which reduces harmful atmospheric emissions and helps to maintain strata pressure. Associated gas is also injected into hydrocarbon pools at certain oil fields to enhance oil recovery rates.

Bashneft reduces its negative impact on surface and ground water through the installation of drainage systems at its oil storage facilities and petrol stations. Equipment is used to collect and purify the water, which is then employed for technical purposes.

Property

Bashneft owns and leases certain land properties, including the property on which its refinery complex is located and the properties on which its petrol stations are located. Bashneft also leases land from municipal authorities generally pursuant to long-term lease agreements.

Employees

In 2009, 2010 and 2011, Bashneft employed on average approximately 62,261, 60,870 and 54,160 employees, respectively. Bashneft believes that the relations with its employees are satisfactory.

BASHKIRENERGO

Overview

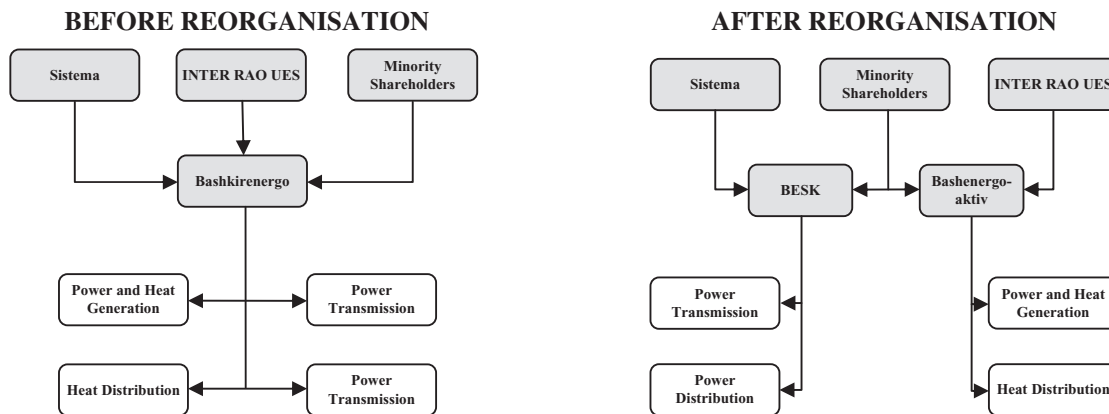
Bashkirenergo is a mid-size regional utility company in the Republic of Bashkortostan in the Russian Federation. It currently consists of two main divisions: (i) power generation and heat generation and distribution; and (ii) electricity distribution and transmission. See "*—History and Development*" for a discussion of the reorganisation of Bashkirenergo. In terms of installed capacity, Bashkirenergo is one of the Russian Federation's leading utility companies. We classify our holding in Bashkirenergo as a Core Asset due to its previous affiliation with Bashneft. See "*—Our businesses—Core Assets.*"

History and Development

OJSC Bashkirenergo was established by the State Committee for State Property Management of the Republic of Bashkortostan on 30 October 1992 as an integrated company that would produce, transmit, distribute and supply heat and power to final consumers. We took control over Bashkirenergo through our purchase of Bashneft in 2009. We beneficially own 39% in OJSC Bashkirenergo (and our voting interests comprise 50.2%). INTER RAO currently owns more than 25% of OJSC Bashkirenergo, with the remaining interests owned by various minority shareholders.

The implementation of new laws in the Russian electricity industry from 2001 to the present transformed the overall structure of the power industry through restructuring regional vertically-integrated power companies. New Russian laws require the unbundling of power generation and sales assets from power transmission and distribution assets. Consequently, Bashkirenergo is currently being reorganised so that its power and heat generation assets and heat distribution assets will be controlled by one company, Bashenergoaktiv, and its power transmission and distribution assets will be controlled by another company, BESK. On 12 May 2012, we entered into an agreement with INTER RAO UES in respect of the proposed reorganisation of Bashkirenergo where we have given certain warranties, indemnities and other undertakings to INTER RAO UES. As a result of this reorganisation, we expect to receive a combination of cash and promissory notes from INTER RAO UES. Subject to the approval of shareholders of Sistema and of Bashkirenergo and certain other conditions, including receipt of necessary government approvals and the execution of additional ancillary agreements, the reorganisation is expected to be completed in the fourth quarter of 2012 or first quarter of 2013. Following the reorganisation, we expect to hold a 75% stake in the power transmission and distribution company, BESK, and no stake in Bashenergoaktiv. In September 2011, Bashkirenergo sold its power retail business (LLC ESKB) to JSC RusHydro for 5.7 billion RUB.

The table below sets forth the existing and target corporate structure of Bashkirenergo:



Strategy

Bashkirenergo aims to (i) enhance its competitive advantage through the implementation of measures to enhance energy efficiency; (ii) remain a leader in the use of state-of-the-art technology in new construction and modernisation projects; and (iii) improve its operational effectiveness by introducing international best practices into its management structure. In August 2011, Bashkirenergo adopted a new organic growth strategy for 2012 to 2016, according to which Bashkirenergo intends to continue its work on the development of electricity and heat grids.

Current Operations

Bashkirenergo’s principal business is the transmission and distribution of electricity, and, currently, the generation of electricity and heat and distribution of heat. Following the reorganisation of Bashkirenergo, which is expected to be completed in the fourth quarter of 2012 or first quarter of 2013, we anticipate disposing of its power and heat generation and heat distribution businesses and keeping its power transmission and distribution business only.

Generation

Bashkirenergo’s current generation facilities are located in the Republic of Bashkortostan. However, as required by Russian law, Bashkirenergo is in the process of a reorganisation in order to separate its generation and sales assets from its power transmission and distribution assets. See *“Regulatory Overview—Regulation of the Electric Power Industry in the Russian Federation.”*

Bashkirenergo’s generation is conducted by its two wholly-owned subsidiaries: BGK LLC and BashRTS LLC. Bashkirenergo’s generation facilities are relatively new. As at 31 December 2011, total installed electricity and heat capacity of Bashkirenergo’s generating facilities equalled 4,296 MW and 13,035 Gcal/h.

Bashkirenergo’s generation units consist of the following:

- Karmanovskaya GRES;
- 10 combined heat and power plants (“CHPP”);
- four gas-turbine mini CHPP (“GT CHPP”);
- four gas generator mini CHPP (“GG CHPP”);
- two hydro power plants (“HPP”);
- eight mini HPP (“mHPP”); and
- one wind power plant.

In 2010, Bashkirenergo decommissioned 333.5 MW and 1,758.7 Gcal/h of old generation capacities as these had become uneconomic to run. However, the following new equipment was commissioned during the same period: bottom turbine K-45-1,6 at the Ufimskaya CHPP-4; GTPP-25 at the Ufimskaya CHPP-1; and the first phase of

Zauralskaya CHPP's development, including hot-water boiler with a capacity of 85 Gcal/h. In addition, the early stages of the second phase of the Zauralskaya CHPP's development had commenced, including the construction of the GTPP-16PA with heat recovery steam generator.

Furthermore, in 2011, Bashkirenergo completed the modernisation of the CCGT-60 at the Ufimskaya CHPP-2. As a result of such modernisation, total installed electricity and heat capacity of this generating facility equalled 493 MW and 1,478 Gcal/h.

Electricity

Bashkirenergo produces electricity in the two integrated energy systems ("IES")—Urals IES and Middle Volga IES. In 2010 and 2011, Bashkirenergo's total power generation was 22.6 billion kWh and 22.8 billion kWh, respectively. Of Bashkirenergo's generating assets, the Karmanovskaya GRES generated the most electricity, producing approximately 50% of Bashkirenergo's total electricity output in 2010 to 2011.

The overall load factor of Bashkirenergo's facilities equalled 60.9% in 2010 and 61.2% in 2011. The load factor is the ratio of actual power generated to potential power that can be generated, assuming continuous operation at nominal capacity over a given period. The load factor depends on several factors, including condition of the overall economy and seasonal factors. Operational capacity is typically lower in the summer months, due to warmer weather and temporary plant closures for repairs.

Wholesale Market for Electricity and Capacity

Bashkirenergo sells electricity and capacity in the first pricing zone of the Russian Federation's wholesale electricity and capacity market. Electricity and capacity are treated as separate economic products in the Russian electricity market. A sale of capacity represents the obligation to maintain sufficient generation capability to satisfy a target level of potential demand, while a sale of electricity represents an actual delivery of electricity to its purchaser.

The wholesale electricity market underwent substantial reform at the end of August 2006. As a result, Bashkirenergo sells its electricity output pursuant to Regulated Contracts and on the free market, either (i) on the Day Ahead Market, which performed a competitive selection of bids of Bashkirenergo and its customers a day before the actual delivery of electricity for every hour of the next day, or (ii) on the Balancing Market, which is a real-time market for electricity based on competitive bids submitted by suppliers and market participants and which is intended to cover the deviations between planned power volumes on the Day Ahead Market and actual generated or consumed volumes, or (iii) pursuant to unregulated bilateral contracts, which flexible price was set as a formula. Whereas prior sales of electricity were priced based on intragroup dealings, during 2011, Bashkirenergo started selling its electricity output based on Regulated Contracts and on the free market. In 2011, Bashkirenergo's electricity sales equalled 24.5 million kW/h, and approximately 14% of its electricity output for sale pursuant to Regulated Contracts.

Capacity sales are made in the Urals Free Power Transfer Zone, one of only two zones not covered by price caps introduced during a competitive capacity selection in 2011. In 2011, Bashkirenergo's capacity sales amounted to 44,9 GW, with Regulated Contracts accounting for approximately 30% of such sales. Capacity tariffs are established by the FTS.

Heat Generation

In 2010, Bashkirenergo's overall heat output totalled 24.1 million Gcal (2.3% of the Russian Federation's heat output) compared to 25.1 million Gcal in 2011, an increase of 4.1% from 2010 (2.2% of the Russian Federation's heat output).

Heat is mainly generated through CHPP's and boiler plants, and, as opposed to the electricity output, the heat output is produced by each Bashkirenergo generating asset in approximately the same quantities.

Heat Distribution

Bashkirenergo currently owns a heat distribution company, BashRTS, which operates 2,031 km of heating grids, 4,047 Gcal/h of water heating boilers and 871 Gcal/h of steam boilers.

In 2010 and 2011, the volume of heat distributed through Bashkirenergo's grids totalled 18.9 million Gcal/h and 15.2 million Gcal/h, respectively. The volume of heat lost during distribution equalled 1.7 million Gcal/h in both 2010 and 2011, respectively.

In 2011, the average tariff for heat consumers was RUB 608/Gcal, an increase of 10% from 2010.

Electricity Transmission and Distribution

Bashkirenergo's transmission and distribution assets include two power grid companies: BSK and BashRES. BSK currently operates high-voltage transmission lines and substations with voltages between 220 and 500kV, including 2,205km of transmission grids and 6,921 MVA of step up and step down transformer substations. BashRES currently operates transmission lines and substations with voltages under 110kV, including 79,828 km of overhead distribution grids and 6,330 km of cable distribution grids.

In 2010 and 2011, the volume of electricity transmitted through Bashkirenergo's transmission grid totalled 21.7 billion kW/h and 21.6 billion kW/h, respectively. The volume of electricity lost during transmission equalled 0.3 billion kW/h both in 2010 and 2011.

The volume of electricity distributed through Bashkirenergo's distribution grid equalled 18.9 billion kW/h and 19.8 billion kW/h, respectively, in 2010 and 2011. The volume of electricity lost during distribution equalled 1.7 billion kW/h and 1.8 billion kW/h in 2010 and 2011, respectively.

In 2011, 14,289 technological connection contracts were concluded, of which approximately 80% comprised contracts with individuals and 20% comprised contracts with legal entities. In 2011, the total amount of capacity claimed as a result of these connection contracts was 326,000 MW.

Tariffs

Power transmission and distribution is a regulated activity. The FTS and the regional energy commissions set the fees payable for technical connection to the grids and for power transmission and distribution services across the grids. Since 1 January 2011, tariffs for some transmission and distribution companies are to be set with reference to return on invested capital ("RAB"). Even though this regulation is optional for Bashkirenergo, it has adopted an operation plan to move to RAB-based regulation.

Capital Expenditures

In 2009, 2010 and 2011, capital expenditures of Bashkirenergo comprised RUB 4,193 million, RUB 3,656 million and RUB 5,033 million, respectively. A large portion of capital expenditures in 2011 has been spent on construction and modernisation of new generating capacities.

Competition

Bashkirenergo's principal competitors in electricity and heat generation include: Tatenergo; Volga TGK-7; TGK-9; Fortum TGK-10; OGK-1; OGK-2; OGK-3; E.ON Russia (OGK-4); Enel OGK-5; and RusHydro. As at 31 December 2011, Bashkirenergo ranked 11th among Russian power generators in terms of installed capacity. The principal advantages of Bashkirenergo in relation to other TGKs are its ownership of a large condensation station (Karmanovskaya GRES) and a highly competitive hydro station (Pavlovskaya GES). Furthermore, as at 31 December 2010, Bashkirenergo ranks fourth among 11 power generating companies in terms of capacity factor.

Bashkirenergo does not have competitors in the power transmission and distribution business.

Fuel

Bashkirenergo's main operating expense is the purchase of fuel, which, in 2010 and 2011, comprised 40.9% and 52%, respectively, of the company's operating expenses. In 2011, the fuel purchase expenses were driven by the growth in gas consumption compared to 2010. There was a significant reduction of the fuel oil share in the overall balance of fuel consumption by power stations and boilers of Bashkirenergo compared to 2010.

Gas

In 2009, 2010 and 2011, Bashkirenergo's generating facilities consumed 8,641 thousand tonnes, 9,863 thousand tonnes and 9,989 thousand tonnes, respectively, of gas.

Coal

In 2009, 2010 and 2011, Bashkirenergo's generating facilities consumed 144 thousand tonnes, 110 thousand tonnes and 108 thousand tonnes, respectively, of coal.

Fuel oil

In 2009, 2010 and 2011, Bashkirenergo's generating facilities consumed 425 thousand tonnes, 127 thousand tonnes and 112 thousand tonnes, respectively, of fuel oil.

Fuel rates

Fuel rates are generally the most common means for assessing the economic efficiency of a power plant or one of its generation units. In 2010 and 2011, Bashkirenergo's average fuel rate weighted by capacity for electricity produced was 323.2 gce/kWh and 320.2 gce/kWh, respectively. In 2010 and 2011, Bashkirenergo's average fuel rate for heat produced was 144.6 kgoe/Gcal and 143.2 kgoe/Gcal, respectively.

Property

Bashkirenergo does not own the land plots on which its generation, transmission and distribution facilities are located. It either leases such plots or occupies them under a right of perpetual use.

Employees

As at 31 December 2010 and 2011, the total number of employees at Bashkirenergo totalled 21,359 and approximately 21,000, respectively.

Health, Safety and Environmental Protection

There have been no major accidents or injuries at any of Bashkirenergo's plants during the periods under review.

Bashkirenergo adopted an environmental protection programme, and, in 2011, the main focus on this programme has been to adopt initiatives to protect the atmosphere and water and soil resources, implement hazardous waste treatment procedures and develop a more effective internal environmental management system. As part of this programme, ecological audits were carried out in 2010 at certain of Bashkirenergo's assets, which resulted in the certification that operations at these assets are in conformity with the State Standard (GOST) R ISO 14001-2007 (ISO 14001:2004). Bashkirenergo regularly conducts environmental monitoring of emissions levels and analyses water and soil quality levels. In 2011, atmospheric emissions totalled 37.2 thousand tonnes, a decrease of 1.7% from 2010.

Business Description—Developing Assets

OVERVIEW

The Developing Assets consist of companies with high potential for growth. The Developing Assets portfolio currently consists of the investments set forth in the table below. We envisage one of two scenarios for our future involvement in a Developing Asset: (i) its transfer to our Core Assets portfolio, once the investment has become a reliable source of dividend flows; or (ii) monetisation of our investment through its sale to outside investors either through an IPO, strategic partnership or other means. In contrast to our Core Assets, Developing Assets may require funding or guarantees from us in order to achieve their targets. We consider RussNeft, in which we hold a non-controlling 49.0% stake, one of our Developing Assets.

SSTL

Overview

SSTL is one of the fastest growing mobile and fixed telecommunications operators and data service providers in the Indian market. It has a spectrum of 22 licence circles that cover all of the 28 administrative states and 7 union

territories in India or a total population of approximately 1.2 billion people. We currently own a 56.7% stake in SSTL, with the Indian Shyam Group owning a 24% stake, the Russian Federation a 17.1% stake and other investors a 2.2% stake. On 2 February 2012, the Supreme Court of India issued a decision regarding the cancellation of 122 telecom licences in India, including 21 licences belonging to SSTL. See “—*Material Litigation*” for further discussion of the revocation of these licences, including potential litigation surrounding the cancellation.

In 2010 and 2011, SSTL accounted for 0.4% and 0.8%, respectively, of our total revenues. In 2010 and 2011, SSTL’s capital expenditures amounted to U.S.\$178.2 million and U.S.\$169.0 million, respectively, a significant part of which was spent on the roll-out of mobile telecom networks in four new circles in 2010 and seven new circles in 2011, as well as the construction of a mobile broadband network covering over 300 cities.

Strategy

SSTL aims to continue developing its high-speed mobile broadband and voice-enabled services in its priority licence circles, the so-called “win” circles. By 2014, it intends to expand its subscriber base to 30 million voice subscribers and 5.6 million data subscribers. SSTL also plans to focus on expanding its presence on the smartphone market. In particular, it plans to expand its sales of Blackberry- and Android-based smartphones in a variety of price segments, including MTS-branded smartphones, with content services focused on both corporate and retail clients. SSTL also plans to launch new value-added services for both corporate and retail consumers. For corporate consumers, it plans to offer Blackberry BES, bulk SMS and managed services, and, for retail clients, it plans to provide cloud services and location-based services. SSTL believes that these value-added services have the potential to provide a stable growth in revenues in the coming years.

As part of its growth strategy, SSTL also intends to assess strategic partnership options with other telecom operators to participate in the expected consolidation of the Indian telecommunications market. SSTL is pursuing various opportunities although these are at an early stage and no binding agreements have been entered into.

Business

Starting in 2007, we entered the Indian market with acquisitions of stakes in SSTL. In 2008, SSTL acquired 21 licences for pan-Indian operations with an initial 2.5 MHz of CDMA 800 frequencies to add to the mobile telecom services it already operated in the Indian state of Rajasthan.

In 2009, SSTL began to market its products under the “MTS” brand name and expanded its mobile network into 10 more licence circles (specific licensed areas in India). By the end of 2009, SSTL had over three million subscribers.

In 2010, SSTL launched operations in four additional licence circles and established a high-speed data network presence in 99 of India’s largest cities. By the end of 2010, SSTL had over 8.5 million subscribers, including approximately 0.4 million data subscribers.

In 2011, SSTL expanded the number of licence circles in which it operates to 22. It continued the roll-out of its high speed data network into over 200 additional towns and communities. By the end of 2011, SSTL’s subscriber base surpassed 15 million, including 1.3 million data subscribers. In March 2011, during the course of an additional placement of shares, Rosimushchestvo purchased a 17.1% stake in SSTL for approximately U.S.\$600 million and certain minority investors purchased a 2.2% stake in SSTL for approximately U.S.\$42 million. In accordance with the agreement between Sistema and Rosimushchestvo, Rosimushchestvo has a put option to sell its stake in SSTL to Sistema during a one-year period beginning five years after its purchase of shares in SSTL. In the event the put option is exercised, Sistema has an obligation to purchase the Russian government’s stake in SSTL for the higher of U.S.\$777 million or the market value as determined by an independent valuator. Furthermore, under the terms of the agreement, until the put has been exercised or expires, Sistema has agreed not to reduce its stake in MTS below 50%+1 share.

Headquartered in Delhi’s satellite city of Gurgaon, SSTL has invested approximately U.S.\$3 billion in its expansion into India’s telecommunications market. Thus far, SSTL has opened more than 1,200 branded retail stores across India and engages customers through a retail universe of over 300,000 outlets. SSTL has created a pan-Indian CDMA 800 MHz mobile network on the basis of its own network, sharing and intra-circle roaming in cooperation with other operators.

SSTL recently launched MTS Pulse, an Android powered Smartphone that the users can get for free with no upfront payment and has added two more Android Smartphones to its range—MTS Livewire and MTS MTag 3.1—both priced in the sub Rs. 5000 category. MTS also offers its data customers innovative applications like MTS TV, a free-to-download application that provides ‘on the move’ access to more than 100 Live TV and video ‘on demand’ channels.

SSTL’s mobile subscriber base increased from 3.1 million subscribers as at 31 December 2009 to 8.5 million subscribers as at 31 December 2010 and 15.1 million subscribers as at 31 December 2011. This increase was due to the pan-Indian roll-out of new telecom networks and services.

SSTL’s mobile broadband subscriber base increased from 0.4 million subscribers at 31 December 2010 to 1.3 million subscribers as at 31 December 2011 due to the roll-out of broadband networks covering over 200 additional cities, expansion of the distribution network and establishment of new market partnerships. By the end of 2011, SSTL had achieved a 23% market share in the mobile broadband data card market, according to internal estimates, and established a leading position in the pre-paid broadband services segment.

SISTEMA MASS-MEDIA

Overview

SMM is one of the leading media holding companies in the Russian Federation, managing assets in pay TV, TV content production, and advertising. SMM owns and manages two pay TV assets, STREAM Television Company (“**STREAM**”) and Digital Television Broadcasting (“**DTV**”), one premium movie and TV content production asset, Russian World Studios (“**RWS**”), and one advertising asset, Maxima Communications Group (“**Maxima**”). We own a 75%-1 stake in SMM. In 2010 and 2011, SMM accounted for 0.4% and 0.3%, respectively, of our revenues. In 2011, SSM’s capital expenditures amounted to U.S.\$41.1 million, a 4.3% increase over 2010 levels.

Strategy

In the pay TV segment, SMM plans to increase the subscriber base of its non-terrestrial TV channels by expanding across both MTS and external networks.

In the TV production segment, SMM plans to strengthen its existing market position by increasing production and distribution volumes, including through partnerships with international players, increasing its volume of repeat sales, expanding its content portfolio into non-scripted documentaries and movies and becoming a leader in the studio facilities market by developing and expanding its Moscow- and St. Petersburg-based studios.

In the advertising segment, SMM plans to build-up core competencies in the “buying” and “selling” advertising segments and to launch and further develop a new in-house advertising sales unit.

SMM also aims to become a leading provider of value-added services in the mobile and internet content markets and internet advertising markets, which would allow for the efficient monetisation of content across mobile and internet-based platforms.

In 2011, Peter Gerwe was appointed as President of SMM. Mr. Gerwe previously founded CTC Media in the Russian Federation and is currently reassessing SMM’s strategy.

Business

SMM, based in Moscow and founded in 1998, offers the following products and services.

Pay TV

SMM’s TV broadcasting business is overseen by STREAM, a leader on the Russian market in the production of satellite channels, in content aggregation and in the supply of modern TV services. It produces nine channels of its own and aggregates over 100 others for the mobile operator MTS in the Moscow metropolitan area, including niche pay TV channels for pay TV networks.

The expansion of the Russian Federation’s pay TV market was an important revenue driver for SMM. At year-end 2011, STREAM’s total subscriber base reached approximately 6.2 million subscribers, a 15.8% increase compared to 2010.

DTV, which is in its start-up phase, was created to provide mobile TV services for the automobile segment.

TV and Film Production

SMM's TV and Film production business is overseen by RWS, a leading producer of film and television content and an increasingly active distributor, with one of the largest libraries on the market.

This year, RWS's client base has expanded to include the REN and Domashny channels in the Russian Federation as well as the Ukrainian channel, Inter. Alongside the Russian Federation and the wider CIS, the subsidiary sells its TV content to the Baltic countries, Israel, Germany and India. RWS' content library expanded to 1,471 hours in 2011, a 21.6% increase compared to 2010. In 2011, RWS produced 261 hours and sold 295 hours of content.

RWS also manages movie studios. At present, it owns 22,000 square meters of facilities in Moscow and St. Petersburg. The second phase of a studio complex in St Petersburg is currently being built and is due to open in 2014.

Advertising

SMM's advertising business is overseen by Maxima, one of the leading independent full-service advertising agencies in the Russian Federation. Maxima offers media-planning services, including Ad-selling services, to both Sistema companies and external clients.

MTS BANK

Overview

MTS Bank is a retail bank, ranked in the top 30 banks in the Russian Federation in terms of assets. MTS Bank operates in 53 cities across the Russian Federation and also owns the Dalcombank in Khabarovsk and the East-West United Bank in Luxembourg. We own a 99% stake in MTS Bank, which, in 2010 and 2011, accounted for 2.2% and 1.7%, respectively, of our revenues. In 2011, MTS Bank's capital expenditures amounted to U.S.\$34.4 million, a 79% increase over 2010 levels.

Strategy

MTS Bank's principal strategy through 2016 is to grow its loan portfolio and expand its retail base and retail product line with the support of MTS' extensive subscriber and sales network. For this reason, the name and brand of the bank were changed in 2012 from the Moscow Bank for Reconstruction and Development to MTS Bank. MTS Bank and MTS intend to provide their customers with an integrated platform for mobile commerce and banking as well as a wide range of banking services that can be accessed in MTS' retail outlets.

Business

MTS Bank currently has 139 points of sale across the Russian Federation, including 20 in Moscow, as well as one point of sale in Luxembourg. MTS Bank provides an array of financial products to both corporate and retail clients.

MTS Bank's corporate banking activities comprise lending, including on the interbank market, savings products and trade finance as well as settlement operations, payroll services, corporate bankcards, foreign currency exchange. MTS Bank also provides investment banking services and conducts financial markets operations. In its capacity as the main servicing bank for Sistema, MTS Bank maintains deposit accounts of Sistema's companies and supports their short-term liquidity.

MTS Bank offers its retail customers a wide range of savings and current accounts in addition to mortgages, credit cards and consumer lending products, using its branch network as well as remote service channels via the Internet and mobile banking platforms. MTS Bank recently completed the roll-out of a new consumer lending product called MTS POS and a new credit card product called MTS Money. Currently, MTS Bank sells approximately 100,000 credit cards each month.

As at 31 December 2011, loans accounted for approximately 51% of MTS Bank's total assets. In 2011, compared to 2010, MTS Bank's corporate and retail loan portfolios increased by 42% and 39%, respectively.

DETSKY MIR

Overview

Established in 1954, Detsky Mir is a leading retailer and wholesaler of children's goods in the Russian Federation, and is among the most recognised brands in the Russian Federation and the CIS. Detsky Mir consists of the Detsky Mir retail chain and the luxury store Yakimanka Children's Gallery. We own a 75% -1 stake in Detsky Mir, which, in 2010 and 2011, accounted for 2.5% and 2.4% of our overall revenues, respectively. In 2011, Detsky Mir's capital expenditures amounted to U.S.\$12.6 million, a 17.3% increase over 2010 levels.

Strategy

Detsky Mir's key strategic goal is to become the largest multi-category retail children's goods chain in the Russian Federation and Kazakhstan, to be a market-maker in the toys category and to develop a strong label in apparel and footwear.

In pursuit of this goal, Detsky Mir plans to develop and expand its existing store format. In particular, it intends to expand its retail network either organically or through acquisitions to over 250 stores within the next three years, with an emphasis on locations in fast-growing regions of the Russian Federation. Detsky Mir believes that this approach will help it diversify its revenue stream away from Moscow and exploit the faster regional consumer market growth in other geographies. In terms of new store concepts, Detsky Mir believes that new formats may allow it to open in city centres and smaller towns.

Detsky Mir believes that one of its core strengths is brand recognition. Going forward, it intends to capitalise on this brand recognition through the promotion of its own brand-name products and the development of its loyalty programmes.

Business

Detsky Mir currently operates 154 stores across the Russian Federation and the CIS, having opened 21 new stores in 2011, including its first store in Astana, Kazakhstan. Detsky Mir believes that its store format allows it to cater to a wide array of needs of its target audience in major non-food categories, such as toys, apparel, footwear and baby products. Detsky Mir's target audience is children up to 14 years of age from middle-income families. Detsky Mir occupies approximately 95% of its stores pursuant to short- long-term leasing contracts, which it believes facilitates faster and more flexible organic growth and lower capital expenditure requirements.

As a result of store openings in 2011, total retail space grew from 215,000 m² as at 31 December 2010 to 236,000 m² as at 31 December 2011, with an average per store selling space of approximately 1,500m². In 2011, a new management team took over operations at Detsky Mir, with several senior executives joining from other leading Russian retail companies.

In December 2010, Sberbank acquired 25% +1 share in Detsky Mir for approximately RUB 3.4 billion. Sberbank has a put option to sell this stake back to us and may exercise the put option if (i) the IPO does not occur within three years from the date of the agreement or (ii) if Sberbank does not sell all of its shares in Detsky Mir during an IPO occurring within three years from the date of the agreement. The put option in this case is exercisable within one year of the earlier of these two circumstances.

As at 31 December 2011, Detsky Mir had 7,000 employees.

INTOURIST

Overview

Founded in 1929, Intourist is the oldest tourism brand and one of the largest leisure companies in the Russian Federation. We currently hold 66% of Intourist, which, in 2010 and 2011, accounted for 1.9% and 0.8%, respectively, of our overall revenues. In 2011, Intourist's capital expenditures amounted to U.S.\$26.7 million, a 12.3% decrease compared to 2010 levels.

Strategy

Intourist's key strategic aim is to develop its hotels business, particularly in the growing 3 to 4 star segment in the Russian Federation. To this end, Intourist may consider partnerships with international hotel chains as a means to attract financing and additional sector expertise.

Business

Intourist currently manages 10 hotels, including three that it owns: the 3-star Kosmos Hotel in Moscow, with 1,777 rooms; the 5-star Principe Forte dei Marmi in Italy, with 28 rooms; and the 5-star Savoy Westend Hotel in the Czech Republic, with 116 rooms. In March 2011, Intourist sold the Hotel Pekin in Moscow for U.S.\$60 million. Intourist intends to use the proceeds from this sale to improve its capital structure and further develop its hotel business. In 2011, occupancy rates at Intourist's 10 hotels increased to 54%, from 52% in 2010 and 48% in 2009. The average price per room per night was RUB 2,723 in 2011, compared to RUB 2,682 in 2010 and RUB 2,915 in 2009. Revenue per room was RUB 1,476 in 2011, compared to RUB 1,395 in 2010 and RUB 1,403 in 2009.

Intourist's tourism segment consists of its tour operator services and retail sales network. In July 2011, as part of its strategy to reduce its exposure to the tour operating business, Intourist established a joint venture with Thomas Cook, one of the leaders in the international tourism market, in which Intourist holds a 49.9% stake and Thomas Cook a 50.1% stake. According to the joint venture agreement, Intourist has a put option with respect to its 49.9% that it can exercise between July 2014 and 2015. Intourist's tourism assets, including operator services and its retail sales network of 143 offices, are now being managed by Thomas Cook through this joint venture. The tourism segment caters to both Russian tourists travelling abroad and foreign tourists and business travellers coming to the Russian Federation. Through this joint venture, Intourist maintains a presence across the Russian Federation and in 168 countries, and cooperates with over 7,000 foreign partners. Through the first nine months of 2011, Intourist serviced approximately 731 thousand tourists.

MEDSI GROUP

Overview

Medsi Group is a leading national network of private out-patient and diagnostic clinics in the Russian Federation, providing healthcare services in Moscow and other Russian regions. Established in 1996, Medsi Group has 31 clinics and 80 medical facilities across the country. We own 100% of the Medsi Group. In both 2010 and 2011, Medsi Group accounted for 0.6% and 0.6%, respectively, of our total revenues. In 2011, Medsi Group's capital expenditures amounted to U.S.\$5.0 million, a 28.2% increase over 2010 levels.

Strategy

Medsi Group's strategic aim consists of regional expansion through organic growth and modernisation of and operational improvement in existing clinics.

Medsi Group intends to open new standard-care and paediatric-care facilities in the regions. In particular, it plans to open new standard-care facilities in regions underserved by private medical service providers with population levels of at least 0.5 million, including up to 10 out-patient care clinics in 2013 to 2016. Medsi Group also plans to expand its paediatric facilities into those regions where Medsi Group already has a presence, modelling them after its successful Moscow-based paediatric clinic, Medsi II. According to current plans, Medsi Group is considering the opening of up to 12 out-patient paediatric clinics through 2016.

Medsi Group also intends to modernise its existing facilities, including the possible reconstruction of the American Medical Center in Moscow, development of its Moscow-based Clinical Diagnostic Center and relocation of up to four Moscow-based facilities.

In addition, Medsi Group aims to make certain operational improvements, including increasing the capacity utilisation level of its existing facilities to approximately 70% by 2016 and expanding its array of products and services to include complex diagnostics, in-patient care and other services that are in high demand, but short supply. Medsi Group also seeks to work more actively with insurance companies, develop direct sales to employers and individuals and increase brand awareness and loyalty amongst patients.

Business

Medsi Group's network consists of 31 medical centres, of which 19 are in Moscow and the surrounding region and 12 in other parts of the Russian Federation, 80 first-aid medical posts and four fitness and wellness clubs. The Medsi Group's facilities include a clinical and diagnostic centre and the VIP-level American Medical Center as well as two children's clinics. Medsi Group also operates a VIP, on-call ambulance service. Medsi Group underwent significant expansion in 2011, opening 32 new medical posts outside the Moscow region, primarily in

the Khanty-Mansiysk Autonomous District and Bashkortostan, and increasing the overall area of regional clinics by almost 50%. Total area of Medsi Group's clinics increased from 39.7 thousand m² at 31 December 2009 to 50.5 thousand m² at 30 September 2011.

Medsi Group offers primarily out-patient services. In 2011, the number of patient visits totalled 3.8 million, up from 3.2 million in 2010 and 2.8 million in 2009. The average bill in 2011 was RUB 1,420, compared to RUB 1,383 in 2010 and RUB 1,285 in 2009. Services provided were estimated at 7.4 million in 2011, an increase from 5.84 million in 2010 and 5.11 million in 2009. As of the date of this Prospectus, approximately 5 of Medsi Group's clinics operate with a capacity utilisation rate in excess of 70%, approximately 11 operate at 60% capacity utilisation and approximately 14 operate at less than 50% capacity utilisation. Medsi Group targets an average capacity utilisation rate of 70% by 2016.

In April 2012, Medsi Group commenced the merger of assets with SUE, a large group of healthcare institutions in Moscow. Within the framework of the transaction, Medsi Group has initiated an additional share issuance via closed subscription in favour of two parties—SUE and a legal entity registered in the European Union, through which investment funds are expected to make their investments into Medsi Group. SUE is expected to pay for the shares issued to it with medical assets and property, which currently has a market value of approximately RUB 6.043 billion. In exchange for this property, SUE is expected to receive a 25.02% stake in the integrated company. According to current plans, SUE is to become a shareholder of Medsi Group upon completion of the transfer of the designated healthcare assets, which is expected to occur by the end of 2012. The legal entity registered in the European Union is currently expected to purchase a 24.98% stake in Medsi Group via the additional share issuance in exchange for RUB 6.035 billion in cash. Should the legal entity participate in the issuance, Sistema JSFC plans to retain a 50% stake in the combined entity. Should the legal entity not participate in the issuance, Sistema JSFC will likely retain up to a 74.98% stake in the combined entity. The combined entity is expected to operate under the Medsi Group name.

BINNOPHARM

Overview

Founded in 2006, Binnopharm is a pharmaceuticals production company that manages the Russian Federation's largest full-cycle facility for the manufacture of bio-technology drugs that is compliant with the Good Manufacturing Practices ("GMP") standard of quality. We are the 100% owner of Binnopharm, having invested approximately RUB 4 billion into the company to date. In both 2010 and 2011, Binnopharm accounted for 0.1% and 0.1%, respectively, of our total revenues. In 2011, Binnopharm's capital expenditures amounted to RUB 189 million, a 6% increase over 2010 levels.

Strategy

Binnopharm has adopted a strategic programme for 2012 to 2015 with the aim of becoming the second largest producer of pharmaceutical products in the Russian Federation. Pursuant to this strategic programme, Binnopharm has enumerated the following key objectives:

First, it intends to develop its R&D capabilities through the creation of alliances and partnerships with leading global pharmaceutical companies. To this end, in 2011, Binnopharm created an alliance with GlaxoSmithKline for the production of vaccines and signed a cooperation agreement with ViiV Healthcare for the production of two retroviral drugs for HIV treatment. It is also cooperating with SunPharma in the joint production of biotechnological and oncological drugs.

Second, Binnopharm intends to begin production of its own line of biotechnological drugs in the form of pre-filled syringes, including erythropoietin α and β , interferon α and a vaccine for the prevention of pneumococcal infections.

Third, it intends to strengthen its position on the infusions solution market through increasing cooperation with infusion solution producers and broadening the range of assortments distributed.

Fourth, Binnopharm intends to actively develop its own distribution network in a number of Russian regions, which is expected to increase sales volumes and potentially allow Binnopharm to capture up to 20% of the state procurement market for Russian-produced pharmaceutical products.

Fifth, because substantial funding is allocated in the federal budget for pharmaceutical procurements, Binnopharm intends to increase its cooperation with the Russian government.

To reach its strategic objectives, Binnopharm is considering both organic growth and growth through acquisitions of selected Russian pharmaceutical companies.

Business

Binnopharm owns and operates the Russian Federation's largest GMP-compliant biological and pharmaceutical complex, with an area of 32,000 m² and a capacity to produce up to 90 million ampoules, 300 million pills and capsules and 20 million spray cans annually. The priority production areas of Binnopharm are the development and manufacture of drugs for the treatment of socially important diseases, such as cancer, blood disorders, infectious diseases and respiratory diseases, vaccines and cellular and tissue technology products for regenerative medicine. As at 31 December 2011, Binnopharm employed 310 people.

Binnopharm currently produces eight generic medicines, including Regevac B, a vaccine against viral Hepatitis B. Binnopharm also maintains its own, in-house R&D department, as well as its own distribution network. In 2011, Binnopharm made the decision to emphasise the production of higher-margin biotechnological products. To this end, it commenced production of Combipek, which treats bronchial asthma, and three new drugs are being registered for future market entry.

In 2011, Binnopharm intensified its efforts to achieve closer cooperation with the Russian government. As a result, Binnopharm has won more than 150 state-procurement tenders, including two state contracts with a cumulative value of over RUB 600 million for 10 million doses of Regevac, Binnopharm's Hepatitis B vaccine.

Until the second half of 2011, Binnopharm was a loss-generating entity with negative OIBDA and net losses. Although net losses totalled RUB 128 million for the full year of 2011, Binnopharm recorded a net profit in the second half of the year. This improvement was, in part, due to the appointment of a new management team, the revamping of its organisational structure in favour of developing its distribution network and the optimisation of administrative expenses.

NIS

Overview

NIS is a leading Russian operator offering navigation and telematics solutions both to corporate and government clients and is the sole federal operator of the GLONASS system, the satellite navigation service comparable to GPS. We currently own a 70% stake in NIS, having increased our stake from 51% in 2011. NIS is in a start-up phase and currently represents an insignificant percentage of our revenues.

Strategy

The principal strategic objective of NIS is to become a market leader in the provision of navigation and telematics solutions and to establish a long-term partnership with the Russian government. To achieve this objective, NIS is focused on ensuring the successful completion of the state-sponsored ERA GLONASS project.

Business

NIS commenced operations in 2010. Currently, NIS generates most of its revenue from its participation in the ERA GLONASS project and the sale of GLONASS-based systems.

The ERA GLONASS project is an emergency accident response system designed to enhance public safety through the installation of GLONASS-based communication devices in all types of public transportation in the Russian Federation. This project is expected to be launched in 2014.

NIS is also engaged in the sale of GLONASS-based systems and solutions to large Russian corporate entities, such as Russian Post, Transneft and car manufacturers, and various governmental agencies. These products include fleet management and monitoring systems. In 2011, Apple Inc. began using GLONASS-based navigation in its iPhone 4s. NIS is currently developing additional GLONASS-based products and services, such as car tracking devices and other security products.

NIS' sales increased five-fold in 2011 compared to 2010 due mainly to the Russian government interest and support in the development of GLONASS, growing demand for navigation technologies and improvements in the Russian legislative framework surrounding usage of GLONASS-based systems. Our investments in NIS have exceeded RUB 1.3 billion.

RTI

Overview

RTI is a leading Russian technology holding company in the fields of defence, complex security systems, systems integration, microelectronics and high-tech R&D. RTI's principal assets are a 97% stake in RTI Systems Concern, a large military-industrial holding, and a 63% stake in SITRONICS, a high-tech company operating in the fields of telecommunications solutions, information technologies, systems integration and consulting. RTI's portfolio includes turnkey solutions for complex security and telecommunications systems, systems integration, microelectronics, geo-informatics and radio navigation as well as large-scale defence projects.

We and the Bank of Moscow formed RTI in February 2011. We took an 84.6% stake in the company in exchange for our 97% stake in RTI Systems Concern and the Bank of Moscow acquired a 15.4% interest for RUB 3.0 billion. Following the formation of RTI, we sold our 63% stake SITRONICS to RTI. In March 2012, RTI made a voluntary cash offer to acquire the remaining 37% stake in SITRONICS for RUB 0.55 per share. The voluntary offer remains open until 22 May 2012. Should the voluntary offer be accepted, RTI intends to delist SITRONICS' shares from MICEX-RTS and SITRONICS' GDRs from the London Stock Exchange.

Strategy

RTI has adopted both a portfolio strategy and a business strategy.

In accordance with its portfolio strategy, RTI intends in the mid-term to begin actively developing its combined businesses in defence and security and systems integration and in the long term to become a leading private sector, defence-oriented company in the CIS with the capacity to participate in large-scale public-private partnerships in the defence industry.

In accordance with its business strategy, RTI aims to become a leading mass producer of satellite and tactical communications equipment and on-board equipment for small space vehicles; a leading supplier and operator of complex security systems for Russian municipalities and government ministries; a leading developer and producer of microelectronic components and solutions in the Russian Federation and the CIS; and a leading IT partner for state-owned oil, energy, telecom and financial companies. It also aims to promote dual-use goods for export.

Business

RTI's principle assets are its stakes in RTI Systems Concern and SITRONICS.

RTI Systems Concern

Founded in 2000, RTI Systems Concern is a large military-industrial holding company, consolidating assets in more than 15 hi-tech defence-oriented institutes and enterprises. RTI Systems Concern specialises in the following spheres: radio equipment and missile defence technologies, where it serves as a general contractor for the development of land-based guidance and warning systems for missile defence and space control systems; integrated communication and security systems, where it uses cartographic materials to develop territorial management systems for various Russian regions; and radar systems, where it is a leading Russian developer of high-capacity above-the-horizon radiolocation technologies, high frequency surface wave radar systems and pre-fabricated radar systems. RTI Systems Concern developed with minimal investments from Sistema, amounting to approximately RUB 200 million between 2005 and 2011.

RTI Systems Concern's main clients are Russian government ministries, including the Ministry of Defence, the Ministry of Emergency Situations, the Federal Security Service, the State Corporation for Atomic Energy and the Ministry of the Interior. RTI Systems Concern, which is included in the Global-100 list of the largest defence companies in the world, generates most of its work through government defence contracts.

SITRONICS

SITRONICS was established in December 2002 as an R&D company combining the assets of JSC NIIME & Micron, a Russian microelectronics producer, and STROM Telecom, a Czech telecommunications equipment and software manufacturer. SITRONICS is now a vertically-integrated company with three business units: information technologies; telecommunications solutions; and microelectronics. SITRONICS went public in 2007,

when its shares were listed on the MICEX-RTS exchange and its GDRs were listed on the London Stock Exchange. Sistema has made investments in SITRONICS, totalling approximately RUB 12.3 billion between 2005 and 2011.

SITRONICS' information technologies unit is a leading system integrator and supplier of IT products, solutions and services in the Russian Federation, the CIS and Eastern Europe. It has over 20 years of experience on the IT market.

SITRONICS' telecommunications solutions unit is a leading international developer and supplier of end-to-end telecom solutions and technologies with over 15 years of experience on the telecommunications market.

SITRONICS' microelectronics unit is the largest manufacturer and exporter of microelectronics in the Russian Federation and the CIS with a complete production cycle encompassing everything from chip development to end product release. It has over 45 years of experience on the microelectronics market.

SITRONICS and RUSNANO created the joint venture SITRONICS-Nano in October 2009 for the purpose of acquiring the equipment and licences necessary to launch 90 nanometre microchip production and to lease them and provide project financing to SITRONICS. Each currently owns a 49.75% stake in the venture. RUSNANO has two put options that allow it to sell its 49.75% stake in SITRONICS-Nano to Sistema. Under the first option, RUSNANO can sell its stake at market price +25% no earlier than nine years and no later than 10.5 years from December 2009. Under the second option, provided that certain conditions are not met (e.g. cancellation of lease agreements or nonpayment of penalties for substantial deviations from target indicators), RUSNANO can put its shares in SITRONICS-Nano at any time during the first nine years of operations of SITRONICS-Nano. The price at which RUSNANO can put its shares under the second option is RUB 6,480 million plus 18% interest per annum, less any net profit attributed and paid to RUSNANO during the period from the date of the put option notice. Sistema, in its turn, has a call option to acquire RUSNANO's stake at any time at the price of RUB 6,480 million plus 18% interest per annum.

In aggregate, RTI's total state defence orders amounted to U.S.\$367 million in 2010 and U.S.\$417 million in 2011.

In January 2012, we announced that we are in discussions with NVision Group Managing Company LLC about a potential transaction between RTI and CJSC NVision Group, one of the largest information and communication technology companies in the Russian Federation.

SITRONICS currently services more than 3,500 clients and exports its goods and services to over 60 countries. SITRONICS has subsidiaries in approximately 30 countries.

RUSSNEFT

Overview

RussNeft is one of the Russian Federation's largest oil companies in terms of production and reserves. We own a non-controlling 49% stake in RussNeft, in relation to which we recognised a loss of U.S.\$20 million in 2010 and neither a gain nor a loss in 2011. In 2011, RussNeft's capital expenditures amounted to RUB 16 billion, a 33% increase over 2010 levels. Most of these capital expenditures were spent on development drilling and construction.

Strategy

RussNeft's main strategy is to increase its resource base up to one billion tonnes by 2017, through the continued implementation of its large-scale geological exploration programme and potentially through the acquisition of new upstream assets.

Business

In December 2010, RussNeft made the decision to divest its downstream assets and focus on upstream exploration and development. In accordance with this decision, RussNeft sold its retail and distribution subsidiary in April 2011 for U.S.\$120 million and its two oil refineries in June 2011 for approximately U.S.\$360 million. Proceeds were used to repay debt.

RussNeft's resource base includes 167 licensed mineral resource sites, located in the following regions of the Russian Federation: the Khanty-Mansiysk Autonomous District; the Yamalo-Nenets Autonomous District; Udmurtia; Bashkortostan; Ulyanovsk; Saratov; Volgograd; Penza; and Kirov. The production enterprises of the company are organised into five territorial groups: West Siberia; the Urals; the Volga region; Central Siberia; and Saratov. As at 31 December 2010 and 2011, RussNeft's 2P reserves equalled 2,250 MMBbls and 2,270 MMBbls, respectively.

In 2011, RussNeft produced 13.6 million tonnes of oil, compared to 12.9 million tonnes in 2010 and 11.9 million tonnes in 2009. This growth in production levels was mainly due the drilling of new wells in West Siberia, Tomsk region and Udmurtia. It is targeting a production level of 14.0 million tonnes in 2012. In 2011, 186 wells were drilled, including 34 horizontal wells, which contributed approximately 1.5 million tonnes to overall production levels in 2011.

In December 2010, RussNeft restructured over U.S.\$6.3 billion of debt owed to Sberbank and Glencore, the oil trading firm. As a result of the restructuring, the average interest rate of RussNeft's debt was reduced to 9% and the maturity was extended to 2020. In large part due to this restructuring, RussNeft's debt burden decreased to U.S.\$5.1 billion as at 31 December 2011, compared to U.S.\$6.3 billion as at 31 December 2010.

RussNeft employs approximately 17,000 thousand people.

Material Litigation

In the ordinary course of business, we may be a party to various legal proceedings, and subject to claims in the regulatory environment where we operate.

MTS

BCTI

In December 2010, MTS suspended its operations in Turkmenistan following a notice received from the Ministry of Communications of Turkmenistan of its decision to suspend all licences held by BCTI, MTS' wholly-owned subsidiary in Turkmenistan, for a period of one month starting from 21 December 2010. On 21 January 2011, although the period of licence suspension expired, MTS continued to be unable to resume operations in Turkmenistan because of other actions taken by Turkmenistan government authorities. In particular, following the decision to suspend licences, they unilaterally terminated interconnection agreements between BCTI and state-owned telecom operators.

In response, MTS initiated a number of proceedings against Turkmenistan government authorities and state-owned telecom operators. On 21 December 2010, MTS filed three requests for arbitration with the International Court of Arbitration of the International Chamber of Commerce ("**ICC**") against the Ministry of Communications of Turkmenistan and several state-owned telecom operators requesting specific performance on the relevant interconnection agreements and compensation for the revocation of the licences and the unilateral termination of the interconnect agreements. Subsequently, the sovereign state of Turkmenistan was joined as a respondent in the proceedings against the Ministry of Communications of Turkmenistan. An independent appraisal has shown that MTS has suffered damages amounting to U.S.\$855.0 million as a result of the alleged breaches of the respondents. MTS has made a claim for this amount in the ICC proceedings. In March 2012, MTS withdrew the demand for specific performance of contractual obligations by the Ministry of Communications of Turkmenistan and Turkmenistan.

In accordance with the process under the relevant Bilateral Investment Treaty, on 21 January 2011, MTS sent a formal notice to the Turkmen government requesting resolution of the dispute through negotiations and notifying it of MTS' intention to file a claim pursuant to that Bilateral Investment Treaty. The dispute was not resolved by negotiations and, accordingly, on 1 September 2011, MTS filed a claim against Turkmenistan in the International Centre for the Settlement of Investment Disputes ("**ICSID**"). On 5 October 2011, the claim was registered by the ICSID Secretariat.

At the end of 2011 negotiations with the Turkmen government stopped and not resumed to date.

As a consequence of the impact of these matters on MTS' ability to conduct operations in Turkmenistan, Sistema determined that all of its long-term assets attributable to Turkmenistan were impaired and recorded an impairment charge of U.S.\$119.6 million in the consolidated statements of operations for the year ended 31 December 2010. Sistema also assessed the recoverability of BCTI's current assets and created provisions for or wrote down those which were considered to be impaired. The total effect of impairment charges on Sistema's statement of operations for the year ended 31 December 2010 was U.S.\$137.8 million.

Bitel

Following the purchase of the 51% stake in Tarino Limited (“**Tarino**”) from Nomihold Securities Inc. (“**Nomihold**”) for U.S.\$150 million in cash based on our belief that Tarino was at that time the indirect owner, through its wholly owned subsidiaries, of Bitel LLC (“**Bitel**”), a Kyrgyz company holding a GSM 900/1800 licence for the entire territory of Kyrgyzstan, MTS Finance entered into a put and call option agreement with Nomihold for “Option Shares,” representing the remaining 49% interest in Tarino shares and a proportional interest in Bitel shares. The call option was exercisable by MTS Finance from 22 November 2005 to 17 November 2006, and the put option was exercisable by Nomihold from 18 November 2006 to 8 December 2006. The call and put option price was U.S.\$170 million.

Following a decision of the Kyrgyz Supreme Court on 15 December 2005, Bitel’s corporate offices were seized by a third party. As Sistema did not regain operational control over Bitel’s operations in 2005, it accounted for its 51% investment in Bitel at cost as at 31 December 2005. Sistema wrote off the costs relating to the purchase of the 51% stake in Bitel, which was reflected in its consolidated financial statements for the year ended 31 December 2006. Furthermore, with the impairment of the underlying asset, a liability of U.S.\$170 million was recorded with an associated charge to earnings.

In November 2006, MTS Finance received a letter from Nomihold purporting to exercise the put option and sell the Option Shares for U.S.\$170 million to MTS Finance. In January 2007, Nomihold commenced an arbitration proceeding against MTS Finance in the London Court of International Arbitration (“**LCIA**”) to compel MTS Finance to purchase the Option Shares. Nomihold sought specific performance of the put option, unspecified monetary damages, interest, and costs. In January 2011, the LCIA made an award in favour of Nomihold satisfying Nomihold’s specific performance request and ordered MTS Finance to pay to Nomihold U.S.\$170 million for the Option Shares, U.S.\$5.9 million in damages and U.S.\$34.9 million in interest and other costs—all representing in total approximately U.S.\$210.8 million (“**Award**”). An amount of the Award is bearing an interest until the Award is satisfied. In addition to the U.S.\$170 million liability related to this case and accrued in the year ended 31 December 2006, Sistema recorded an additional U.S.\$40.8 million and U.S.\$3.2 million in the consolidated financial statements for the year ended 31 December 2010 and 2011, respectively, representing interest accrued on the awarded sums.

On 26 January 2011, Nomihold obtained a freezing order in respect of the Award from the English High Court of Justice which, in part, restricts MTS Finance from dissipating its assets. Additionally, MTS Finance has been granted permission to appeal the Award, but the Court has imposed conditions upon the appeal. MTS Finance is currently seeking to have the conditions lifted.

Further, on 1 February 2011, Nomihold obtained an order of the Luxemburg District Court enforcing the Award in Luxembourg. This order is in the process of being appealed.

As an issuer of U.S.\$400,000,000 2012 notes (the “**2012 Notes**”) pursuant to an Indenture dated 28 January 2005 (as amended), MTS Finance was due to redeem the principal of the notes and pay the final coupon payment on 28 January 2012. MTS therefore applied to and obtained from the English Court an order authorising both payments to be made by MTS on behalf of MTS Finance (the “**Direct Payments**”), since MTS Finance was subject to the freezing order. The Direct Payments to noteholders by the trustee under the Indenture were made on or around 28 January 2012.

Pursuant to the Intercompany Loan Agreement MTS Finance had lent the proceeds of the issuance of the 2012 Notes to MTS. MTS believes that the Direct Payments should have satisfied MTS’ obligations under the Intercompany Loan Agreement. To resolve this question, MTS Finance and MTS have agreed to refer it to arbitration. On 9 February 2012, MTS received a request for arbitration from MTS Finance. The process is underway and will clarify the rights between the parties under that Intercompany Loan Agreement. The arbitration will be conducted under the Rules of the LCIA and it is expected to last between 6 and 12 months. See “*Management’s Discussion and Analysis of Financial Condition and Results of Operations—Liquidity and Capital Resources—Capital Resources—Description of notes and corporate bonds*” and “*Risk Factors—Risks Relating to Our Business and Industry—The servicing and refinancing of our indebtedness will require a significant amount of cash. Our ability to generate cash is subject to the terms of our existing indebtedness, which contains certain restrictive covenants and stringent events of default, and is dependent on other factors beyond our control.*”

In addition, three Isle of Man companies affiliated with MTS (the “**KFG Companies**”) have been named defendants in lawsuits filed by Bitel in the Isle of Man seeking the return of dividends received by these three

companies in the first quarter of 2005 from Bitel in the amount of approximately U.S.\$25.2 million plus compensatory damages, and to recover approximately U.S.\$3.7 million in losses and accrued interest. In the event that the KFG Companies do not prevail in these lawsuits, they may be liable to Bitel for such claims. Bitel's Isle of Man advocates have recently withdrawn from their representation of Bitel, and Bitel does not appear to be pursuing these claims.

In January 2007, the KFG Companies asserted counterclaims against Bitel, and claims against other defendants, including Altimo LLC ("**Altimo**"), Altimo Holdings & Investments Limited ("**Altimo Holdings**"), CP-Crédit Privé SA and Fellowes International Holdings Limited, for the wrongful misappropriation and seizure of Bitel. The defendants sought to challenge the jurisdiction of the Isle of Man courts to try the counterclaims asserted by the KFG Companies.

On 10 March 2011, the Judicial Committee of the UK Privy Council ruled in favor of the KFG Companies and confirmed the jurisdiction of the Isle of Man courts to try the counterclaims asserted by the KFG Companies against various defendants, including Sky Mobile, Altimo and Altimo Holdings, for the wrongful misappropriation and seizure of Kyrgyz telecom operator Bitel and its assets.

On 30 June 2011, the KFG Companies obtained from the Isle of Man court a general asset freezing injunction over the assets of Altimo and Altimo Holdings. The general freezing injunction against Altimo Holdings was replaced on 30 November 2011 by a specific freezing injunction over (i) Altimo Holding's interest in its Dutch subsidiary, Altimo Coöperatief U.A., and (ii) Vimpelcom common shares worth U.S.\$500 million that Altimo Coöperatief U.A. has lodged with the Isle of Man court. The KFG Companies are proceeding with their counterclaims in the Isle of Man. A trial has been set to commence in May 2013.

In a separate arbitration proceeding initiated against the KFG Companies by Kyrgyzstan Mobitel Investment Company Limited ("**KMIC**") under the rules of the LCIA, the arbitration tribunal found that the KFG Companies breached a transfer agreement dated 31 May 2003 (the "**Transfer Agreement**") concerning the shares of Bitel. The Transfer Agreement was made between the KFG Companies and IPOC International Growth Fund Limited ("**IPOC**") although IPOC subsequently assigned its interest to KMIC, and KMIC was the claimant in the arbitration. The tribunal ruled that the KFG Companies breached the Transfer Agreement when they failed to establish a date on which the equity interests in Bitel were to be transferred to KMIC and by failing to take other steps to transfer the Bitel interests. This breach occurred prior to MTS Finance's acquisition of the KFG Companies. The arbitration tribunal ruled that KMIC is entitled only to damages in an amount to be determined in future proceedings. The tribunal is currently deciding whether to stay the damages phase of the LCIA proceedings pending conclusion of the Isle of Man proceedings.

We are not able to predict the outcome of these proceedings or the amount of damages to be paid, if any.

Bashneft

After winning the auction in December 2010, JSOC Bashneft obtained a 25-year licence to explore and develop the Trebs and Titov oil fields in the Nenets Autonomous District. The licence was issued in February 2011 by Rosnedra on the recommendation of the auction committee. JSOC Bashneft paid RUB 18.5 billion (U.S.\$629 million) for geological examination, exploration and production rights at the Trebs and Titov oil fields.

According to order of Rosnedra on reissuance of the licence of 12 December 2011, the licence was transferred from JSOC Bashneft to Bashneft-Polus, JSOC Bashneft's wholly owned subsidiary at that time. In April 2011, a 25.1% stake in Bashneft-Polus was sold to LUKOIL as part of the process for establishing a joint venture with LUKOIL for the development of the Trebs and Titov oil fields. Neither JSOC Bashneft nor Bashneft-Polus believe they have breached the terms of the licence.

In March 2012, Ms. Proskuryakova, a minority shareholder in JSOC Bashneft, filed a lawsuit with the Moscow Arbitrazh Court against Rosnedra seeking to (i) invalidate the order of Rosnedra on reissuance of the licence to Bashneft-Polus for the use of the subsoil plot of federal importance that includes Trebs and Titov oil fields; (ii) terminate the right held by Bashneft-Polus to use the subsoil plot of federal importance, and (iii) make an entry to the state register on the termination of the licence.

According to the plaintiff, Rosnedra reissued the licence with no proof that Bashneft-Polus was solvent and employed suitably qualified persons and without having received FAS approval, which, according to the plaintiff, was required in order to validate the licence transfer. JSOC Bashneft and Bashneft-Polus are joined in these proceedings as third parties.

Ms. Proskuryakova's claim was also supported by another minority shareholder in JSOC Bashneft. On 16 April 2012, Mr. Zubairov joined Ms. Proskuryakova as an interested third party to this case. In his application, Mr. Zubairov supported Ms. Proskuryakova's claim and additionally requested Rosnedra to make an entry to the state register on the restoration of the licence to JSOC Bashneft.

On 20 and 23 April 2012, the Moscow Arbitrazh Court held preliminary hearings regarding the claim of the minority shareholder. The court hearing on the merits is scheduled to take place on 21 May 2012. If the claim of the minority shareholder is granted, Bashneft-Polus' licence to Trebs and Titov may be transferred back to JSOC Bashneft or cancelled. While we believe that it is unlikely Bashneft-Polus' licence to Trebs and Titov will be transferred back to JSOC Bashneft or cancelled, there can be no assurance that such transfer or cancellation will not occur. Should the licence be transferred back to JSOC Bashneft or cancelled, there may be significant delays in JSOC Bashneft's exploration and development plans and JSOC Bashneft may be prevented from adequately replenishing its reserves base, which, in turn, may have a material adverse effect on our business and results of operations. See *"Risk Factors—Risks Relating to Our Business and Industry—General Risks—The licences and permits that we require for our business may be invalidated, suspended or may not be issued or renewed, or may contain onerous terms and conditions that restrict our ability to conduct our operations or could result in substantial compliance costs or administrative penalties"* and *"Risk Factors—Risks Relating to Our Business and Industry—General Risks—Bashneft's exploration and development licence to the Trebs and Titov oil fields is currently the subject of legal proceedings brought by a minority shareholder in Bashneft. A negative outcome in these proceedings may lead to significant delays in Bashneft's exploration and development plans and may otherwise have a material adverse effect on Bashneft's business and results of operations. In addition, the cancellation of Bashneft's Trebs and Titov licence may well result in JSOC Bashneft's pre-export facility being capable of being accelerated, which, in turn, would trigger cross-default provisions under certain of our other financing agreements."*

Furthermore, the cancellation of the licence may result in the JSOC Bashneft's Pre-Export Finance Term Loan Facility being capable of being accelerated. A default under the JSOC Bashneft's Pre-Export Finance Term Loan Facility would, in turn, trigger cross default provisions under the Sistema JSFC facilities and, if it resulted in acceleration of the loan, under Bashneft's loan agreements with Sberbank. See *"Management's Discussion and Analysis of Financial Condition and Results of Operations—Liquidity and Capital Resources—Capital Resources—Description of material loan agreements."* Lenders under these agreements would, as a result, be entitled to declare all outstanding amounts under these loans immediately due and payable, which, as at 31 March 2012, amounted to \$2.4 billion.

SSTL

On 2 February 2012, the Indian Supreme Court delivered the Indian Judgment on two public interest petitions seeking cancellation of 122 cellular phone licences granted by the Government of India in 2008, including licences granted to SSTL in 21 telecom circles, which SSTL relies upon to operate its mobile telecommunications business in India. The Indian Judgment granted the petition, with cancellation of the licences effective as at 2 June 2012 and subsequently extended by the Indian Supreme Court on 24 April 2012 until 7 September 2012. The Indian Supreme Court also directed the Government of India to conduct 2G spectrum auctions and grant licences on or before 31 August 2012. Without the licences subject to cancellation under the Indian Judgment, SSTL will be unable to conduct more than 85% of its operations in India in terms of 2011 revenues.

On 2 March 2012, we filed a review petition against the Indian Judgment with the Indian Supreme Court, which was denied on 3 April 2012. We plan to file a curative petition, the decision on which will be final and nonappealable. On 18 April 2012, SSTL filed a clarification petition requesting that the Supreme Court delay the cancellation of our licences until the new 2G auctions have taken place, with the Supreme Court deciding on 24 April 2012 to extend the licences until 7 September 2012 and ordering the new 2G auction be held by 31 August 2012.

Should there be a re-auction, we will take a decision on whether to participate in such re-auction after consideration of its terms, once they have been announced.

If our curative petition and clarification application are denied or not granted before 7 September 2012, substantially all of our Indian licences will be cancelled. As a result of the impact of the situation related to the Indian Judgment on the terms of the SSTL Agreements and the Sistema JSFC Agreements, these may well currently be capable of being accelerated by the lenders. See *"Management's Discussion and Analysis of*

Financial Condition and Results of Operations—Capital Resources—Description of material loan agreements,” “Risk Factors—Risks Relating to Our Business and Industry—General Risks—The licences and permits that we require for our business may be invalidated, suspended or may not be issued or renewed, or may contain onerous terms and conditions that restrict our ability to conduct our operations or could result in substantial compliance costs or administrative penalties” and “Risk Factors—Risks Relating to Our Business and Industry—General Risks—As a result of litigation proceedings involving SSTL, certain financing arrangements of SSTL and Sistema JSFC may well currently be capable of being accelerated. In addition, pursuant to a put option agreement, we may be required to repurchase the stake in SSTL held by the Russian government. If the Russian government were to exercise its put option over its stake in SSTL, there can be no assurance that such exercise would not have a material adverse effect on our financial condition” The Lenders under these loan agreements have not yet accelerated any payments thereunder or indicated that they intend to do so, and we do not expect them to accelerate in the context of the current circumstances. Nevertheless, there can be no assurance they will not ultimately do so. The total amount of indebtedness outstanding under the SSTL Agreements and the Sistema JSFC Agreements as at 26 April 2012 was \$1,656.1 million.

As a consequence of the cancellation of the licences with effect from 7 September 2012, we reassessed the carrying amount of assets in SSTL as at 31 December 2011. A total impairment loss of U.S.\$694.7 million was recognised. Of this total impairment loss, the loss from impairment of the operating licences amounted to U.S.\$346.0 million and the loss from impairment of goodwill amounted to U.S.\$348.7 million. In addition, because we may be required to pay on demand all of the outstanding indebtedness under SSTL’s loan agreements where we serve as guarantor, we have reclassified such outstanding indebtedness, in an amount of U.S.\$1,573.5 million, as short-term debt as at 31 December 2011. See *“Management’s Discussion and Analysis of Financial Condition and Results of Operations—Liquidity and Capital Resources—Capital Resources.”*

On 28 February 2012, we filed a formal notice of dispute in connection with the Indian Judgment with the Government of India under the Russia-India Bilateral Investment Treaty (“**Russia-India BIT**”). Parties have six months from the date of the filing of the formal notice to resolve the dispute amicably. If the dispute is not resolved amicably by 28 August 2012, we will be entitled to bring a formal claim under the Russia-India BIT.

In addition, notwithstanding the potential or actual cancellation of the licences, at any time between March 2016 and March 2017 we may be required to purchase the stake in SSTL that is currently held by the Russian government for the higher of \$777 million or the market value as determined by an independent valuator. See *“Risk Factors—Risks Relating to Our Business and Industry—General Risks—The licences and permits that we require for our business may be invalidated, suspended or may not be issued or renewed, or may contain onerous terms and conditions that restrict our ability to conduct our operations or could result in substantial compliance costs or administrative penalties” and “Risk Factors—Risks Relating to Our Business and Industry.”*

MANAGEMENT

Overview

Our current charter was approved by the General Shareholders' Meeting on 26 June 2010 and was duly registered in the Unified State Register of Legal Entities on 26 July 2010. In accordance with Russian legislation governing joint stock companies and Sistema JSFC's charter, Sistema JSFC's principal management bodies are the General Shareholders' Meeting, the Board of Directors, the Management Board and the President. A brief description of each of the management bodies is set out below.

General Shareholders' Meeting

The General Shareholders' Meeting is the supreme governance body of Sistema JSFC pursuant to the Joint Stock Companies Law. An Annual General Shareholders' Meeting must be held every year and Extraordinary General Shareholders' Meetings can be called by the Board of Directors, the Statutory Audit Commission, Sistema JSFC's independent auditor or shareholders holding not less than 10% of the voting shares of Sistema JSFC. Each ordinary share of Sistema JSFC carries the right to cast one vote at any General Shareholders' Meeting. The authority of the General Shareholders' Meeting is limited to those matters that are expressly set out in Sistema JSFC's charter and the Joint Stock Companies Law. The following decisions, among others, can be taken only by the General Shareholders' Meeting: amendments to the charter; the reorganisation or liquidation of Sistema JSFC; the election of the members of Sistema JSFC's Board of Directors and early termination of their powers; the appointment of the members of the Review Commission and early termination of his/her powers; the determination of the quantity, category and nominal price of Sistema JSFC's authorised shares as well as the rights arising out of the ownership of such shares; the increase of the charter capital; the reduction of the charter capital; the approval of the annual report and annual accounts; and the approval of certain major transactions and interested party transactions, in accordance with the provisions of the Joint Stock Companies Law.

Board of Directors

The Board of Directors is responsible for general management matters, with the exception of those matters that are designated by Sistema JSFC's charter and the Joint Stock Companies Law as being the exclusive responsibility of the General Shareholders' Meeting. The Board of Directors meets and casts absentee voting regularly, at least twice every quarter, and makes its decisions by simple majority so long as a quorum of at least half of the elected members of the Board of Directors is present, unless otherwise required by law or Sistema JSFC's charter. Sistema JSFC's shareholders elect members of the Board of Directors until the next Annual General Shareholders' Meeting, and such members may be re-elected an unlimited number of times. Sistema JSFC's Board of Directors currently consists of twelve directors. One director is an executive director and eleven directors are non-executive directors, five of whom are also independent directors.

The following table sets forth the name, age, position and first year of appointment on the Board of Directors for each director.

<u>Name</u>	<u>Age</u>	<u>Position</u>	<u>First Year Appointed</u>
Vladimir Evtushenkov	64	Chairman of the Board of Directors	1993
Dmitry Zubov	58	Deputy Chairman of the Board of Directors, Non-Executive Director	1999
Alexander Goncharuk	56	Non-Executive Director	1996
Mikhail Shamolin	42	Executive Director, President, Chief Executive Officer	2011
Vyacheslav Kopiev	58	Non-Executive Director	1997
Leonid Melamed	45	Deputy Chairman of the Board of Directors, Non-Executive Director	2009
Roger Munnings	62	Independent Director	2010
Evgeny Novitsky	55	Independent Director	1995
Ron Sommer	63	Non-Executive Director	2005
David Iakobachvili	55	Independent Director	2011
Serge Tchuruk	75	Independent Director	2011
Robert Kocharyan	58	Independent Director	2009

All of Sistema JSFC's directors were appointed or re-appointed at the Annual General Shareholders' Meeting on 25 June 2011. The terms of appointment for all directors expire on the date of the next Annual General Shareholders' Meeting. The business address of each of the members of Sistema JSFC's Board of Directors is Sistema JSFC's registered office.

Vladimir Evtushenkov—Chairman of the Board of Directors

Mr. Vladimir Petrovich Evtushenkov was born in 1948. He graduated from the Moscow Mendeleyev Chemical-Engineering Institute in 1973 with a degree in production engineer and from the Moscow State University named after M.V. Lomonosov in 1980 with a degree in economics. He was awarded Doctor of Economics in 2001. From 1975 to 1982, Mr. Evtushenkov worked as Machine Shop Manager, Deputy Director, Chief Engineer of the Karacharovo Factory of Plastics. From 1982 to 1987, he served as Chief Engineer and then as First Deputy General Director of Polymer Scientific and Production Association. For the period from 1987 to 1990, Mr. Evtushenkov occupied the various positions in Moscow City Executive Committee and then he was Chairman of the Moscow Municipal Committee for Science and Technology. Mr. Evtushenkov has been active member of a number of government commissions for the improvement of competitiveness of the Russian industry, development of high technologies and innovations, science and culture; a member of the National Council on corporate governance, member of the management boards of the main associations of entrepreneurs in the Russian Federation—the Russian Union of Industrialists and Entrepreneurs, the Russian Chamber of Industry and Commerce, Chairman of the Russian side of the Russian-Arab Business Council. In 2004, he was elected Chairman of the Board of Trustees of the State Russian Museum Development Fund and currently he is also Head of the Board of Trustees of the Charitable Foundation of Sistema. Mr. Evtushenkov, together with several partners, founded Sistema in 1993. He served as President from the foundation of Sistema JSFC until 1995, and as Chairman of the Board from 1994 to 2005. He once again was appointed President of Sistema JSFC in the run up to Sistema's IPO on the London Stock Exchange. Since 2006, Mr. Evtushenkov has served as Chairman of the Board of Directors and Chairman of Sistema JSFC's Strategy Committee. He is the principal shareholder of Sistema JSFC.

Dmitry Zubov—Deputy Chairman of the Board of Directors, Non-Executive Director

Mr. Dmitry Lyvovich Zubov was born in 1954. He graduated from the Moscow Aviation Institute named after S. Ordzhonikidze in 1977 with a degree in engineering. He was awarded Doctor of Economics in 2000. From 1978 to 1979, Mr. Zubov worked as a foreman at the Lukhovitsy Engineering Plant. From 1979 to 1989, he held various positions in the Komsomol organisation including Secretary of the Young Communist League's Committee, Head of the All-Union Centre of Housing Cooperatives for Youth, and later he served as Deputy General Director of the All-Union Centre of Cinema and Television for Children and Youth. From 1992 to 1996, Mr. Zubov was Director General of AOZT Alon, and then he held management positions in MosEximBank, IBN Sistema and PromChemVest. Mr. Zubov was elected member of Sistema JSFC's Board of Directors in 1999. He has also occupied senior positions within Sistema, including Chairman of the Board of Directors of Sistema Halls, Head of the Project Construction Union Sistema Halls and member of the Board of Trustees of the Charitable Foundation of Sistema. Since 2000, Mr. Zubov has been Deputy Chairman of Sistema JSFC's Board of Directors and a member of the Nomination, Remuneration and Corporate Governance Committee and the Audit and Finance Committee of Sistema JSFC.

Alexander Goncharuk—Non-Executive Director

Mr. Alexander Yurievich Goncharuk was born in 1956. He graduated from the Sevastopol Higher Navy and Engineering School in 1978 with a degree in submarine electricity and from the Grechko Navy Academy in 1987 with a degree in organizing the operation of ship power systems. From 1987 to 1991, Mr. Goncharuk served as senior officer at the Main Headquarters of the Russian Navy. In 1991, Mr. Goncharuk became Executive Director of Galaktina business centre. From 1993 to 1996, he was General Director of Leader Joint-Stock Insurance Company. From 1995 to 1998, Mr. Goncharuk occupied the position of Vice-President of Sistema. For the period from 1998 to 2003, he was also Chairman of the Board of Directors of Sistema Telecom and MTS OJSC. From 2003 to 2006, he held the same position in SITRONICS Concern. From 2006 to 2008, Mr. Goncharuk was President of Sistema JSFC. Currently, he serves on the boards of Sistema Halls, SITRONICS, Ecu Gest Holding S.A. and the Board of Trustees of the Charitable Foundation of Sistema. Mr. Goncharuk has also served as Chairman of the Board of Directors of SMM, JSOC Bashneft and OJSC Polief. Since 1996, Mr. Goncharuk has been a non-executive director on the Board of Directors of Sistema JSFC and since 2006, he has also been a member of Sistema JSFC's Nomination, Remuneration and Corporate Governance Committee, the Investor Relations and Dividend Policy Committee and the Strategy Committee of Sistema JSFC.

Mikhail Shamolin—Executive Director, President and Chief Executive Officer

Mr. Mikhail Valerievich Shamolin was born in 1970. He graduated from the Moscow Automobile and Road Technical Institute in 1992 with a degree in construction engineering, from the Russian Academy of Public Administration under the President of the Russian Federation in 1993 with a degree in social science and from Wharton Business School in 1997 with a degree in finance and management. From 1998 to 2004, Mr. Shamolin occupied various positions from transactions analyst to junior partner at McKinsey & Co. From 2004 to 2005, he served as Managing Director of the Ferroalloys Division at Interpipe Corp. (Ukraine). From 2005 to 2011, Mr. Shamolin occupied various positions as Vice President for Sales and Customer Service, Vice President and Head of the MTS Russia business unit and later as President and CEO of MTS OJSC. Since 2011, he has been an executive director on Sistema JSFC's Board of Directors, President of Sistema JSFC, a member of the Nomination, Remuneration and Corporate Governance Committee, the Ethics and Internal Control Committee and the Strategy Committee of Sistema JSFC.

Vyacheslav Kopiev—Non-Executive Director

Mr. Vyacheslav Vsevolodovich Kopiev was born in 1954. He graduated from the Moscow Engineering and Physical Institute in 1977 with a degree in cybernetics, from the Russian Academy of Management in 1993 with a degree in law and from the International Academy of Marketing and Management in 1994 with a degree in economics. He was awarded a candidate of technical sciences in 1982 and a candidate of legal sciences in 1994. From 1977 to 1990, Mr. Kopiev held various senior positions in the Komsomol organisation, including First Secretary of the Moscow City Committee of the Young Communist League and Second Secretary of the Central Committee of the Young Communist League. From 1989 to 1997, he was a member of the Board of Management of the Union of Scientific and Engineering Societies, Director for International Relations and Innovation Activities of this Union. From 1990 to 1997, Mr. Kopiev served as Chairman of the Board of Directors of JSC Sputnik. Mr. Kopiev joined Sistema as Vice President in 1997 and from 2000 to 2003, he held the positions of Senior Vice-President, Head of the External Business Environment Complex. Since 2008, he has served as a member of the Presidential Council of the Russian Federation for development of physical education and sports, professional sports, preparations for the XXII Olympic Games and XI Paralympic Games of 2014 in Sochi, President of the Russian Rugby Union. Since 2003, Mr. Kopiev has been a non-executive director on Sistema JSFC's Board of Directors, Chairman of the Charitable Foundation of Sistema JSFC and a member of the Ethics and Internal Control Committee and the Investor Relations and Dividend Policy Committee of Sistema JSFC.

Leonid Melamed—Deputy Chairman of the Board of Directors, Non-Executive Director

Mr. Leonid Adolfovich Melamed was born in 1967. He graduated from the Moscow Medical Academy named after I. Sechenov in 1992 with a degree in medicine. He was awarded Doctor of Medicine in 2006. From 1991 to 2006, Mr. Melamed occupied various positions in ROSNO insurance company, including General Director and Chairman of the Management Board. From 2004 to 2006, he also was Chairman of the Expert Council on Insurance Legislation of the Russian State Duma Committee on Credit Organisations and Financial Markets. From 2006 to 2008, Mr. Melamed served as President, Chairman of the Management Board and a member of the Board of Directors of MTS OJSC. From 2008 to 2011, he was President and Chairman of the Management Board of Sistema JSFC. He has also occupied senior positions within Sistema, including member of the Board of Directors of JSOC Bashneft and Chairman of the Board of Directors of RussNeft. Since 2009, Mr. Melamed has been a member on Sistema JSFC's Board of Directors, Chairman of the Nomination, Remuneration and Corporate Governance Committee and a member of the Ethics and Internal Control Committee and the Strategy Committee of Sistema JSFC. Since 2011, he has also served as Deputy Chairman of Sistema JSFC's Board of Directors.

Roger Munnings—Independent Director

Mr. Roger Munnings was born in 1950. He graduated from the Oxford University in 1972 with a degree in master of arts in politics, philosophy and economics. From 1974 to 2008, Mr. Munnings occupied various positions in KPMG, including international auditor, President and Managing Partner of KPMG in the Russian Federation and the CIS, Chairman of the world energy and natural resources committee of KPMG. He has been a member of the U.K. Government Special Representative for Trade and Investment between the U.K. and the Russian Federation, a member of Executive Board of the Association of European Businesses and Chairman of the Audit Committee Institute in the Russian Federation. Roger Munnings is actively involved in professional associations in the Russian Federation, being a member of the Russian National Council on Corporate

Governance, the Russian Union of Industrials and Entrepreneurs, the Russian institute of directors, the management board of the American-Russian business council, the management board of the Russian-British chamber of commerce etc. Since 2010, Mr. Munnings has been an independent director on Sistema JSFC's Board of Directors, Chairman of the Audit and Finance Committee and a member of the Nomination, Remuneration and Corporate Governance Committee, the Ethics and Internal Control Committee and the Investor Relations and Dividend Policy Committee of Sistema JSFC.

Evgeny Novitsky—Independent Director

Mr. Evgeny Grigorievich Novitsky was born in 1957. He graduated from the Moscow Bauman Higher Technical School in 1985 with a degree in engineering and in 1990 with a degree in engineer mathematician, from the Moscow State University of International Relations in 1989 with a degree in management and from the University of Manchester, in the U.K. in 1990 with a degree in management. He was awarded a candidate of technical sciences in 2000. From 1991 to 1995, Mr. Novitsky headed the development and production of computers as well as assembly of IBM computers at the Kvant plant in Zelenograd, he also served as Chairman of the Board of Directors of the Russian IT company IVK (Information and Innovation Company). From 1995 to 2005, he served as President of Sistema JSFC. Since 2005, Mr. Novitsky has occupied various positions on Sistema JSFC's Board of Directors, including Chairman of the Board of Directors, a non-executive director and later an independent director. He is also a member of Sistema JSFC's Audit and Finance Committee, the Strategy Committee and the Board of Trustees of the Charitable Foundation of Sistema JSFC.

Ron Sommer—Non-Executive Director

Mr. Ron Sommer was born in 1949. He graduated from the Vienna University in 1971 with a Doctor's Degree in mathematics. From 1980 to 1995, Mr. Sommer occupied various positions in Sony, including Managing Director in the German branch of the Sony Group, Chairman of the Management Board of Sony Deutschland, Chief Operating Officer of Sony Corporation USA and Chief Operating Officer of Sony Europe. From 1995 to 2002, he served as Chairman of the Management Board of Deutsche Telekom AG. In 2003, Mr. Sommer was elected Chairman of the International Advisory Board of Sistema. Mr. Sommer serves on the Boards of Directors of Tata Consultancy Services and Munich Reinsurance, and he is also a member of the International Consultative Council of Blackstone Group. Mr. Sommer has served as Chairman on the Board of Directors of MTS OJSC, Chairman of the Board of Directors of SMM and Chairman of the Board of Directors of SSTL. Since 2005, Mr. Sommer has been a member on Sistema JSFC's Board of Directors, initially as an independent director and later as a non-executive director, and a member of the Strategy Committee, the Investor Relations and Dividend Policy Committee and the Audit and Finance Committee of Sistema JSFC.

David Iakobachvili—Independent Director

Mr. David Mikhailovich Iakobachvili was born in 1957. He graduated from the Georgian Technical University in Tbilisi in 1977 with a degree in civil and industrial engineering. From 1986 to 2000, Mr. David Iakobachvili was a private entrepreneur involved in various projects: official dealership of General Motors cars, tourism and hotel business, timber processing, management of furniture supplies, retail management, communications and banking. In 1992, David Iakobachvili became one of the founders of Wimm-Bill-Dann. From 1992 to 2011, he was a member and later the Chairman of the Board of Directors of Wimm-Bill-Dann. Mr. Yakobashvili serves on the Boards of Directors of a number of companies: CJSC Gorki-2 Agro-Complex, Airport Financial Services Limited, OJSC Melnichniy kombinat No 4 (grain mill), LLC Kolmogorovskaya-2 mine, LLC Promuglesbyt Managing Company and JSOC Bashneft. Since 2000, he has been a member of the Management Board of the Russian Union of Industrialists and Entrepreneurs (Employers). Since 2004, he has served as a member of the Bureau of the Management Board of the Union. Since 2011, Mr. Yakobashvili has been an independent director on Sistema JSFC's Board of Directors, Chairman of the Investor Relations and Dividend Policy Committee and a member of the Audit and Finance Committee of Sistema JSFC.

Serge Tchuruk—Independent Director

Mr. Serge Tchuruk was born on 1937. He graduated from Ecole Polytechnique in 1960 and from the National Defence Institute in 1963 with a degree in engineering. From 1964 to 1979, Mr. Tchuruk held a number of management positions in Mobil Corporation in France and in the USA, including the Chief Executive Officer of Mobil Benelux. From 1980 to 1986, he occupied management positions at Rhone-Poulenc, an international chemical and pharmaceutical company, including Managing Director of the company. From 1986 to 1990, Mr. Tchuruk served as Co-Chairman and Chief Executive Officer of Orkem, a European chemical company

(earlier known as CDF-Chimie). From 1990 to 1995, he was Chairman and Chief Executive Officer of Total, one of the largest oil and gas companies globally. Since 1995, Mr. Tchuruk has served as Chief Executive Officer of Alcatel. Since 2011, Mr. Tchuruk has been an independent director on Sistema JSFC's Board of Directors and a member of the Investor Relations and Dividend Policy Committee and the Strategy Committee of Sistema JSFC.

Robert Kocharyan—Independent Director

Mr. Robert Sedrakovich Kocharyan was born in 1954. He graduated from the Yerevan Polytechnic Institute in 1982 with a degree in electricity-engineering. From 1981 to 1990, he held various positions in Komsomol and Communist party organisations of Nagorny Karabakh. From 1989 to 1990, Mr. Kocharyan was a deputy of Armenia's Supreme Council and member of the Presidium of the Supreme Council of the Armenian SSR. From 1991 to 1994, he served as Deputy of the First Supreme Council of the Nagorny-Karabakh Republic, Chairman of the State Defense Committee of the Nagorny-Karabakh Republic and Prime Minister of the Nagorny-Karabakh Republic. From 1994 to 1997, Mr. Kocharyan was President of the Nagorny-Karabakh Republic. From 1997 to 1998, he occupied the position of the Prime Minister of the Republic of Armenia. From 1998 to 2008, Mr. Kocharyan served as President of the Republic of Armenia. Since 2009, Mr. Kocharyan an independent director on Sistema JSFC's Board of Directors, Chairman of the Ethics and Internal Control Committee and a member of the Nomination, Remuneration and Corporate Governance Committee of Sistema JSFC.

Management Board

The Management Board is Sistema JSFC's collective executive body. It is elected by the Board of Directors and may be re-elected an unlimited number of times. The Management Board meets regularly and makes its decisions by simple majority, provided that a quorum of at least half of the elected members of the Management Board is present. The Management Board is responsible for Sistema JSFC day-to-day management and administration. The President represents Sistema JSFC and acts as Chairman of the Management Board.

The following table sets forth the name, age, position and first year of appointment of each of Sistema JSFC's member of the Management Board:

<u>Name</u>	<u>Age</u>	<u>Position</u>	<u>First Year Appointed</u>
Mikhail Shamolin	42	President and Chief Executive Officer, Chairman of Management Board	2011
Felix Evtushenkov	34	First Vice President, Head of Core Assets Business Unit	2008
Anton Abugov	35	First Vice President, Head of Strategy and Development Functional Division	2006
Alexey Buyanov	43	Senior Vice President, Chief Financial Officer	2002
Sergei Drozdov	42	Senior Vice President, Head of the Corporate Governance Division	2002
Rafael Nagapetiants	50	Senior Vice President, Head of Developing Assets Business Unit	2011
Anna Goldin	49	Vice President, Head of the Legal Functional Division	2007
Andrey Terebenin	50	Vice President, Head of the Corporate Communications Division	2011

The business address of each of the members of Sistema JSFC's Management Board is Sistema JSFC's registered office.

Mikhail Shamolin—President and Chief Executive Officer, Chairman of the Management Board

See “—Board of Directors” for a brief biography of Mr. Shamolin.

Felix Evtushenkov—First Vice President, Head of Core Assets Business Unit

Mr. Felix Vladimirovich Evtushenkov was born in 1978. He graduated from the Institute of International Law and Economics named after A. S. Griboedov in 2000 with a degree in law. From 1999 to 2000, Mr. Evtushenkov

served as Assistant to President of CJSC Sistema-Invest (“**Sistema-Invest**”) and Executive Director of Industry Department in Sistema JSFC. From 2000 to 2008, he occupied various management positions in Sistema-Hals, including Deputy General Director, Head of Strategy and Marketing Department, General Director and President. From 2008 to 2010, Mr. Evtushenkov was Chairman of the Board of Directors of Sistema-Hals and later a member of the Board of Directors of Sistema-Hals. From 2008 to 2011, he was Vice President of Sistema JSFC and Head of the “Consumer Assets” Business Unit. Since 2011, Mr. Evtushenkov has been First Vice President of Sistema JSFC and Head of the Core Assets Business Unit.

Anton Abugov—First Vice President, Head of Strategy and Development Functional Division

Mr. Anton Vladimirovich Abugov was born in 1976. He graduated from the Academy of National Economy under the Government of the Russian Federation in 1998 with a degree in management. From 1995 to 2002, Mr. Abugov served as Director for Corporate Finance in United Financial Group. From 1997 to 2006, he was an advisor to the TAIF Group and in 1999, he also served as an advisor to RAO UESR of the Russian Federation. From 2002 to 2003, he was Partner in Eurasia Capital Partners. From 2003 to 2006, he occupied the position of Managing Director for Corporate Finance in Joint-Stock Commercial Bank Rosbank. Since 2006, Mr. Abugov has been First Vice President of Sistema JSFC, Head of Strategy and Development Functional Division. For the period from 2007 to 2009, he also occupied position of Chairman on the Boards of Directors of Sky Link, Comstar, Detsky Mir Center and RWS. Since 2010, Mr. Abugov has also been a member of the Boards of Directors of MTS OJSC, JSOC Bashneft, OJSC Bashkirengo, RussNeft and Vice Chairman of the Board of Directors of NIS.

Alexey Buyanov—Senior Vice President, Chief Financial Officer

Mr. Alexey Nikolaevich Buyanov was born in 1969. He graduated from the Moscow Physics and Engineering Institute in 1992 with a degree in applied mathematics and physics. From 1992 to 1994, he was an intern researcher at the Institute of Mechanics Problems of the Russian Academy of Sciences. Mr. Buyanov joined Sistema JSFC group in 1994, where he held various positions including from 1995 to 1998—Department Head, Vice President, First Vice President of CJSC Sistema-Invest and from 1998 to 2002—Vice President of MTS OJSC. He has also been a member of the Boards of Directors of MTS OJSC, MTS Bank (formerly MBRD) and East-West United Bank. Since 2002, Mr. Buyanov has been Vice President and Chief Financial Officer of Sistema JSFC.

Sergei Drozdov—Senior Vice President, Head of the Corporate Governance Division

Mr. Sergei Alekseevich Drozdov was born in 1970. He graduated from the State Academy of Management named after S. Ordzhonikidze in 1993 with a degree in engineering and economy. He was awarded a candidate of economic sciences. From 1993 to 1994, Mr. Drozdov served as Economist in the Division of Trust Operations and Funds, Deputy Head of the Division of Securities and Trust Operations, and later as Head of the Securities Department in Yugorskiy Joint-Stock Bank. From 1994 to 1995, he was Head of the Financial Innovations and Marketing Department of Moscow Property Fund. From 1995 to 1998, Mr. Drozdov occupied the position of Executive Director and Deputy Head of the Department of Development and Investments in Sistema JSFC. From 1998 to 2002, he held the positions of Head of Division, Vice President and later First Vice President in Sistema-Invest. From 2002 to 2005, Mr. Drozdov occupied the positions of Head of the Corporate Property Department and Acting First Vice President and later First Vice President of Sistema JSFC. Since 2005, Mr. Drozdov has been Senior Vice President and Head of the Corporate Governance Division of Sistema JSFC.

Rafael Nagapetiants—Senior Vice President, Head of Developing Assets Business Unit

Mr. Rafael Nesterovich Nagapetiants was born in 1962. He graduated from the Moscow Finance Institute in 1984 with a degree in international economics, from the Moscow State University named after M.V. Lomonosov in 1995 with a degree in law, and from the Amsterdam Institute of Finance in 1996 with a degree in finance. He was awarded Doctor of Economics in 2007. From 1984 to 1990, Mr. Nagapetiants held various positions in the USSR Ministry of Finance. From 1991 to 1993, he served as Deputy Chairman of the Committee for Foreign Investments (later Russian Agency for International Cooperation and Development). From 1994 to 2001, he worked as Vice President and Head of Investment and International Business at Inkombank. From 2001 to 2005, Mr. Nagapetiants was Director of SUN Capital Partners, a private equity fund in the Russian Federation. From 2005 to 2008, he served as Managing Director of Corporate Finance Department and Head of Investment Committee at Alfa Bank. At the same time, from 2007 to 2009, Mr. Nagapetiants worked as Chairman of the Supervisory Board at Amtel-Vredestein. From 2009 to 2011, he was Managing Director and Head of Investment Banking at Societe Generale, the Russian Federation. Since 2011, Mr. Nagapetiants has been Senior Vice President, Head of the Developing Assets Business Unit of Sistema JSFC.

Anna Goldin—Vice President, Head of the Legal Functional Division

Ms. Anna Goldin was born in 1963. She graduated from the University of California in Berkeley in 1990 where she was awarded Doctor of Law. In 1988, Ms. Goldin joined Baker & McKenzie as a lawyer trainee. In 1989, she held position of a lawyer trainee in Gibson, Dunn & Crutcher and later in Morrison & Foerster. From 1990 to 1998, she was a lawyer in Latham & Watkins. From 1999 to 2007 Ms. Goldin served as Partner and later as Managing Partner of the Moscow office of Latham & Watkins. Since 2007, Ms. Goldin has been Vice President, Head of the Legal Functional Division of Sistema JSFC.

Andrey Terebenin—Vice President, Head of the Corporate Communications Division

Mr. Andrey Borisovich Terebenin was born in 1962. He graduated from the Moscow State Institute of International Relations in 1985 with a degree in international relations and Arabic. From 1985 to 1999, Mr. Terebenin held a number of management positions with the Publishing House *Economicheskaya Gazeta*, Dun&Bradstreet CIS and AIG the Russian Federation. In 1999, he became a partner at the Triangle Porter Novelli Communications Agency, and since 2003 to 2006, he was General Director and Partner at the R.I.M. Porter Novelli Communications Holding. From 2006 to 2011, Mr. Terebenin occupied the position of Vice President for Corporate Communications of MTS OJSC. Since 2011, Mr. Terebenin has been Vice President, Head of Corporate Communications Division of Sistema JSFC.

President

The President is the chief executive officer and Chairman of the Management Board by virtue of being the President. Pursuant to the Joint Stock Companies Law and Sistema JSFC's charter, the President of Sistema JSFC is responsible for implementation of decisions of the General Shareholders' Meeting and the Board of Directors. The President acts on behalf of Sistema JSFC without a power of attorney, representing its interests, entering into transactions, disposing of assets, approving staffing structure and issuing internal orders and directives. Sistema JSFC's current President is Mr. Shamolin who was appointed on 10 March 2011.

Compensation

The aggregate amount of remuneration paid by Sistema JSFC to members of Sistema JSFC's Board of Directors and Management Board for services in all capacities provided to Sistema during the year ended 31 December 2009, 2010 and 2011 was approximately RUB 1.4 billion, RUB 3.6 billion and RUB 4.5 billion, respectively, in salary and bonuses.

The remuneration for the members of Sistema JSFC's Board of Directors is calculated on the basis of the "Policy on remuneration and compensations payable to the members of the Board of Directors of the Company," approved by the resolution of the General Shareholders' Meeting on 30 June 2006, as amended by the resolution of the General Shareholders' Meeting on 16 February 2009. The Policy provides for the following payments to the members of Sistema JSFC's Board of Directors:

- fixed amounts for participation in meetings of the Board of Directors and its committees;
- fixed amounts for acting in the capacity of the Chairman or the Deputy Chairman of the Board of Directors, and for chairmanship of the committees under the Board;
- additional performance-related remuneration in the form of a fixed amount, half of which is payable in shares (\$250,000—325,000) based on the results of a year;
- additional remuneration amounting to 0.1% of the incremental capitalisation subject to growth of the capitalisation of Sistema over the year.

Incentive Schemes

In addition, the remuneration of the Sistema JSFC's management is based on the short-term (up to one year) and long term (over one year) incentive schemes, which were updated by Sistema JSFC's Board of Directors in September 2011.

Short-term incentive scheme

The short-term incentive scheme for the Sistema JSFC's management comprises the following elements:

- monthly fixed salary determined in line with the internal system of job categories (grades);

- one annual bonus paid for achievement of a) financial key performance indicators set for Sistema as a whole and its business units for a respective reporting period and b) functional key performance indicators set individually for each of Sistema JSFC's top managers for the respective reporting period;
- additional remuneration paid for achievement of investment targets of Sistema for the year;
- additional bonus which may be paid only following a decision of the Board of Directors.

The short-term incentive scheme also provided for four quarterly bonuses for the management of Sistema JSFC which were excluded by the relevant decision of Sistema JSFC's Board of Directors starting from 1 January 2012.

Long-term incentive scheme

The long-term incentive scheme for the Sistema JSFC's management comprises the Motivation Programme for the management of Sistema JSFC and the Stock Option Plan for Initiation and Development of Merger and Acquisition Projects.

The previous Motivation Programme for the management of Sistema JSFC was effective from 2009 to 2011. According to the programme, participants were granted phantom shares of the Company upon their continued employment with Sistema JSFC. Participants had right to convert up to two-thirds of phantom shares granted before 31 December 2010 into cash and the rest, including shares granted during 2011, were converted into ordinary shares of Sistema JSFC in January 2012. The grant-date fair value of an equity portion of the award was measured at the fair value of the Company's ordinary shares at grant-date and equated to \$54.3 million and \$83.8 million as at 31 December 2010 and 2011, respectively. Sistema JSFC recognized \$41.0 million, \$75.5 million and \$31.7 million of compensation expense for the Motivation Programme for the years ended 31 December 2009, 2010 and 2011, respectively. In January 2012, Sistema JSFC granted approximately 1% of our charter capital to certain members of Sistema JSFC's Board of Directors and Management Board within the framework of this Motivation Programme.

The new Motivation Programme (2012-2014) for the management of Sistema JSFC was adopted by the Board of Directors in September 2011 and has been effective since 1 January 2012. According to this Motivation Programme the remuneration of the programme participants depends on the capitalisation growth of Sistema JSFC and, as opposed to the previous Motivation Programme, may be paid only in ordinary shares of Sistema JSFC and its subsidiaries. The ordinary shares of Sistema JSFC and its subsidiaries will be transferred to the programme participants starting from 2013 and during two years after the expiration of this Motivation Programme in 2014. The total number of ordinary shares in portfolio subsidiaries and affiliates of Sistema JSFC allocated for payment of compensations to Business Unit managers is designated in separate resolutions of Sistema JSFC's Board of Directors. The total (maximum) number of ordinary shares in Sistema JSFC allocated for payment of compensations to Functional Division managers amounts to 2% of the total number of ordinary shares in the charter capital of Sistema JSFC.

A stock option plan for initiation and development of merger and acquisition projects was adopted by Sistema JSFC's Board of Directors in September 2011 and was aimed at increasing the management's motivation in searching for, acquiring and developing new assets, in order to raise the equity and market value of Sistema JSFC. The stock option fund for each merger and acquisition project is determined in separate resolutions of Sistema JSFC's Board of Directors but may not exceed 10% of the charter capital of the new asset. As at 31 December 2011, Sistema JSFC allocated no shares in the charter capital of the new assets to its management based on this stock option plan.

No remuneration is paid for the executive work of the managers sitting on Sistema JSFC's Management Board.

Contracts with Sistema JSFC's management

As at the date of this Prospectus, Sistema JSFC had no service contracts with the members of its Board of Directors and the Management Board.

Loans and Guarantees

As at 31 December 2011, Sistema JSFC had no outstanding loans and guarantees to the members of the Board of Directors and the Management Board.

D&O Liability Insurance

Since 2005, Sistema JSFC has entered into the directors' and officers' annual insurance policy ("D&O Policy"). In addition to the D&O Policy, Sistema JSFC entered into indemnification agreement with each member of the Board of Directors and the Management Board. The indemnification agreement covers those risks arising from actions of the Sistema JSFC's management that have not been addressed in the D&O Policy.

Interests of Members of Sistema JSFC's Board of Directors and Management Board

Share Ownership

Certain members of Sistema JSFC's Board of Directors and Sistema JSFC's Management Board have ownership interests in the share capital of Sistema JSFC. As at 20 January 2012, these members of the Board of Directors and the Management Board held, in aggregate, 68.9% of Sistema JSFC's issued shares. In addition, the members of Sistema JSFC's Board of Directors and Management Board owned approximately 0.2% of the issued shares of MTS OJSC as at 25 April 2012.

As at 20 April 2012, the following members of Sistema JSFC's Board of Directors and Management Board owned ordinary shares in Sistema JSFC in the following percentages:

Name of the member of Sistema JSFC's Board of Directors and Management Board	Shares Beneficially Owned	
	Number	Percentage
<i>Members of Sistema JSFC's Board of Directors</i>		
Vladimir Evtushenkov	6,193,659,297	64.1830
Evgeny Novitsky	192,153,232	1.9912
Alexander Goncharuk	96,686,550	1.0019
Dmitry Zubov	94,098,265	0.9751
Leonid Melamed	7,983,533	0.0827
Vyacheslav Kopiev	5,370,441	0.0556
Mikhail Shamolin	3,147,750	0.0326
Ron Sommer	2,074,073	0.0215
Robert Kocharyan	180,737	0.0019
Roger Munnings	87,500	0.0009
David Iakobachvili	5,771	0.00006
<i>Members of Sistema JSFC's Management Board</i>		
Sergei Drozdov	23,545,381	0.2440
Anna Goldin	11,027,030	0.1142
Alexey Buyanov	6,526,627	0.0676
Felix Evtushenkov	5,739,688	0.0595
Anton Abugov	5,029,243	0.0521
Rafael Nagapetians	1,143,315	0.0118
Andrey Terebenin	40,016	0.0004

Conflict of Interest

The members of Sistema JSFC's Board of Directors and Management Board have the following potential conflicts of interest:

- Mr. Vladimir Evtushenkov and Mr. Felix Evtushenkov are father and son. None of the other members of Sistema JSFC's Board of Directors or Management Board are related to one another for the purposes of the Prospectus Rules.
- The economic interests through shareholdings in Sistema JSFC of certain members of Sistema JSFC's Board of Directors and Management Board (as indicated in the table above), may give rise to a conflict of interest between their duties owed to Sistema JSFC and their private interests in the share capital of Sistema JSFC. For example, it could cause them to pursue short term gains in respect of those private interests.
- Mr. Gutseriyev, RussNeft's President and founder, Mr. Melamed, chairman of RussNeft's board of directors, and Mr. Abugov, a member of RussNeft's board of directors, are also on the board of directors of JSOC Bashneft, a competitor of RussNeft in the Russian market. Mr. Gutseriyev,

Mr. Melamed and Mr. Abugov could use their influence at RussNeft or JSOC Bashneft in a manner which could conflict directly with JSOC Bashneft's or RussNeft's interests. See *"Risk Factors—Risks Relating to Our Business and Industry—General Risks—Certain of our subsidiaries' directors and executive officers may also serve as directors or officers of our subsidiaries' competitors, which may lead to certain conflicts of interest."*

Other than the potential conflicts of interest described in the bullet-points immediately above, we are not aware of any other potential conflicts of interest between any duties owed by members of Sistema JSFC's Board of Directors or Management Board to Sistema JSFC and their private interests and/or other duties.

Corporate Governance

Sistema JSFC complies with the corporate governance requirements applicable to Russian public companies listed on Russian stock exchanges. Sistema JSFC's shares have been listed on the Russian Trading System Exchange and on the Moscow Stock Exchange since 2005 and, as a result, Sistema JSFC is required to comply with a number of corporate governance requirements imposed by such exchanges. Such requirements, *inter alia*, include: (i) the obligation to have at least one independent director on the Board of Directors, (ii) the formation of an audit committee, (iii) the adoption of a bylaw on insider trading and (iv) the implementation of internal control procedures. Sistema JSFC is in full compliance with these requirements. In 2005, the National Rating of Corporate Governance by the Russian Institute of Directors and Expert RA rating agency, Sistema JSFC's level of corporate governance was rated A (high).

In the Russian Federation, a director is deemed "independent," if such director: (i) as of the moment of his appointment is not, and during the last one year has not been, an executive officer or an employee of the issuer or its executive director, (ii) is not an executive officer of another company where any of the issuer's current executive officers serves on that company's HR and remuneration committee, (iii) is not a close relative (*i.e.* a spouse, parent, child or siblings) of an executive officer (or an executive director) of the issuer or of an executive officer of the issuer's management company, (iv) is not an affiliate of the issuer (except by virtue of membership of the issuer's supervisory board), (v) is not a party under a commitment with the issuer, pursuant to which such director can acquire property (receive funds) in the amount equal to or exceeding 10% of his/her total annual revenue (except for a director's fee) and (vi) is not a state representative. The criteria of the "director's independence," set forth in Russian law and the FSFM guidance, differ in some respects from the criteria for independent directors that are set out in the U.K. Corporate Governance Code and under applicable listing requirements in the United States. In particular, the following criteria of "director's independence" are not explicitly set forth in Russian law or the FSFM guidance: a director may not (i) have a material business relationship with the issuer as a partner, shareholder, director or senior employee of a body that has such a relationship with the issuer, (ii) have close family ties with any of the issuer's advisers, (iii) represent a significant shareholder, or (iv) be a current partner or employee of a firm that is the issuer's auditor.

In July 2004 and in June 2011 respectively, Sistema JSFC's Board of Directors approved a Corporate Code of Conduct and an Ethics Code for Sistema JSFC. The main priorities of the Corporate Code of Conduct are respect for shareholders' and customers' rights and interests, transparency of information, further improvement of the efficiency of Sistema JSFC's governance and maintenance of Sistema JSFC's financial stability and profitability. The Ethics Code serves to establish corporate values, as well as to promote the principles and rules of ethical conduct of Sistema JSFC's employees. The Ethics Code applies to Sistema JSFC's employees as well as to Sistema JSFC's senior management. Sistema JSFC views the adoption of these codes as an important step in the continued improvement in the corporate governance of Sistema JSFC. In April 2010 and in October 2011, Sistema JSFC's Board of Directors approved a Regulation on Information Policy and a Regulation on Dividend Policy of Sistema JSFC as part of Sistema JSFC's corporate governance initiatives pursuant to the Code of Corporate Conduct of Sistema JSFC recommended by the Federal Commission for Securities Markets of the Russian Federation. The Information Policy is designed to ensure that regular, timely, balanced, complete and accurate information is available to all interested stakeholders, including shareholders, potential investors, media representatives and securities professionals in compliance with applicable legislation and regulations. The Dividend Policy is intended for Sistema JSFC's Board of Directors to determine its approach to recommendations on the amounts of, and procedures for share dividend payments.

Strategy Committee

The Strategy Committee is responsible for initial discussion and analysis of the issues of strategic development of Sistema JSFC, provision of recommendations to the Board of Directors of Sistema JSFC, preliminary approval

of the strategic transactions, projects related to entering new markets, as well as public and private partnerships. The Strategy Committee was established in 2044 and currently consists of V. Evtushenkov, A. Goncharuk, R. Sommer, E. Novitsky, L. Melamed, M. Shamolin and S. Tchuruk. The Strategy Committee is chaired by V. Evtushenkov.

Audit and Finance Committee

The Audit and Finance Committee supervises the preparation of financial reports and internal audit of Sistema JSFC and its subsidiaries, and coordinates the work of internal control and audit services. In addition, the Audit and Finance Committee monitors the work of the independent auditors, gives recommendations on their appointment and the amount of their fees, and acts as an intermediary in resolving disputable issues that may arise in the course of the audit. The Audit and Finance Committee was established in 2004 and currently consists of R. Munnings, R. Somner, D. Zubov, E. Novitsky and D. Iakobachvili. The Audit and Finance Committee is chaired by R. Munnings.

Nomination, Remuneration and Corporate Governance Committee

The Nomination, Remuneration and Corporate Governance Committee advises the Board of Directors on appointment of the President and executive officers of Sistema JSFC and nomination of members to the boards of directors of subsidiaries. In addition, the Nomination, Remuneration and Corporate Governance Committee is responsible for the development of Sistema JSFC's incentive and remuneration system and corporate governance policy. The Nomination, Remuneration and Corporate Governance Committee was established in 2004 and currently consists of L. Melamed, A. Goncharuk, D. Zubov, R. Kocharyan, R. Munnings and M. Shamolin. The Nomination, Remuneration and Corporate Governance Committee is chaired by L. Melamed.

Ethics and Internal Control Committee

The Ethics and Internal Control Committee works out the proposals on enhancing the standards of corporate conduct and improving the quality of corporate governance at subsidiaries and affiliates. In addition, it monitors compliance with the current laws, our charter and the business ethics standards. The Ethics and Internal Control Committee is responsible for preventing and settling corporate and ethical conflicts. The Ethics and Internal Control Committee was established in 2011 and currently consists of R. Kocharyan, V. Kopiev, R. Munnings, L. Melamed and M. Shamolin. The Ethics and Internal Control Committee is chaired by R. Kocharyan.

Investor Relations and Dividend Policy Committee

The Investor Relations and Dividend Policy Committee is responsible for maintaining effective relations with the investors, financial institutions and government agencies. In addition, the Committee advises the Board of Directors of Sistema JSFC on and facilitates maintaining of a transparent and stable dividend policy of Sistema JSFC. The Investor Relations and Dividend Policy Committee was established in 2005 and currently consists of D. Iakobachvili, A. Goncharuk, R. Sommer, V. Kopiev, R. Munnings and S. Tchuruk. The Investor Relations and Dividend Policy Committee is chaired by D. Iakobachvili.

Litigation Statement about Directors and Officers

At the date of this Prospectus, none of the members of Sistema JSFC's Board of Directors or the members of Sistema JSFC's Management Board for at least the previous five years:

- has had any convictions in relation to fraudulent offences; nor
- has held an executive function in the form of a senior manager or a member of the administrative, management or supervisory bodies, of any company, or a partner in any partnership, at the time of or preceding any bankruptcy, receivership or liquidation; nor
- has been subject to any official public incrimination and/or sanction by any statutory or regulatory authority (including any designated professional body) nor has ever been disqualified by a court from acting as a member of the administrative, management or supervisory bodies of a company or from acting in the management or conduct of the affairs of any company.

PRINCIPAL SHAREHOLDERS

The following table sets forth information regarding the beneficial ownership of Sistema JSFC's shares as at 20 April 2012:

<u>Beneficial owner</u>	<u>Shares Beneficially Owned</u>	
	<u>Number</u>	<u>Percentage</u>
Vladimir Evtushenkov ⁽¹⁾	6,193,659,297	64.1830
Evgeny Novitsky	192,153,232	1.9912
Alexander Goncharuk	96,686,550	1.0019
Dmitry Zubov	94,098,265	0.9751
Sergei Drozdov	23,545,381	0.2440
Anna Goldin	11,027,030	0.1142
Leonid Melamed	7,983,533	0.0827
Alexey Buyanov	6,526,627	0.0676
Felix Evtushenkov	5,739,688	0.0595
Vyacheslav Kopiev	5,370,441	0.0556
Anton Abugov	5,029,243	0.0521
Mikhail Shamolin	3,147,750	0.0326
Ron Sommer	2,074,073	0.0215
Rafael Nagapetians	1,143,315	0.0118
Robert Kocharyan	180,737	0.0019
Roger Munnings	87,500	0.0009
Andrey Terebenin	40,016	0.0004
David Iakobachvili	5,771	0.00006
GDR Holders	1,825,980,560	18.9220
Other	1,175,520,991	12.1815
Total	9,650,000,000	100
<i>including</i>		
Treasury	382,014,975	3.9587

(1) Mr. Evtushenkov is the Chairman of Sistema JSFC's Board of Directors. Of his ownership stake, a portion is held by Zelnik Holdings Limited, a company 100% owned by Mr. Evtushenkov.

RELATED PARTY TRANSACTIONS

The following is a summary of our transactions with related parties for the years ended 31 December 2009, 2010 and 2011. For further details, see Note 25 to our U.S. GAAP Financial Statements.

GENERAL MATTERS

Parties are considered to be related if one party has the ability to control the other party or exercise significant influence over the other party in making financial or operational decisions, as defined in ASC 850 “*Related Party Disclosures*.” In considering each possible related party relationship, attention is directed to the substance of the relationship, not merely the legal form.

We are, and have been, a party to various agreements and other arrangements with certain related parties and interested parties, the most significant of which are described below. See “*Risk Factors—Risks Relating to Our Business—General Risks—We have engaged and may continue to engage in transactions with related parties that may present conflicts of interest, potentially resulting in the conclusion of transactions on less favourable terms than could be obtained in arm’s length transactions.*”

TRANSACTIONS WITH RELATED PARTIES

We provided services to and purchased services from affiliates and companies related by means of common control. During the years ended 31 December 2009, 2010 and 2011, our transactions with related parties were as follows:

	Year ended 31 December		
	2009	2010	2011
	<i>(\$ in thousands)</i>		
Sales of goods and services	(144,707)	(864,187)	(750,027)
Revenue from banking activities	(21,782)	(11,554)	(13,926)
Cost of sales	2,086	8,097	249,197
Cost related to banking activities	2,342	14,043	550
Selling, general and administrative expenses	44,252	72,164	12,850

We entered into transactions to purchase and sell goods and services from and to our related parties in the ordinary course of business. For the years ended 31 December 2009, 2010 and 2011, the most significant transactions were entered into by JSOC Bashneft and Intracom Telecom Solutions S.A. (“**Intracom**”) and related to supplies of refined products and sales of high technology products to their related parties, respectively.

Supply Agreements between JSOC Bashneft and OJSC Polief

In the years ended 31 December 2010 and 2011, JSOC Bashneft entered into several transactions with OJSC Polief related to supplies of refined products. OJSC Polief was considered a related party of JSOC Bashneft because starting from February 2010, JSOC Bashneft managed 17.5% stake in the charter capital of OJSC Polief owned by the Republic of Bashkortostan and Mr. Goncharuk, a member of JSOC Bashneft’s board of directors was also on the board of directors of OJSC Polief. For the years ended 31 December 2010 and 2011, JSOC Bashneft recorded revenues in the total amount of approximately \$84 million and \$111 million, respectively.

Supply Agreements between Bashneft-Region, Bashneft-Udmurtia and JSOC Bashneft

In the years ended 31 December 2010 and 2011, JSOC Bashneft entered into several transactions with Bashneft-Region and LLC Bashneft-Udmurtia (“**Bashneft-Udmurtia**”) related to supplies of refined products. Prior to the acquisition by JSOC Bashneft of 100% in Bashneft-Region and Bashneft-Udmurtia in July 2011, JSOC Bashneft held indirect interest in these companies through its 49.99% stake in ASPEC. For the years ended 31 December 2010 and 2011, JSOC Bashneft recorded revenues in the total amount of approximately \$660 million and \$498 million, respectively.

Sale and purchase agreements between Intracom and Intracom Holdings S.A.

In the year ended 31 December 2009, Intracom, in which we held a controlling 51% stake through SITRONICS, entered into several transactions with subsidiaries and affiliates of Intracom Holdings S.A. related to the sale of software and high technology products. Intracom Holdings S.A. was considered a related party of Intracom due to the holding of the remaining 49% stake in the charter capital of Intracom. For the year ended 31 December 2009, Intracom recorded revenue in the total amount of approximately \$125 million.

As at 31 December 2010 and 2011, the related party balances were as follows:

	Years Ended 31 December	
	2010	2011
	<i>(\$ in thousands)</i>	
Assets		
Cash and cash equivalents	1,457	1,038
Short-term investments	29,475	3,323
Account receivable, net	94,688	136,201
Other current assets	6,261	7,166
Long-term investments	144,144	188,043
Liabilities		
Accounts payable	(63,781)	(46,225)
Accrued expenses and other current liabilities	(81,535)	(53,898)

REGULATORY OVERVIEW

Below is a brief description of certain key provisions of Russian legislation relating to our operations, including in the telecommunications sector and oil and electric power industries. This description is not comprehensive and is qualified in its entirety by reference to applicable Russian law.

Regulation of the Telecommunications Sector in the Russian Federation

Applicable Laws, Rules and Regulations

In the Russian Federation, the federal government regulates telecommunications services. The principal law regulating telecommunications in the Russian Federation is the Communications Law, which provides for, among other things, the following:

- licensing of telecommunications services;
- requirements for obtaining a radio frequency allocation;
- equipment certification;
- fair competition;
- freedom of pricing other than pricing by companies with a substantial position in public telecommunication networks; and
- liability for violations of Russian legislation on telecommunications.

The Communications Law came into force on 1 January 2004 and replaced the law of 1995 regulating the same subject matter. The Communications Law creates a framework in which government authorities may enact specific regulations. Regulations enacted under the legislative framework in place prior to the enactment of the Communications Law continue to be applied to the extent they do not conflict with the Communications Law. The lack of interpretive guidance from the regulatory authorities regarding the new regulations and the uncertainty surrounding their compatibility with the regulations still in effect impedes MTS' ability to assess effectively the full impact of the new regulations under the Communications Law on its business.

The Communications Law, which confers broad powers to the state authorities to regulate the communications sector, including the allocation of frequencies, the establishment of fees for frequency use and the allocation and revocation of numbering capacity and significantly modifies the system of government regulation of the provision of communications services in the Russian Federation. In particular, licences to provide communications services in territories where frequency and numbering capacity are limited may be issued only on the basis of a tender. In addition, the Communications Law provides for the establishment of a "universal services reserve fund" which is funded by a levy imposed on all operators of public networks, including MTS.

Regulatory Authorities

The Russian telecommunications industry is regulated by several governmental agencies. These agencies form a complex, multi-tier system of regulation that resulted, in part, from the implementation of the Communications Law, as well as from the large-scale restructuring of the Russian government in March 2004 and subsequent restructuring in May 2008. The system of regulation is still evolving and further changes are expected. See also *"Risk Factors—Risks Relating to the Russian Federation and Other Emerging Markets—Political and Social Risks—Political and governmental instability or changes in government lead to a deterioration in the Russian Federation's investment climate and may make it more costly for us to conduct our business."*

The Ministry of Communications and Mass Media is the federal executive body that develops and supervises the implementation of governmental policy in the area of communications and coordinates and controls the activities of its subordinate agencies. The Ministry has the authority to issue certain regulations implementing the Communications Law and other federal laws.

The Federal Service for Supervision in the Area of Communications is a federal executive body that supervises and controls certain areas of communications and information technologies, including:

- the issuance of licences and permissions in the area of communications and information technologies;
- the registration of radio-electronic and high-frequency equipment;

- the assignment of radio frequencies based on decisions taken by the State Radio Frequencies Commission and registration of such assignments;
- the technical supervision of networks and network equipment throughout the Russian Federation;
- the monitoring of compliance by network operators with applicable regulations, terms of their licences and terms of the use of frequencies allocated and assigned to them;
- the enforcement of equipment certification requirements;
- the examination of electromagnetic compatibility of equipment with existing civil radio-electronic equipment;
- the organisation of tenders with respect to licences in the sphere of communications; and
- the control of activity in the processing of personal data.

The Federal Agency of Communications is a federal executive body that manages state property and provides public services in the area of communications, including the allocation of numbering capacity and the certification of equipment for compliance with technical requirements.

The State Radio Frequencies Commission is an inter-agency coordination body acting under the Ministry of Communications and Mass Media which is responsible for the regulation of the radio frequency spectrum and for developing a long-term policy for frequency allocation in the Russian Federation.

The FAS is a federal executive body that supervises competition regulations and enforces the Natural Monopolies Law and the regulations enacted thereunder. The FAS controls certain activity of natural monopolies, including monitoring their execution of certain obligatory contracts, and can issue mandatory orders as provided for in the Natural Monopolies Law.

In addition, the FTS regulates certain tariffs in the sphere of telecommunications, including the tariffs for local and DLD calls by subscribers of PSTNs, and installation and subscription fees. The Federal Service for Supervision in the Area of Consumer Rights Protection and Human Well-Being which is responsible for the enforcement of sanitary regulations, has certain authority over the location of telecommunications equipment and supervises the compliance of companies with the regulations relating to the protection of consumer rights. The Federal Registration Service is responsible for registering certain telecommunications infrastructure that is considered real property in accordance with Resolution of the Russian government No. 68 dated 11 February 2005.

Licensing of Telecommunications Services and Radio Frequency Allocation

In order to provide commercial telecommunications services, MTS needs to obtain a telecommunications licence. A telecommunications licence is issued based on the Communications Law and Resolution of the Russian government No. 8 “On Approval of Regulations for Holding a Competitive Tender (Auction, Tender) for Receipt of a Telecommunication Licence” dated 12 January 2006, as amended. According to the Communications Law, the Russian government may also determine and annually review the list of activities subject to licensing and the list of licensing requirements applicable to various communication services being licensed. Such lists were adopted by the Resolution of the Russian government No. 87 dated 18 February 2005, as amended, and include communications services in connection with mobile radiotelephone usage, communication channels, data transmission and telematics.

Under the Communications Law, a telecommunications licence may be issued and renewed for periods ranging from three to 25 years. Several different licences to conduct different communication services may be issued to one entity. Provided the licensee has conducted its activities in accordance with the applicable law and terms of the licence, renewals may be obtained upon application to the Federal Service for Supervision in the Area of Communications. Officials of the Federal Service for Supervision in the Area of Communications have broad discretion with respect to both issuance and renewal procedures.

A company must complete a multi-stage process before the commercial launch of its communications network. A company must:

- receive a licence from the Federal Service for Supervision in the Area of Communications to provide communications services;

- obtain approval to use specific frequencies within the specified band from the State Radio Frequencies Commission if providing wireless telecommunications services; and
- obtain permission from the Federal Service for Supervision in the Area of Communications for network operations. To receive this permission, a wireless telecommunications services provider must develop a frequency assignment and site plan, which is then reviewed and certified by the Federal Service for Supervision in the Area of Communications for electromagnetic compatibility of the proposed cellular network with other radio equipment operating in the licence area. The Federal Service for Supervision in the Area of Communications has discretion to modify this plan, if necessary, to ensure such compatibility.

A telecommunications licence may be transferred to a legal successor upon application filed by the licence holder with the Federal Service for Supervision in the Area of Communications. In case of mergers or other changes in the organisational form of the licence holder, the telecommunications licence may be transferred upon application by a transferee as the new licence holder. By the moment of transfer of the telecommunications licence, the new transferee must also have obtained all approvals to use specific frequencies within the specified band and permissions for network operations.

If the terms of the telecommunications licence are not fulfilled or the licence holder violates applicable legislation, the telecommunications licence may be suspended or revoked. The telecommunications licence may be suspended in certain circumstances, including:

- violations which may cause damage to rights, interests, life or health of individuals or to interests of government authorities, state security and defence;
- annulment of a frequency allocation if it results in the inability to provide communications services; and
- failure to comply with an order of the Federal Service for Supervision in the Area of Communications to cure violations regarding failure to comply with Russian law or the terms and conditions of the licence or failure to provide services for over three months from the start-of-service date set forth in the licence.

The Federal Service for Supervision in the Area of Communications may issue a written order to cure violations if a licence holder fails to comply with Russian law or the terms and conditions of the licence or fails to provide services for over three months from the start-of-service date set forth in the licence. This order must set forth a reasonable period, not to exceed six months, during which the licence holder may cure the violation that resulted in the order. If the licence holder cures the violation within this period, the licence remains valid. If the licence holder fails to cure the violation within period indicated in the order, the Federal Service for Supervision in the Area of Communications may then suspend the licence and apply to a court to revoke the licence.

A court may revoke the telecommunications licence upon a demand filed by either the Federal Service for Supervision in the Area of Communications or any other interested person in the following cases:

- the documents that served as the basis for issuing the telecommunications licence contained inaccurate information;
- the licensee fails to cure violations that triggered suspension of the licence; or
- if the licence was issued in an auction or tender, the licensee fails to perform the obligations it undertook as a condition of participating in the auction or tender.

Additionally, the Federal Service for Supervision in the Area of Communications may revoke the telecommunications licence without a court order upon an application of the licence holder or in case of its liquidation or reorganisation. The decision of the Federal Service for Supervision in the Area of Communications to suspend or revoke the telecommunications licence may be appealed in court.

According to the Communications Law, wireless telecommunications operators must, in addition to securing a licence, apply for radio frequencies in order to operate their networks.

Pursuant to Resolution of the Russian government No. 336 dated 2 July 2004, as amended, the State Commission on Radio Frequencies, an interagency body, regulates the use of radio frequencies in the Russian Federation and decides on the allocation of radio frequencies to operators. This commission's responsibilities also include

ensuring efficient and appropriate use of radio frequencies in the interests of all users, taking into consideration government needs and priorities and developing federal policies on the allocation and use of radio frequencies. Once this commission has made a decision on allocation, the Federal Service for Supervision in the Area of Communications assigns and registers the allocated frequencies.

Frequencies are allocated for a maximum term of ten years, which may be extended upon the application of a frequency user. Under the Communications Law, frequency allocations may be changed for reasons relating to interests of government authorities, state security and defence with the licence holder to be compensated for related losses. Frequency allocations may be suspended or terminated for a number of reasons, including failure to comply with the conditions on which frequency was allocated.

The Communications Law requires that users of radio frequencies make one-time and annual payments for the use of the radio frequency spectrum. The payment procedure is established by the Resolution of the Russian government No. 171 dated 16 March 2011, as amended, and the guidelines for calculating the amount of such payments are set forth in Order No. 164 of the Ministry of Communications and Mass Media dated 30 June 2011, as amended. The Resolution of the Russian government No. 171 came into effect on 1 January 2012, and the Order came into effect on 21 October 2011. Telecommunications licence fees were abolished as at May 2010.

Equipment Certification

Resolution of the Russian government No. 532 dated 25 June 2009 sets forth the communications equipment that is subject to mandatory certification. Communications equipment must be certified, or its compliance with the established requirements must be declared and proved, in the interconnected communications network of the Russian Federation, which includes all fixed line and wireless networks open to the public. All of MTS' networks must be certified. The Federal Agency of Communications issues certificates of compliance with technical requirements to equipment suppliers based on this agency's internal review. In addition, a Presidential decree requires that licences and equipment certifications should be obtained from the Federal Security Service to design, produce, sell, use or import encryption devices. Some commonly used digital cellular telephones are designed with encryption capabilities and must be certified by the Federal Security Service.

Furthermore, certain radio electronic devices and high-frequency equipment, a list of which was approved by Resolution of the Russian government No. 539 dated 12 October 2004, as amended, manufactured or used in the Russian Federation are subject to registration with the Federal Service for Supervision in the Area of Communications. If use of a radio electronic device involves the allocation of a radio frequency, this registration is valid for the term of the frequency allocation. Registration of radio electronic devices and high-frequency equipment that do not involve the use of radio frequencies is valid for ten years. The registration certificate for each particular radio electronic device or high-frequency equipment is specific to the entity that receives them and does not allow the use of these devices or equipment by other parties. Failure to receive such certification could result in the mandatory cessation of the use of such equipment.

Competition, Interconnection and Pricing

The Communications Law requires federal regulatory agencies to encourage competition in the provision of communication services and prohibits the abuse of a dominant position to limit competition. The Communications Law provides that telecommunications tariffs may be regulated in cases provided for by legislation. Presidential Decree No. 221 "On Measures for Streamlining State Regulation of Prices (Tariffs)" dated 28 February 1995, as amended, allows for regulation of tariffs and other commercial activities of telecommunications companies that are "natural monopolies." Resolution of the Russian government No. 637 dated 24 October 2005, as amended, authorises the FTS to set the tariffs for the natural monopolies in the communications market, which include, among others:

- provision of access to a local telephone network;
- permanent use of a subscriber's line; and
- local, intra-zone and DLD calls.

In addition, the Natural Monopolies Law establishes the legal basis for federal regulation of natural monopolies, including those in the communications market, and provides for governmental control over tariffs and certain activities of natural monopolies. The Natural Monopolies Law outlines the types of transactions for which a regulated entity must obtain prior FAS approval and establishes the general principle that regulated entities may

not refuse to provide regulated services to certain types of consumers. Regulated entities are also subject to continuous reporting requirements, including submitting plans for capital investments. See “—*Antimonopoly and Related Regulation—Regulation of Natural Monopolies.*”

The FTS maintains a register of natural monopolies (the “**Register of Natural Monopolies**”) whose tariffs are controlled and regulated by the state. A telecommunications operator may be included in this register upon a decision by the FTS based on FTS’ analysis of the operator’s activities and the market conditions.

MTS OJSC’s subsidiary, MGTS, was added to the Register of Natural Monopolies in 2000. In addition, Comstar-Regions, a former subsidiary of Comstar, was added to the Register of National Monopolies in 2009. As a result, such subsidiaries are subject to the requirements of the Natural Monopolies Law including, *inter alia*, the following:

- the FTS regulates and controls tariffs for services provided by these subsidiaries, including installation fees, monthly subscription fees (for subscribers to the unlimited tariff plan) and local call charges (for subscribers who do not use the unlimited tariff plan), as well as interconnection and traffic transit tariffs;
- these subsidiaries must obtain prior FAS approval for any transaction involving the acquisition, disposal or lease of assets not related to the regulated activity, if the value of such assets exceeds ten percent of their share capital, additional capital, retained profits and reserves;
- these subsidiaries are required to maintain separate accounting records for each type of activity it carries out; and
- these subsidiaries are required to publicly disclose information on its tariffs, products, material conditions of its contracts with customers, capital expenditure programs and certain other information.

In addition, the FAS is authorised by law to maintain a register of companies holding a dominant position. Companies included in this register may become subject to certain restrictions in conducting their business, including in relation to pricing, acquisitions, geographical expansion, and associations and agreements with competitors. For detailed discussion see “—*Antimonopoly and Related Regulation—Regulation of Dominant Position in a Particular Market.*” MTS OJSC is categorised by the FAS as a company with a market share exceeding 35% in Ivanovo Region and Nenets Autonomous District, and MGTS is categorised by the FAS as a company with a market share exceeding 35% in Moscow. See also “*Risk Factors—Legal Risks and Uncertainties—If the FAS was to conclude that Sistema JSFC or any of its significant subsidiaries acquired or created a new company in contravention of antimonopoly legislation, or otherwise violated competition rules, it could impose administrative sanctions.*”

The Communications Law also provides for the special regulation of telecommunications operators occupying a “substantial position,” i.e., operators which together with their affiliates have, in the Russian Federation generally or in a geographically defined specific numerical zone, 25% or more of installed capacity or capacity to carry out transmission of not less than 25% of traffic. Comstar and MGTS were added to the register of telecommunications operators occupying a substantial position in 2005 and 2006, respectively. Following the completion of MTS’ merger with Comstar on 1 April 2011, MTS and MGTS are subject to the requirements of the Communications Law relating to operators occupying a substantial position in the public switched telephone networks including, *inter alia*, the following:

- MTS and MGTS must develop interconnection rules and procedures in accordance with the requirements set forth by the federal government;
- MTS and MGTS must ensure that interconnection agreements with operators who intend to interconnect to their networks are entered on the same terms and conditions as the agreements between MGTS, MTS and MTS’ affiliates; MTS and MGTS also cannot refuse to provide interconnection or discriminate against one operator over another; and
- the Federal Service for Supervision in the Area of Communications may monitor MTS’ and MGTS’ interconnection terms and procedures and issue mandatory orders to the companies where non-compliance with the law is found.

The Communications Law and implementing rules adopted by Resolution of the Russian government No. 161 dated 28 March 2005, and No. 627 dated 19 October 2005, also provides for government regulation of interconnection tariffs established by operators occupying a substantial position. In addition, such operators, including MTS and MGTS, are required to develop standard interconnection contracts and publish them as a public offer for all operators who intend to use such interconnection services.

Notwithstanding the above, fixed line operators not considered to occupy a substantial position and not included in the Register of Natural Monopolies, as well as mobile operators, are free to set their own tariffs.

Calling Party Pays

In March 2006, the Communications Law was amended to incorporate a “calling party pays” scheme effective as at 1 July 2006. Prior to the implementation of the “calling party pays” principle, subscribers of fixed line operators could initiate calls to mobile phone users free of charge. Under the new system, fixed line operators began charging their subscribers for such calls and transfer a percentage of the charge to mobile operators terminating such calls. The percentage transferred to mobile operators is regulated by the Federal Service for Supervision in the Area of Communications and is known as the settlement rate. Any reduction of the settlement rate by the regulator could have a negative impact on MTS’ average monthly service revenues per subscriber and margins.

Regulation of the Oil Industry in the Russian Federation

Applicable Laws, Rules and Regulations

The regulation of economic and administrative relations in the Russian oil industry is based on the Constitution of the Russian Federation, the Russian Civil Code, Law No. 2395-1 “On Subsoil” dated 21 February 1992, as amended (the “**Subsoil Law**”), the Natural Monopolies Law, the Strategic Foreign Investment Law and the Tax Code of the Russian Federation. There are also numerous regulations issued by the Russian federal government through its ministries and agencies as well as by regional and local authorities that regulate certain aspects of the oil industry in the Russian Federation.

Regulatory Authorities

The principal Russian federal authorities regulating the Russian oil industry include the Ministry of Natural Resources and Ecology, the Ministry of Energy, the Ministry of Industry and Trade and the Ministry of Economic Development. These federal ministries are generally responsible for development of governmental policy in the oil industry and regulation of exploration, use and protection of natural resources and the environment.

In particular, the Ministry of Natural Resources and Ecology is a policy maker entitled to pass binding legal acts in the areas of research, use, replenishing and protection of natural resources. The Ministry passes regulations, inter alia, setting safety requirements with respect to exploration and development of natural resources, regulating the re-issuance and transfer of subsoil licences and establishing the rules governing access to geological information belonging to the state. The Ministry of Natural Resources and Ecology also establishes rules on the accounting of natural resources on the state balances and on the classification and evaluation of natural resources.

The Ministry of Energy is a policy maker entitled to pass binding legal acts in the area of fuel and energy, including oil production and refining, and manages state property in the fuel and energy sector.

In addition to the federal ministries, various federal agencies exercise certain powers, such as management of state property and control over compliance with adopted regulations.

The Federal Service for the Supervision of the Use of Natural Resources (“**Rosprirodnadzor**”) monitors compliance with environmental legislation (including legislation relating to handling of hazardous wastes) and regulates geological exploration and the rational use and protection of land and subsoil (including compliance with the relevant terms and conditions of subsoil licences).

The Federal Service for Environmental, Technological, and Nuclear Supervision (“**Rostekhnadzor**”) monitors compliance with mandatory industrial and energy safety regulations in relation to subsoil use, including safety procedures in connection with the installation, deployment and operation of technical devices and machinery used at hazardous industrial sites. Rostekhnadzor, among other activities, issues licences for certain industrial activities and permits governing the use of certain machinery.

Rosnedra organises licence tenders and auctions, issues and revokes licences and approves design documentation for subsoil use.

In addition, the FAS regulates competition and enforces compliance with legislation on natural monopolies. The FAS also coordinates the process of granting state permission for investments in enterprises of strategic

importance. See “—*Foreign Investment in Strategic Enterprises*” below. The FTS is responsible for setting tariffs for the services of certain natural monopolies, including pipeline and railway transportation tariffs. Regional and local authorities exercise certain taxation powers, administer land-use regulations and oversee compliance with environmental and worker safety rules.

Licensing

Bashneft and RussNeft are required to obtain various licences, authorisations and permits from Russian governmental authorities to conduct their operations. The Federal Law No. 99-FZ “On Licencing of Certain Types of Activities” dated 4 May 2011, as amended (the “**Licensing Law**”), as well as other laws and regulations, lists activities that require government-issued licences and establishes procedures for issuing such licences. In particular, to conduct their operations, Bashneft and RussNeft are required to have licences and permits for the following activities:

- subsoil use. See “—*Subsoil Licensing*;”
- pollutant discharges. See “—*Environmental Protection*;”
- the handling of hazardous waste; and
- the storage and use of explosive and chemically hazardous materials.

Licensing regulations and the terms of licences and permits require compliance with numerous industrial standards. In particular, Bashneft and RussNeft must employ qualified personnel, maintain certain equipment and a system of quality control, maintain insurance coverage, monitor operations, make appropriate filings and, upon request, submit specified information to the licensing authorities that control and inspect their activities. Generally, under the Licensing Law, licences are issued for an unlimited term. Nevertheless, licences can be suspended and/or revoked by court order for non-compliance.

Subsoil Licensing

In order to explore, develop and produce natural resources, Bashneft and RussNeft are required to obtain a subsoil licence and the right (ownership, leasehold or other) to use the land site where the licensed subsoil deposit is located. The primary law regulating subsoil licensing is the Subsoil Law, and the regulations adopted thereunder. There are several types of licences applicable to the exploration, development and production of natural resources, including:

- Licences for geological exploration and assessment within the licensed area (which is defined in terms of latitude, longitude and depth) (“**Exploration Licences**”);
- Licences for the development and production of natural resources within the licensed area (“**Production Licences**”); and
- Combined licences for the exploration, assessment, development and production of natural resources within the licensed area (“**Combined Licences**” or “**Exploration and Production Licences**”).

In general, Production Licences and Combined Licences are currently issued by tender or auction. The tenders (auctions) for licences in respect of subsoil deposits (other than Strategic Deposits, as defined below) are conducted by special commissions of the Subsoil Agency. While such auction or tender commission may include a representative of the relevant region, such representative has no veto right and, therefore, issuance of subsoil licences is no longer conditional upon the formal consent of regional authorities. The tender commission selects the winner based on several factors, including the technical quality of the exploration and/or production programme, potential contribution to the social and economic development of the region and impact on the environment. In limited circumstances, Production Licences may also be issued without holding an auction or tender: for instance, to holders of Exploration Licences that discover natural resource deposits through exploration work at their own expense.

Exploration Licences are generally awarded without a tender or auction by the special commission formed by the Subsoil Agency, which includes representatives of the relevant regional executive authority. The Ministry of Natural Resources and Ecology maintains an official list of deposits in respect of which exploration licences can be issued. A company may obtain a licence for geological exploration (to be conducted at the company’s own expense) of a deposit included into the above-mentioned list by filing an application with the Subsoil Agency (or its regional department). Unless there is more than one application with respect to the same deposit (in which case the Subsoil Agency sets up an auction for a Combined Licence for the deposit), the special commission decides whether to grant the licence based upon the merits of the application.

The term of the licence is set forth in the licence. Prior to January 2000, Exploration Licences had a maximum term of five years, Production Licences a maximum term of 20 years and Combined Licences a maximum term of 25 years. After amendments to the Subsoil Law in January 2000, Exploration Licences have a maximum term of five years (or ten years for offshore geological exploration works). Production Licences and Combined Licences are generally granted for the duration of the expected operational life of the field based on a feasibility study, except under certain limited circumstances in which a Production Licence may be issued for one year. These amendments do not affect the terms of licences issued prior to January 2000, but permit a licence holder to apply for an extension of a licence issued before 2000 so that it would be valid for the expected operational life of the field.

The Subsoil Law permits a subsoil licensee to request an extension of a Production Licence in order to complete production or vacate the land once the use of the subsoil is complete. In order to change any condition of a subsoil licence, including extension of its term, a company should file an application with the federal authorities to amend the licence. We believe that our existing Production Licences will be extended at or prior to their scheduled expiration. However, if the Russian government determines that we have not complied with the terms of any of our licences, it may not extend them upon the expiration of their current term. See *“Risk Factors—Risks Relating to Our Business and Industry—General Risks—The licences and permits that we require for our business may be invalidated, suspended or may not be issued or renewed, or may contain onerous terms and conditions that restrict our ability to conduct our operations or could result in substantial compliance costs or administrative penalties.”*

Licences may be transferred only under certain limited circumstances as identified in the Subsoil Law, including changes in the organisational form of the licence holder, including its merger with another legal entity, a spin off or, in certain circumstances, its insolvency. On 25 October 2006, the Subsoil Law was amended to simplify the transfer of licences in the case of transfers between a parent company and its subsidiary. Under these amendments, the circumstances under which licences may be transferred were extended to cover (i) transfer from a parent company to its subsidiary, (ii) transfer from a subsidiary to its parent company and (iii) transfer between two subsidiaries of a common parent company where such transfer is effectuated at the direction of such parent company. The new transferee must be a company incorporated under the laws of the Russian Federation, comply with the statutory requirements applicable to a subsoil user and other requirements imposed by the conditions of the tender, auction or licence under which the right of subsoil use was granted and must have received all assets necessary, including infrastructure, for conducting activities specified in the licence.

A licence holder has the right to develop and sell crude oil and natural gas extracted from the licence area. The Russian Federation, however, retains ownership title to all subsoil resources at all times, and the licence holder only has rights with respect to the crude oil and natural gas as extracted.

A licence granted under the Subsoil Law is generally accompanied by a licensing agreement executed by the federal authorities and the licensee. The licensing agreement sets out the terms and conditions for the use of the subsoil licence, including:

- certain environmental, safety and production commitments;
- annual extraction targets;
- agreed drilling and other exploratory and development activities;
- the provision of geological information and data to the relevant authorities;
- the regular submission of progress reports to regional authorities; and
- tax commitments.

If the licence holder fails to fulfil the licence conditions, upon notice, the licence may be terminated by the governmental authorities that issued the licence. However, if a licence holder cannot meet certain deadlines or achieve certain volumes of exploration work or production output as set forth in the licence due to material changes in circumstances, it may apply to amend the relevant licence conditions.

The Subsoil Law and other Russian legislation contain extensive provisions governing licence restrictions and the suspension or termination of licences. A licensee can be fined for failing to comply with a subsoil licence and a subsoil licence can be revoked, suspended or limited in certain circumstances, including:

- breach or violation by the licensee of material terms and conditions of the licence;
- repeated violation by the licensee of the subsoil regulations;

- failure of the licensee to commence operations within a required period of time or to produce required volumes, both as specified in the licence;
- the occurrence of an emergency situation (military conflicts, calamities or other);
- the emergence of a direct threat to the life or health of people working or residing in the area affected by the operations under the licence;
- liquidation of the licensee; and
- failure to submit data reports, as required by law.

In the event a licence expires or is early terminated, all crude oil facilities in the relevant licensing area, including underground facilities, must either be removed or undergo proper closedown procedures. In accordance with removal and closedown regulations, all exploration, production and storage facilities must be maintained at a level that is safe for the population, the environment and surrounding facilities. Closedown procedures must also ensure the conservation of the relevant oil field and extraction, production and storage facilities.

For a discussion of the licensing regime governing Strategic Deposits, please see “—*Foreign Investment in Strategic Enterprises*,” below.

Land Use Permits and Ground Allotments

In addition to a subsoil licence, surface rights to the licence area are required for oil and gas production. Subsoil licences do not grant any surface rights. Russian legislation prohibits any commercial activity, including mineral extraction activities, on a land plot without appropriate land use rights.

Under the Land Code of the Russian Federation No. 136-FZ of 25 October 2001, as amended, (the “**Land Code**”), companies may have one of the following rights with regard to land in the Russian Federation: (i) ownership; (ii) lease; (iii) right of free use for a fixed term; or (iv) right of perpetual use. However, rights of free use for a fixed term are now less common, and those companies that have obtained a right of perpetual use over land prior to the enactment of the Land Code are required, by 1 July 2012, either to purchase the land from, or to enter into a land lease agreement with, the relevant federal, regional or municipal authority owning the land. Those companies that have a right of perpetual use over land containing linear facilities (such as power transmission lines, communication lines, pipelines, railway lines, etc.) may either purchase such land or enter into a land lease agreement by 1 January 2015.

Most land in the Russian Federation is owned by federal, regional or municipal authorities, which can sell, lease or grant other use rights to the land to third parties through public auctions or tenders or private negotiations. Under the Land Code, land that is owned by state or municipal authorities and is required for subsoil use is leased to subsoil users without holding an auction or a tender.

Surface rights are typically granted for specified areas, upon the submission of standardised reports, technical studies, pre-feasibility studies, budgets and impact statements. Documents that grant surface rights generally require that the holder make lease payments and return the land plot to a condition sufficient for future use, at the licence holder’s expense, upon the expiry of the permit.

Payments for Subsoil Use

The Subsoil Law provides for the following types of payments related to the use of subsoil:

- one-off payments in the circumstances specified in the licence;
- regular payments for subsoil use, such as rent payments for the right to conduct prospecting, appraising and exploration work; and
- fees for the right to participate in tenders and auctions.

The rates for such payments are generally set forth in the relevant licence by the federal authorities within a range of minimum and maximum rates established by the Subsoil Law.

Fees for geological information on subsoil resources were abolished as at 1 January 2011.

In addition, subsoil users pay other taxes and tariffs as established by legislation of the Russian Federation.

Transportation

Pipeline Transport

The state-owned natural monopoly Transneft and its subsidiary Transnefteprodukt control, respectively, the trunk pipelines for the transportation of crude oil and refined products in the Russian Federation. Access to Transneft's pipeline system is regulated by the Natural Monopolies Law and the Resolution of the Russian government No. 218 dated 29 March 2011 ("**Resolution No. 218**"), which approves the rules for securing non-discriminatory access to Transneft's pipeline network. Crude oil is transported pursuant to transportation services agreements, which are concluded with the applicable pipeline operator on an annual basis. A transportation service agreement sets forth, inter alia, the procedure for accepting, transporting and transferring crude oil, the quality and quantity of crude oil to be delivered, delivery and destination points, payment procedures and other rights and obligations of the parties. According to Resolution No. 218, in case of insufficient pipeline capacity, the pipeline operator shall prioritise domestic deliveries over export deliveries.

The FTS sets a tariff on domestic shipments and tariffs on auxiliary services related to acceptance and delivery of crude oil. These tariffs are set in roubles for each segment of the pipeline and for the entire pipeline. The FTS is authorised to periodically review and set the tariff rates applicable for each segment of the pipeline and for all of the pipeline. Fees for the transportation of oil that is carried out outside the Russian Federation (including transportation by Transneft and its subsidiaries) as well as Transneft agency or similar fees for organisation of such transportation are not subject to the FTS regulation. Such fees may be payable in hard currency (commonly in U.S. dollars). Both tariffs and fees must be paid by oil producers before the delivery of oil (refined products) for transportation. The Druzhba crude oil pipeline, which is operated by Transneft in the Russian Federation and extends from central the Russian Federation to markets in the Czech Republic, Germany, Hungary, Poland and Slovakia, has a throughput capacity of approximately 1.5 mmbbl of crude oil per day and currently accommodates over one-third of total Russian exports.

Currently, the allocation of pipeline and terminal access rights are overseen by the Ministry of Energy, which approves quarterly schedules that, inter alia, detail the precise volumes of crude oil that each crude oil producer can pump through the Transneft system. These quarterly schedules provide certain stability in the export regime for Russian oil companies. Once the access rights are allocated, crude oil producers generally cannot increase their allotted capacity in the export pipeline system, although they do have limited flexibility in altering delivery routes. Pursuant to Resolution No. 218, crude oil producers are allowed to assign their access rights only to legal entities that are engaged in the production of crude oil and belong to the same group as the assigning oil producer, provided the operator of the pipeline is informed within the timeframe established by the transportation agreement.

In 2001, the Russian government began reforming the system of pipeline allocation and terminal access rights. Since September 2001, pipeline and terminal access rights have been distributed among crude oil producers and their parent companies in proportion to the volumes of crude oil produced and delivered to the Transneft pipeline system in prior periods (not only in proportion to the crude oil production volumes).

Generally, Transneft has no ability to transport individual batches of crude oil, which results in the blending of crude oil of differing qualities. Transneft does not currently operate a system whereby companies, shipping heavy and sour (high sulphur content) crude oil compensate the shippers of higher quality crude oil for the deterioration in crude quality due to blending.

Refined products are transported by similar means as crude oil, including railways, sea transportation and specially designed pipelines for refined products. The majority of refined products, however, are transported by railways. The regime for the transportation of refined products is generally similar to the regime for the transportation of crude oil. In particular, the rules provide for equal access to refined products pipelines, which currently transport primarily gasoline and diesel fuel. Deliveries through Transnefteprodukt are based on the applications of oil companies in proportion to Transnefteprodukt pipeline capacity. The FTS sets the upper limits of the tariffs for the use of Transnefteprodukt pipelines as well. Transnefteprodukt establishes tariffs for the transportation of crude refined products within the limits established by the FTS.

Railway Transport

The State-owned monopoly Russian Railways provides railway transportation services and is a major owner of rolling stock. Railway tariffs are set by the FTS on an annual or semi-annual basis and are indexed to account for certain factors, such as inflation. Tariffs are denominated in Roubles and take into consideration certain factors, such as the type of product being transported, the distance of transportation and the delivery volume.

Railway transport in the Russian Federation is regulated by the Federal Law No. 17-FZ “On Railway Transport in the Russian Federation” dated 10 January 2003, as amended, the Federal Law No. 18-FZ “Railway Transport Charter” dated 10 January 2003, as amended, and regulatory acts of the Russian government. The Russian Federation is also a party to the Convention Concerning International Carriage by Rail of 9 May 1980 and the Agreement on the International Transport of Goods by Rail of 1 November 1951.

Current System of Oil-Related Taxes and Payments

In general, the Russian oil industry is subject to the same tax regime as other industries. In addition, oil companies are subject to industry-specific taxes.

System of Payments for the Use of Subsoil

Beginning 1 January 2002, the previously existing system of payments for the use of subsoil was modified by merging royalties, excise taxes and mineral restoration payments into a single tax called the unified mineral production tax. Further, based on amendments to the Subsoil Law, the following types of payment obligations were established:

- one-time payments in cases specified in the licence;
- regular payments for subsoil use, such as payments for granting the exclusive rights to conduct prospecting/appraising and exploration work; and
- fees for the right to participate in tenders and auctions.

The rates at which particular payments are to be levied are usually established in a licence by federal authorities within the range of minimum and maximum rates established by the Subsoil Law. These rates are generally not substantial.

Oil-Related Payments for Granting the Exclusive Rights to Explore and Assess Oil Fields and Prospect for Natural Resources

Historically, Russian oil companies made payments for the exclusive rights to explore and assess oil fields granted by the government, as well as payments for the right to prospect for natural resources as certain percentage of the value of the respective works. Starting from 2002, Federal Law No. 126-FZ “On Amendments in Part II of the Tax Code of the Russian Federation and Several Other Legislative Acts of the Russian Federation, and on Repeal of Certain Legislative Acts of the Russian Federation” of 8 August 2001, which amended the Russian Tax Code and became effective on 1 January 2002 (the “**Mineral Production Tax Law**”), introduced a new approach to the calculation of these payments. This law linked the payments to the size of the subsoil area provided to the subsoil user. The minimum and the maximum rates of quarterly payments are set by Federal Law No. 57-FZ “On Amending and Supplementing Part II of the Tax Code of the Russian Federation and Certain Other Legislative Acts of the Russian Federation” of 29 May 2002:

- the rate for the right to explore and assess oil fields may not be set below RUB 120 (RUB 50 for offshore areas) per square kilometre and may not exceed RUB 360 (RUB 150 for offshore areas) per square kilometre; and
- the rate for the right to prospect for natural resources may not be set below RUB 5,000 (RUB 4,000 for offshore areas) per square kilometre and may not exceed RUB 20,000 (RUB 16,000 for offshore areas) per square kilometre.

The rates for specific licensed areas are set by the Subsoil Agency within the limits specified above.

The Mineral Extraction Tax

The Mineral Extraction Tax Law introduced the unified mineral production tax, a tax on the extraction of commercial minerals.

Since 2002, the mineral production tax on crude oil (dewatered, desalted and stabilised oil) has been assessed on the extracted quantity of crude oil at fixed rate that has been adjusted monthly depending on the world prices of Urals blend and dollar exchange rate for the relevant calendar month.

Federal Law No. 151-FZ “On Amendments in to Chapter 26 of Part II of the Tax Code of the Russian Federation and on Repeal of Certain Provisions of the Legislative Acts of the Russian Federation” dated 27 July 2006 (the

“**Revised Mineral Production Tax Law**”) has introduced a floating rate for the unified mineral production tax that has been in effect since 1 January 2007. Under the Revised Mineral Production Tax Law, starting from 1 January 2007 the standard tax rate for the production of crude oil was set at the level of RUB 419 per ton. Since 1 January 2012, this standard tax rate has been increased to RUB 446 per ton and since 1 January 2013, it will constitute RUB 470 per ton. The standard tax rate is adjusted for (1) the monthly average world market price of Urals blend crude oil (in U.S.\$ per barrel), (2) the depletion factor, which represents the depletion of an oil field, (3) the reserves factor applicable as at 1 January 2012 to reflect the amount of resources for a particular oil field and (4) the monthly average U.S.\$/RUB exchange rate.

The formula for calculation of the crude oil production tax rate also provides for a cut-off price of Urals blend crude oil at or below which the tax rate amounts to zero. Since 1 January 2009, the cut-off price has been U.S.\$15.00 per barrel, while previously it amounted to U.S.\$9.00 per barrel. The depletion factor depends on the ratio of accumulated volume of oil produced to the total volume of the oil field reserves (the “**Depletion**”), based on reserves and production information reported to the Russian government, and will equal:

- 1.0 for oil fields with a Depletion below 80%, which means that the actual tax rate will not be affected by the Depletion (Depletion factor is expected to benefit crude oil producers with “brownfield” interests that are 80% or more depleted);
- a value of $(3.8 - 3.5 * \text{Depletion})$ for oil fields with a Depletion of at least 80%. In this instance, each 1% increase in the Depletion over 80% results in the reduction of the depletion factor by 3.5% and a corresponding decrease of the actual tax rate as compared to the standard tax rate; and
- 0.3 for oil fields with a Depletion exceeding 100%, which means that the actual tax rate will be equal to 30% of the standard tax rate.

Assuming the average monthly U.S.\$/RUB exchange rate is constant and the depletion factor equals 1.0, each increase in the average world market price of Urals blend oil by U.S.\$1.00 per barrel above the cut-off price (currently set at U.S.\$15.00 per barrel) will result in an increase of the actual tax rate by approximately U.S.\$1.61 per ton of oil produced (or U.S.\$0.22 per barrel of oil produced using a conversion factor of 7.33 barrels/ton).

The tax rate is zero for crude oil produced in certain regions, including Republic of Sakha (Yakutia), the Irkutsk region, the Krasnoyarsk territory, region to the north of the Arctic Circle, Azov and Caspian Seas, Nenetsk autonomous district and Yamal Peninsula, the Yamal-Nenets autonomous district, Black Sea and Sea of Okhotsk, subject to the certain legislative requirements to the production volume and total period of exploration of subsoil deposits.

The Russian Tax Code also establishes a zero per cent. tax rate for highly viscous crude oil production from resources containing crude oil of viscosity over 200 Megapascal second in layer conditions and certain exemptions for small oil fields.

Oil-Related Export Duties

The principal legislation regulating export duties on oil products is Law No. 5003-1 “On Customs Tariffs” dated 21 May 1993, as amended (the “**Law on Customs Tariffs**”). According to the Law on Customs Tariffs, export duties on crude oil and refined products are determined by the Russian government on a monthly basis, taking into consideration the average world market price for Urals blend oil for the preceding month. Export duty rates on crude oil established by the Russian government may not exceed the rates calculated in accordance with the following framework set out in the Law on Customs Tariffs.

The table below sets forth the calculation of the maximum export customs duty on crude oil:

<u>Urals price⁽¹⁾</u>	<u>Maximum export customs duty</u>
Below U.S.\$109.50 per ton (U.S.\$15.00 per barrel ⁽²⁾) . . .	Export customs duty is not levied
U.S.\$109.50 to U.S.\$146.00 per ton (U.S.\$15.00 to U.S.\$20.00 U.S.\$ per barrel)	35% of the difference between Urals price and U.S.\$109.50 per ton (U.S.\$15.00 per barrel)
U.S.\$146.00 to U.S.\$182.50 per ton (U.S.\$20.00 to U.S.\$25.00 per barrel)	U.S.\$12.78 (U.S.\$1.75 per barrel) plus 45% of the difference between Urals price and U.S.\$146.00 per ton (U.S.\$20.00 per barrel)
Above U.S.\$182.50 per ton (U.S.\$25.00 per barrel)	U.S.\$ 29.20 (U.S.\$4.00 per barrel) plus 60% of the difference between Urals price and U.S.\$182.50 per ton (U.S.\$25.00 per barrel)

(1) The Urals crude oil blend price is calculated as the price for Urals blend on world markets (Mediterranean and Rotterdam) for a month immediately preceding the current monthly period.

(2) Using a conversion factor of 7.3 barrels/ton.

Resolution of the Russian government No. 695 of 16 November 2006, as amended (“**Resolution No. 695**”) sets rates of export customs duty on crude oil and certain refined products exported from the territory of the Russian Federation to the non-member states of Customs Union. Export duty is not payable on exports of crude oil and refined products to CIS countries that are members of the Customs Union (Kazakhstan, Kirgiziya and Tadjikistan).

The current export duties on crude oil and refined products, pursuant to Resolution No. 695 (as amended by Resolution of the Russian government No. 205 of 21 March 2012 and effective from 1 April 2012) are as follows:

<u>Type of oil product</u>	<u>Export duty (in U.S. dollars/metric ton)</u>
Crude oil	460.70
Crude oil with a density not less than 694.7 kg/m ³ , but not more than 887.6 kg/m ³ at 20°C and a sulphur content not less than 0.04 % by weight, but not more than 1.5 % by weight	241.50
Naphtha	414.60
Trimer and propylene tetramery	29.90
Light oils; medium oils; gas oil	304.00
Commercial gasoline	414.60
Fuel oils; lubricating oils; processed oil products	304.00
Propane; butanes; ethylene, propylene, butylenes and butadiene; other liquefied gases	158.60
Petroleum jelly; mineral waxes, and similar products, except for:	304.00
crude	0
other	0
Petroleum coke, petroleum bitumen and other residues of petroleum oils obtained from bituminous minerals, except for:	304.00
petroleum coke, calcinated	0
Benzene; toluene; xylenes	304.00

Export duties for certain refined products are determined according to the following formula stipulated by Resolution of the Russian government No. 1155 dated 27 December 2010, as amended (“**Resolution No. 1155**”):

$$R_{(\text{oil product})} = C * R_{(\text{oil})}$$

$R_{(\text{oil product})}$ – export duty

C – ratio as provided in Resolution No. 1155

$R_{(\text{oil})}$ – export duty for crude oil as stipulated Resolution No. 695 above

The Russian government has introduced the 60-66-90 Scheme for calculating export duties on crude oil and refined products. According to Resolution 716 signed by Prime Minister Putin on 26 August 2011, beginning

1 October 2011, export duties for refined products have been calculated at 66% of the export duty on crude oil, with the exception of export duty on gasoline which is set at 90% of the export duty on crude oil. In addition, the 60-66-90 Scheme included the reduction in the maximum marginal crude oil export duty from 65% to 60%. The relevant amendments to the Russian Tax Code were made in November 2011 and became effective from 1 January 2012.

The 60-66-90 Scheme is designed, in part, to stimulate investment in upstream oil projects. It is also intended to incentivise downstream oil companies to increase refining depth in order to export a greater share of light oil products; because the export duties on heavy oil products were increased from their previous level of 46.7% of the crude oil export duty, it is expected that it will become less profitable in the future to produce heavy oil products, such as fuel oil.

As at the date of this Prospectus, Resolution No. 1155 has established the following percentages for “C” in the equation above that apply when calculating the export duties on refined products:

<u>Type of oil product</u>	<u>Percentage of Export Duty for Crude Oil (%)</u>	
	<u>Effective from 1 October 2011 to 31 December 2014</u>	<u>Effective from 1 January 2015</u>
Naphtha	90.0	90.0
Trimer and propylene tetramery	65.0	65.0
Light oils	66.0	66.0
Medium oils	66.0	66.0
Diesel fuel	66.0	66.0
Commercial gasoline	90.0	90.0
Benzene	66.0	66.0
Toluene	66.0	66.0
Xylenes	66.0	66.0
Residual oil	66.0	100.0
Lubricating oils; other oils	66.0	100.0
Processed oil products	66.0	100.0
Petroleum jelly and wax, except for:	66.0	100.0
crude	0	0
other	0	0
Petroleum coke and bitumen, except for:	66.0	100.0
petroleum coke, calcinated	0	0

Current Excise Tax on Refined Products

Historically gasoline, diesel fuel and motor oils were subject to a fuel sales tax at 25% of their value. Excise tax was payable only on the sales of gasoline. However, the excise tax now applies to all refined products, since the fuel sales tax was abolished on 1 January 2001.

The excise tax rates applicable for transactions with refined products for 2012, 2013 and 2014, respectively, are as follows:

<u>Type of oil product</u>	<u>Tax rate (RUB/metric tonne)</u>			
	<u>Effective from 1 January to 30 June 2012</u>	<u>Effective from 1 July to 31 December 2012</u>	<u>Effective from 1 January to 31 December 2013</u>	<u>Effective from 1 January to 31 December 2014</u>
Gasoline not complying with Euro-3, Euro-4 or Euro-5 standards	7,725	8,225	10,100	11,110
Euro-3 gasoline	7,382	7,882	9,750	10,725
Euro-4 gasoline	6,822	6,822	8,560	9,416
Euro-5 gasoline	6,822	5,143	5,143	5,657
Diesel fuel not complying with Euro-3, Euro-4 or Euro-5 standards	4,098	4,300	5,860	6,446
Euro-3 diesel fuel	3,814	4,300	5,860	6,446
Euro-4 diesel fuel	3,562	3,562	4,934	5,427
Euro-5 diesel fuel	3,562	2,962	4,334	4,767
Motor oil	6,072	6,072	7,509	8,260
Naphtha	7,824	7,824	9,617	10,579

Technical Regulation of Petroleum Products

Technical regulations governing the safety, quality and other requirements, including environmental requirements, for petroleum products in the Russian Federation is primarily established by Federal Law No. 184-FZ “On Technical Regulation” dated 27 December 2002, as amended (the “**Technical Regulation Law**”). The Technical Regulation Law sets forth a system of technical regulations, standards, certification and standardisation procedures.

Pursuant to the Technical Regulation Law, depending on the nature of the regulated good, regulations may be adopted in the form of mandatory standards, which set forth minimal requirements for, among others things, radiation, biological, explosive and industrial safety or voluntary standards, which are national standards adopted in part to enhance the safety and marketability of goods and improve compliance with technical regulations.

On 27 February 2008, the Russian government adopted the Technical Regulation “On Specifications of Motor and Aviation Gasoline, Diesel and Ship Fuel, Aviation Fuel and Fuel Oil” (the “**Petroleum Products Regulations**”), which became the principal document regulating the quality of petroleum products. Under the Petroleum Products Regulations, all motor gasoline in the Russian Federation must be Euro-3 compliant by 1 January 2011, Euro-4 compliant by 1 January 2012 and Euro-5 compliant by 1 January 2015.

On 18 October 2011, the Customs Union adopted the Technical Regulation “On Requirements for Motor and Aviation Gasoline, Diesel and Ship Fuel, Aviation Fuel and Fuel Oil,” which will come into effect on 31 December 2012 (the “**Customs Union Regulations**”). The Customs Union Regulations set forth new requirements for petroleum products and supersedes the Petroleum Products Regulation upon its effective date.

Environmental Protection

Oil operations are subject to extensive federal and regional environmental laws and regulations. These laws and regulations set forth various standards for health and environmental quality, provide for penalties and other liabilities for the violation thereof, and establish, in certain circumstances, obligations to compensate for environmental damage and restore environmental conditions. Environmental protection in the Russian Federation is regulated primarily by the Environmental Protection Law, as well as by a number of other federal and local laws.

Pay-to-pollute

The Environmental Protection Law establishes a “pay-to-pollute” regime administered by federal and local authorities. The Ministry of Natural Resources and Ecology establishes standards relating to resource extraction and its permissible impact on the environment, while Rosprirodnadzor sets forth limits on emissions and disposal of substances and waste. A company may obtain approval for exceeding these statutory limits from federal or regional authorities, depending on the type and scale of the environmental impact. As a condition for such approval, a plan for the reduction of emissions or disposals must be developed by the company and cleared with the appropriate governmental authority. Fees, as set forth in the Decree of the Russian government No. 344 “On Rates of Payments for Pollutant Emissions into the Air by Stationary and Mobile Sources, Pollutant Disposals into Surface and Underground Waters, Disposal of Production and Consumption Waste” dated 12 June 2003, are assessed on a sliding scale for both the statutory and individually approved limits on emissions and effluents and for pollution in excess of these limits, whereby the lowest fees are imposed for pollution within the statutory limits, higher fees are imposed for pollution within the individually approved limits and the highest fees are imposed for pollution exceeding such limits. Payments of such fees do not relieve a company from its responsibility to take environmental protection measures and undertake restoration and clean-up activities.

In addition, the Resolution of the Russian government No. 7 “On Stimulating Measures for Reduction of the Air Pollution by Flaring of the Extracted Related Gas” dated 8 January 2009 is aimed at reducing the volumes of flared related gas of Russian oil producers by imposing substantially higher payments for associated gas flared in volumes exceeding certain limits. According to this Resolution, starting from 1 January 2012, no more than 5% of the amount of associated gas produced may be flared. The mandatory payment for burning more than 5% of extracted associated gas by producer is 4.5 times higher than the payment required for burning an amount of extracted associated gas below the 5% limit.

Oil Spills and Soil Contamination

On 21 August 2000, the Russian government approved the “Basic Requirements for Plans to Prevent and Clean-up Oil and Oil Products Spills,” which obliges companies to develop plans for the prevention and clean-up

of accidental oil and oil products spills. Such plans must be approved by a number of Russian authorities. A further Resolution of the Russian government No. 240 “On Approval of the Rules for Organising the Prevention and Liquidation of Oil and Oil Products Spills” dated 15 April 2002 requires crude oil production, transportation, refinery and storage companies to have sufficient human, technical and financial resources to clean-up oil and oil products spills if and when they occur.

In addition, the Environmental Protection Law and the Land Code contain provisions relating to the payment of compensation for damages caused by land contamination. According to the Land Code, if a company’s activities cause chemical contamination of the land, making it impossible to use such land for a “designated purpose,” or reducing its quality generally, the offender must pay compensation to the owner of the land in respect of such damage, any agricultural losses and costs of cleaning up the land so that it can again be used for its “designated purpose.”

Companies that damage fertile soil during construction or other activities are required to restore the land at the end of their activities at their own expense and in accordance with restoration programmes approved by environmental experts, pursuant to Resolution of the Russian government “On the Restoration of Land and Removal, Storage and Use of the Fertile Soil Layer” No. 140 dated 23 February 1994.

According to the Water Code of the Russian Federation No. 74-FZ of 3 June 2006, as amended, water users are required to take measures to prevent and clean-up accidents that may affect the condition of rivers, lakes or other bodies of water. Facilities for the transportation and storage of crude oil cannot operate without devices for preventing contamination of rivers, lakes or other bodies of water and controlling and detecting oil spills.

In addition to the payment of compensation for damages caused by soil and water contamination, the company responsible for such contamination may also be subject to fines or the suspension of its activities for up to 90 days subject to the Administrative Violations Code of the Russian Federation No. 195-FZ dated 30 December 2001, as amended.

Environmental Approval

An ecological expert review (“**EER**”) must be conducted prior to the implementation of any project that could result in environmental harm. If a company does not obtain an EER approving the relevant project, its implementation will be prohibited. EERs are carried out by a commission appointed by Rostekhnadzor or by the competent regional authority, depending on the nature of the project. The public must be provided with initial information concerning the planned project and its potential impact on the environment. Comments from members of the public must be taken into account and reflected in the preparation and further development of the proposed project and the assessment thereof. The public may also carry out an independent review, except where project materials constitute commercial or state secrets. The result of such public independent review will have legal effect only if approved by Rostekhnadzor or by the competent regional authority, depending on the nature of the project.

Health and Safety

Much of Bashneft’s and RussNeft’s business activity is conducted at industrial sites by large numbers of workers, and workplace safety is of significant importance to the operation of these sites. The principal laws regulating industrial safety are the following: the Federal Law No. 116-FZ “On Industrial Safety of Dangerous Industrial Facilities,” dated 21 July 1997, as amended (the “**Safety Law**”); the Technical Regulation No. 123-FZ “On Fire Safety Requirements,” dated 22 July 2008; and the Federal Law No. 256-FZ “On the Safety of Fuel and Energy Facilities” dated 21 July 2011 (the “**Facilities’ Safety Law**”). The Safety Law applies, in particular, to industrial facilities and sites where certain activities are carried out with respect to the usage, production, processing, storage, transportation or utilisation of fuels and explosive, toxic and environmentally dangerous substances. The Safety Law also contains a list of dangerous substances and in case of critical concentration of these dangerous substances at the industrial facility or site, a company is obliged to adopt an industrial safety declaration. The Facilities’ Safety Law applies to facilities in the power, oil producing, refining, petrochemical and other fuel and energy industries, with the exception of nuclear energy facilities. The Facilities’ Safety Law requires, among other things, that owners of a fuel and energy facility maintain safety logs of the facility and prevent and mitigate the effect of unlawful acts that threaten safety at the facility. It also sets forth a list of requirements related to the ownership of such facilities. For example, facilities considered to be highly hazardous can only be owned by Russian entities and may not be leased without prior approval of the authorities.

Bashneft's and RussNeft's activities also include the operation of certain hazardous industrial sites registered with and regulated by Rostekhnadzor. Any construction, exploitation, liquidation or other activities in relation to such hazardous industrial sites and hazardous industrial equipment is subject to Rostekhnadzor's oversight. Companies that operate regulated industrial sites have a wide range of obligations under the Safety Law and the Labour Code of the Russian Federation (the "**Labour Code**"). In particular, they must limit access to such sites to qualified specialists, maintain industrial safety controls and carry mandatory civil liability insurance for damage resulting from accidents. The Safety Law also requires these companies to enter into contracts with professional accident-rescue service companies or create their own accident-rescue services in certain cases, conduct personnel training programmes, create systems to cope with and inform Rostekhnadzor of accidents and maintain these systems in good working order. In certain cases, companies operating regulated industrial sites must also prepare declarations of industrial safety that summarise the risks associated with operating such sites and the measures the company has taken and will take to mitigate such risks. Such declarations must be adopted by the chief executive officer of the company, who is personally responsible for the completeness and accuracy of the data contained therein. Both an industrial safety declaration and an industrial safety expert review are required for the issuance of a licence permitting the operation of a dangerous industrial facility.

In the case of an accident, a special commission led by a representative of Rostekhnadzor conducts a technical investigation of the cause. The company operating the industrial facility where the accident took place bears all costs of such investigation. Rostekhnadzor has the right to access industrial sites and may inspect documents to ensure a company's compliance with safety rules. Rostekhnadzor may also impose administrative liability on a company or its officials, as well as suspend a company's operations.

Any company or individual violating industrial safety rules may incur administrative and/or civil liability and individuals may also incur criminal liability. A company that violates safety rules in a way that negatively impacts the health of an individual may also be liable to compensate the individual for lost earnings and health-related damages and, in certain cases, its activity may be suspended.

Regulation of the Electric Power Industry in the Russian Federation

Applicable Laws, Rules and Regulations

The legal and regulatory framework of the Russian electric power industry has been subject to significant change in recent years. Currently, the principal laws and regulatory acts relating to the electric power industry are as follows:

- Resolution of the Russian government No. 526 "On Restructuring the Electric Power Industry of the Russian Federation" dated 11 July 2001 ("**Resolution No. 526**"), which establishes the principles and objectives of the reform of the Russian electric power industry, including the separation of competitive businesses such as generation and supply from natural monopoly businesses such as transmission, distribution and dispatching;
- The Electric Power Industry Law, which serves as a framework law governing the electric power industry and provides specific details in relation to the operation and management of the unified national electricity grid, electricity transmission and the development of separate wholesale and capacity markets.;
- Federal Law No. 36-FZ "On Specific Features of Functioning of Electric Power Industry during the Transitional Period, and on Introduction of Amendments into Certain Laws of the Russian Federation and on Abolishing Certain Laws of the Russian Federation in Connection with the Adoption of the Federal Law "On the Electric Power Industry" dated 26 March 2003, as amended (the "**Transitional Period Law**"), which, subject to certain exceptions, prohibits individuals, legal entities and groups of affiliates within one pricing zone of the wholesale market from combining activities relating to the transmission and/or dispatch of electricity, on the one hand, with generation or sale of electricity, on the other hand. If a legal entity violates this requirement of the Transitional Period Law, it may be subject to a compulsory reorganisation upon decision of the FAS;
- Resolution of the Russian government No. 24 "On Approval of Standards for Disclosure of Information by the Participants in the Electricity Wholesale and Retail Market" dated 21 January 2004, as amended ("**Resolution No. 24**"), which sets out special rules for the disclosure of information by wholesale and retail electricity market participants and supplements the disclosure rules of Russian securities laws; and

- Numerous other laws and regulations concerning, among other things, safety, energy efficiency and further development of the rules and regulations on reform of the wholesale electricity and capacity markets and the retail market.

Regulatory Authorities

The electric power sector in the Russian Federation is subject to federal and local governmental regulation. According to the Electric Power Industry Law, the Russian government is the principal body responsible for the regulation of the electricity market in the Russian Federation at the federal level. The Ministry of Energy supervises wholesale and retail market participants and their compliance with statutory requirements. The FTS is the main tariff-setting authority, establishing tariffs for the retail market, and certain segments of the wholesale market, as well as for electricity transmission and dispatch management services. The FAS monitors the compliance of wholesale and retail electricity market participants with antimonopoly laws. Rostekhnadzor sets limits on waste disposal, maintains a register of hazardous industrial facilities and oversees compliance with certain safety rules applicable to the electric power industry.

Regional and local governmental authorities are responsible for, among other things, determining tariffs for retail heat and electricity sales and the transmission and distribution of electricity and heat within local grids.

Russian Electric Power Industry Reform

In 2001, the Russian government launched a large-scale reform of the power sector with the aim of creating a competitive and sustainable power industry. The Russian electric power industry underwent significant changes intended to reform the market structure, liberalise the competitive segments of the power sector, including power generation, electricity supply and ancillary services (e.g., repair services) and improve regulatory pricing for non-competitive segments of the power sector. The most significant changes to the regulatory structure of the power industry occurred in the period from 2001 to 2008, but additional reforms have continued into subsequent years. The liberalisation of the wholesale electricity and capacity market was expected to have been completed and all prices on the wholesale electricity and capacity markets were expected to have been deregulated, with limited exceptions, by 1 January 2011.

However, in 2011, the rules and regulations of the wholesale electricity and capacity market in the Russian Federation were significantly modified, with the result that prices on the Russian electricity market remain significantly regulated. In particular, on 29 December 2011, the Russian government issued Resolution No. 1178, ratifying the “Foundations of Pricing Applicable to the Regulated Prices (Tariffs) in the Electric Power Industry” and “Rules of State Regulation (Revision, Application) of Prices (Tariffs) in the Electric Power Industry” that established a broad range of governmentally regulated prices and surcharges on the retail and wholesale electricity markets. In January 2012, the price liberalisation has been suspended when the Third Antimonopoly Package came into effect. The Third Antimonopoly Package introduced the definition of the price manipulation on the wholesale market for electricity/capacity by way of amendment of Article 3 of the Electric Power Industry Law. Moreover, the Third Antimonopoly Package provides that agreements resulting in price manipulation on the wholesale and/or retail markets for electricity/capacity between wholesale and/or retail vendors or buyers of electricity/capacity are prohibited. Such agreements are permissible only in limited circumstances. It is not yet clear, however, how the new rules will be implemented. See *“Risk Factors—Risks Relating to Our Oil and Energy Business—Reform of the Russian wholesale electricity market, price liberalisation and tariff regulation in the heat and electricity industry are associated with a number of risks that may materially adversely affect our energy business.”*

The current Russian electricity market is divided into a retail electricity (capacity) market and wholesale electricity (capacity) market. Prices on the retail market are regulated by the Russian government. The wholesale electricity and capacity market is the system of contractual relations governing the purchase and sale of electricity and capacity within the Russian unified energy system. Its participants are electricity producers, guaranteeing suppliers, distribution companies and large electricity consumers who can act as both a purchaser and seller of electricity or capacity. On the wholesale market, electricity and capacity are traded both at regulated prices and non-regulated prices. Non-regulated prices, however, are still subject to certain regulation by the Russian government, which sets a range for such prices, depending on, among other factors, the geographical location of the wholesale market participant.

Antimonopoly and Related Regulation

Antimonopoly Approval of Certain Transactions

The antimonopoly regulation of the Russian Federation is based on Federal Law No. 135-FZ “On the Protection of Competition” dated 26 July 2006, as amended (the “**Competition Law**”), and other federal laws and regulations governing antimonopoly issues.

Antimonopoly regulation of the Russian Federation is aimed at the prevention and termination of monopolistic activity and control over economic concentration and governs relations that involve, among others, Russian legal entities, foreign legal entities, state agencies of the Russian Federation and local government authorities. Antimonopoly restrictions include prohibitions on the conclusion of anti-competitive agreements, the exercise of anti-competitive coordinated actions, acts resulting in unfair competition and the abuse of a dominant position.

Compliance with antimonopoly legislation in the Russian Federation is monitored by the FAS. Russian legislation grants the FAS the powers necessary for the performance of its functions and for dealing with violations of antimonopoly legislation. The FAS is, among other things, authorised: (i) to initiate or examine cases regarding the violation of antimonopoly legislation; (ii) to issue binding orders to business entities in cases specified in the Competition Law; (iii) to hold commercial and non-commercial organisations and their officers to account for violating antimonopoly laws in the instances and by the procedure established by Russian legislation; and (iv) to file with a court or an arbitration court applications in respect of violations of antimonopoly laws, including, among other things, invalidating in full or in part any agreements that do not comply with antimonopoly legislation.

(i) The Competition Law provides for antimonopoly control over economic concentration and requires prior approval by the FAS of the following transactions:

- acquisition by a person (or its group) of more than 25%, 50%, or 75% of the voting shares of a Russian joint stock company (or more than 1/3, 1/2 or 2/3 participation interest in a Russian limited liability company);
- acquisition by a person (or its group) of the core production assets (with certain exceptions) located in the territory of the Russian Federation and/or intangible assets of an entity if the balance sheet value of such assets exceeds 20% of the total balance sheet value of the core production and/or intangible assets of such entity, as applicable;
- obtaining rights to determine the business activity of a Russian entity or to exercise the powers of its executive body by a person (or its group); or
- acquisition by a person (or its group) of more than 50% of the voting shares (participation interest) of a foreign legal entity or obtaining other rights to determine its business activity or to exercise the powers of its executive body;

in each case, if any of the following thresholds are met:

- the aggregate asset value of the acquirer (or its group) together with the target (or its group) exceeds RUB 7 billion;
- the total annual revenues of the acquirer (or its group) and the target (or its group) for the preceding calendar year exceed RUB 10 billion and the total asset value of the target (or its group) exceeds RUB 250 million; or
- the acquirer and/or the target and/or any entity within the acquirer’s group or the target’s group are included in the register of entities having a market share in excess of 35% on a particular market or having a dominant position on a particular market maintained by the FAS (the “**FAS Register**”).

(ii) Furthermore, the Competition Law provides for prior approval by the FAS of the following actions:

- mergers and consolidations of entities, if any of the following thresholds are met:
 - the aggregate asset value of such entities (or of the groups of persons to which they belong) exceeds RUB 7 billion;
 - the total annual revenues of such entities (or of the groups of persons to which they belong) for the preceding calendar year exceed RUB 10 billion; or

- one or more of these entities is included in the FAS Register; or
- formation of an entity, if any the following thresholds are met:
 - its charter capital is paid by the shares (or participation interest) and/or the assets of another entity (save for monetary funds) or the newly founded entity acquires the rights in respect of such shares (or participation interest) and/or assets as specified in the Competition Law, provided that the aggregate asset value of the founders (or group of persons to which they belong) and the newly founded entity (or groups of persons to which they belong) exceeds RUB 7 billion;
 - the total annual revenues of the founders (or group of persons to which they belong) and the newly founded entity (or groups of persons to which they belong) for the preceding calendar year exceed RUB 10 billion; or
 - the entity, the shares (or participation interest) and/or assets of which are contributed to the charter capital of the newly founded entity, is included in the FAS Register.

The Competition Law provides for a mandatory post-transaction notification (within 45 days of the closing) of the antimonopoly authorities in connection with actions specified in item (i) above if the aggregate asset value or total annual revenues of an acquirer (and its group) and a target (and its group) for the preceding calendar year exceed RUB 400 million and at the same time the total asset value of the target (and its group) exceeds RUB 60 million; and in connection with actions specified in item (ii) above if their aggregate asset value or total annual revenues of the relevant companies for the preceding calendar year exceed RUB 400 million.

The Competition Law expressly provides for extraterritorial application to transactions which are made outside of the Russian Federation but lead, or may lead, to the restriction of competition in the Russian Federation and which relate to assets located in the Russian Federation or to the shares (or participation interests) in Russian companies or rights in relation to such companies.

Under the Competition Law, if an acquirer has acted in violation of the merger control rules and acquired, for example, shares without obtaining the prior approval of the FAS, the transaction may be invalidated by a court order initiated by the FAS, provided that such transaction has led or may lead to the restriction of competition, for example, by means of strengthening of a dominant position in the relevant market.

More generally, Russian legislation provides for civil, administrative and criminal liability for the violation of antimonopoly legislation.

Regulation of Dominant Position in a Particular Market

The antimonopoly regulation is aimed at the prevention of the abuse of a dominant position. According to the Competition Law, an entity or a group of entities is deemed to have a dominant position in a particular commodity market if: (a) the entity (or the group of entities) has a market share in a particular commodity market in excess of 50%, unless it is specifically established by the FAS that the entity (or the group of entities) does not have a dominant position; or (b) the entity has a market share in a particular commodity market which is less than 50% but more than 35% and the dominant position of the entity (or the group of entities) is specifically established by FAS based on (i) the stability or near stability of such entity's (or such group of entities') share in the particular commodity market, and (ii) certain characteristics of the relevant commodity market (such as the accessibility of the commodity market to new competitors); or (c) even if the entity has a market share of less than 35% in certain specific circumstances.

The Competition Law also provides the possibility of several unrelated entities being considered to collectively have a dominant position. In particular, each of three business entities collectively having a market share exceeding 50%, or each of five business entities collectively having a market share exceeding 70%, provided that the market share of each entity in any case is not less than 8%, may be considered as having a dominant position provided that: (i) market shares of relevant entities have been stable or nearly stable during a significant period of time; (ii) the access of new competitors into the particular commodity market is hindered; (iii) the relevant commodity cannot be easily substituted; and (iv) the increase of the price for the commodity does not lead to decrease of demand for it.

The Competition Law establishes a regulatory framework for companies having dominant positions in certain markets, aimed at protection of competition in the relevant markets. In particular, an entity having a dominant position is prohibited from abusing such a position through, among others, the following activities: (i) fixing

and/or maintaining a monopolistic high or low price of goods; (ii) withdrawing goods from circulation, which results in price increases; (iii) dictating to a counterparty the terms of an agreement unfavourable to it or not relevant to the subject-matter of the agreement; (iv) economically or technologically unjustified reduction or termination of the production of certain goods; (v) economically or technologically unjustified refusal to enter into an agreement with certain buyers (customers) or avoiding such agreement; (vi) economically or technologically unjustified fixing of various prices (tariffs) for the same goods; (vii) creating discriminatory conditions; (viii) creating impediments for other entities to either access or exit a particular commodity market; and (ix) violation of established pricing rules.

If a company having a dominant position systematically carries out any monopolistic activities a court, based on a claim brought by the FAS, may decide that such company is subject to forcible division or spin-off. In addition, the FAS is authorised to issue binding orders to stop abuse of a dominant market position and to transfer to the federal budget profits obtained as a result of abusing a dominant position.

Regulation of Natural Monopolies

The Natural Monopolies Law defines “natural monopoly” as a condition of the commodity market in which the demand for goods is satisfied more effectively in the absence of competition and in which other goods cannot readily be substituted for the monopoly goods. The Natural Monopolies Law regulates (i) the operations of the companies engaged in naturally monopolistic activities, (ii) major investments of such companies in assets that are not used for the naturally monopolistic activities and (iii) transactions involving fixed assets and shares of such companies. The FAS supervises the activities of natural monopolies and the FTS is responsible for regulation of the tariffs.

Some of our subsidiaries are included in the register of natural monopolies in the market for telecommunications services and electricity distribution services and subject to the Natural Monopolies Law regulation. The Natural Monopolies Law provides for the following key restrictions apply to the investment activities and dealing in shares of the natural monopolies:

- a natural monopoly needs to receive prior written approval from the state authorities for any acquisition of fixed assets or rights to use such assets, if (a) such assets are not used for the naturally monopolistic activities and (b) the book value of such asset exceeds 10% of the natural monopoly entity’s own capital (as calculated in accordance with its latest balance sheet);
- a party that intends to acquire, rent or obtain the right to own or use in another way the fixed assets of a natural monopoly must obtain prior written approval of the regulators, if such assets (a) are used for the naturally monopolistic activity and (b) exceed by value 10% of the natural monopoly entity’s own capital (as calculated in accordance with its latest balance sheet);
- a natural monopoly requires prior regulatory approval for any investments in production or distribution of goods, not related to the industry of the natural monopoly entity, whose value exceeds 10% of the natural monopoly entity’s own capital (as calculated in accordance with its latest balance sheet); and
- any person or group of persons that acquires more than 10% of the total number of votes attributable to voting shares of a natural monopoly is obliged to notify the regulatory authorities of such acquisition, as well as of any subsequent changes in his or their stake.

The relevant authority can adopt binding decisions in the case of a breach of the law and issue binding instructions to a natural monopoly to prevent a breach of the law, including instructions on eliminating the consequences of a breach. The principal methods of regulating the activities of natural monopolies by relevant supervising authorities are:

- price regulation by setting prices (tariffs) or price limits; and
- identifying consumers entitled to obligatory services and/or setting natural monopoly minimum supply levels for such consumers (with a view to protecting the rights and legal interests of citizens, state security, the environment and cultural values).

As a natural monopoly, we must submit ongoing reports on our activities and drafts of capital investment plans to the relevant supervisory authority pursuant to the Natural Monopolies Law.

In order to promote transparency in activity and regulation, the changes require natural monopolies to grant free access to the information on their activity in accordance with the standards of disclosure approved by the Russian

government. The information on the regulated activity of the natural monopolies include the following: (i) information on prices (tariffs) for regulated goods and services; (ii) information on principal operational and financial activity, which is regulated; (iii) information on basic consumer characteristics of the regulated goods and services; (iv) information on technical access to the regulated goods and services, or the lack thereof; (v) information on the terms and conditions of supply of the regulated goods and services; (vi) information on investment plans and performance reports, etc. The supervisory authority has the right: (i) to regulate natural monopoly entities and to use methods of regulation contemplated by the Natural Monopolies Law including price regulation; (ii) to instruct natural monopoly entities to stop violations and mitigate its consequences, including entering into contracts with those consumers entitled to obligatory service, to instruct natural monopoly entities to make amendments to existing contracts, to instruct natural monopoly entities to transfer revenues from activities which contravene the existing federal laws; and (iii) to perform other acts contemplated by federal laws.

Foreign Investment in Strategic Enterprises

The Strategic Foreign Investment Law sets forth certain limitations on the acquisition by a foreign investor of shares in strategic companies. According to the Strategic Foreign Investment Law, a company is considered to be of strategic importance to the national defence and security of the Russian Federation, if (i) it is included in the register of natural monopolies, with certain exceptions, (ii) it holds a dominant position in the market for communication services in the Russian Federation or in the market for fixed line communication services in five or more regions of the Russian Federation and/or in cities of federal importance; or (iii) it is involved in the geological exploration of subsoil plots and/or the production of natural resources on subsoil plots of federal significance.

The criteria for determining whether a subsoil mineral deposit is of federal importance (a “**Strategic Deposit**”) are set forth in the Subsoil Law. These include, among other things, subsoil deposits:

- containing recoverable oil reserves of 70 million tonnes or more, as evidenced by the State Register of Reserves, as at 1 January 2006;
- located in internal sea waters, territorial sea waters or on the continental shelf of the Russian Federation; or
- that can only be developed using land designated for defence and security purposes.

The Strategic Foreign Investment Law sets forth a general prohibition on transactions resulting in the acquisition of control over strategic companies by foreign states and international organisations or an organisation controlled by any foreign state or international organisation and requires other foreign investors to obtain prior approval of a state committee (the “**State Committee**”) for the acquisition of control over a strategic company.

The Strategic Foreign Investment Law contains special rules for obtaining control over and regulating strategic companies engaged in the geological exploration of subsoil plots and/or production of natural resources on Strategic Deposits (the “**Strategic Subsoil User**”). In particular, the Russian government may impose restrictions on the right of a Russian entity with a direct or indirect foreign participation to participate in any auction or tender for the right of subsoil use in a Strategic Deposit. Such restrictions are not subject to the criteria for control pursuant to the Strategic Foreign Investment Law. In respect of Strategic Deposits, only Production Licences and Combined Licences may be issued. Licences for Strategic Deposits are issued by the Subsoil Agency pursuant to a decision of the Russian government based either on the results of a tender or auction, or upon the discovery of a Strategic Deposit. Under a Combined Licence, advanced exploration and production operations in a Strategic Deposit may only commence after geological study operations are fully completed, in contrast to the general rule applicable to other deposits, according to which advanced exploration and production under a combined licence may be conducted simultaneously with geological study.

If in the course of geological study a discovery is made and the relevant deposit meets the criteria of a Strategic Deposit, the Russian government may veto the issuance of an advanced Exploration and Production Licence to the subsoil user that made the discovery if a foreign investor has an interest in the Strategic Subsoil User. If the relevant discovery is made under a Combined Licence by an entity which is under control of a foreign investor or in which a foreign investor has an interest, the Russian government has the right to terminate the licence. If an Exploration and Production Licence is denied, or a Combined Licence is terminated, the affected Strategic Subsoil user is entitled to be reimbursed for the costs it incurred in the prospecting and appraisal of the discovered deposit and, in the case of the termination of a Combined Licence, of the one-time payment made under the terms of such licence. This reimbursement and certain other compensation will be payable from the

federal budget pursuant to a procedure established by the Russian government. The provisions outlined in this paragraph only apply to subsoil deposits discovered after 7 May 2008. They do not apply to subsoil deposits if the geological study was completed and advanced exploration and extraction of minerals from such deposits began before 7 May 2008.

A person is deemed to control a strategic company if such person: (i) controls (directly or indirectly) more than 50% (25% or more for the Strategic Subsoil User) of the total number of votes attributable to the voting shares or stakes making up the share capital of a strategic company; (ii) has the right (on the basis of an agreement or otherwise) to direct decisions of a strategic company, including the terms of its business operations; (iii) has the right to appoint the sole executive body of a strategic company and/or for more than 50% (25% or more for the Strategic Subsoil User) of the members of its collective executive body; (iv) has an unconditional ability to procure the election of more than 50% (25% or more for the Strategic Subsoil User) of the members of a strategic company's board of directors or other management body; or (v) acts as a management company for a strategic company. Also, a strategic company is deemed to be under control if a controlling foreign entity controls (directly or indirectly) less than 50% of the total number of votes attributable to the voting shares or stakes making up the share capital of a strategic company provided the proportion between the amount of votes available to the controlling foreign entity and the amount of votes available to other shareholders provides the controlling foreign entity with an opportunity to determine the decisions of the strategic company.

If the proportion of votes available to the foreign entity changed due to (i) the buyback or transfer of shares in a strategic company to it and, consequently, formation of a block of treasury shares, (ii) distribution of treasury shares in a strategic company between its shareholders, (iii) conversion of preferred stock into ordinary stock or (iv) any other reason, and the foreign entity subsequently obtained control over the respective strategic company, such foreign entity is obliged under the Strategic Investment Law to file an application to the State Committee within three months upon obtaining control.

Prior approval of the State Committee is also required in the event a foreign state, international organisation or an organisation controlled by any of them acquires direct or indirect control over more than 25% (more than 5% for the Strategic Subsoil User) of the votes represented by shares in a strategic company or other ability to block decisions of the management bodies of such entity.

In addition, foreign investors are required to notify the State Committee about any transactions undertaken by them resulting in the acquisition of 5% or more of the charter capital of a strategic company.

The Strategic Foreign Investment Law provides for certain exceptions to the general rules described above. No prior approval or post-closing notification is required for obtaining control over a Strategic Subsoil User if the Russian government owns or has the right to vote (directly or indirectly) more than 50% of the voting shares of such strategic company, or for making foreign investments in the Russian Federation if such investment activity is governed by other federal laws or international treaties of the Russian Federation, including treaties on military and technical cooperation

The Strategic Foreign Investment Law governs the procedure for review by the State Committee of an application of foreign investors seeking to obtain control over a strategic company. A foreign investor initiates this process by filing an application with the FAS. The term for review of such an application is three months and may be extended for another three months. FAS will issue its approval upon confirmation from the Federal Security Service of the Russian Federation and the State Committee that the acquisition of control does not threaten the national defence and security of the Russian Federation.

Transactions which are subject to review under the Strategic Foreign Investment Law and are not subsequently approved by the State Committee are void, and the foreign investor, by order of the courts, may be denied its right to vote at shareholder meetings of such strategic company.

At the date of this Prospectus, JSOC Bashneft and some other subsidiaries are considered to be strategic companies.

Employment and Labour

Labour matters in the Russian Federation are primarily governed by the Labour Code. In addition to this core legal act, certain employment matters are governed by other federal laws. The major purpose of the labour law is to establish certain types of guarantees and protections for an employee.

Employment contracts

As a general rule, an employment contract may not provide for its termination upon the expiration of a set term. Such provision of an employment contract is only valid in certain cases listed in the Labour Code and in federal laws (primarily when labour relations may not be established for an indefinite term due to nature of employee's duties or circumstances). Employment contract with the chief executive officer, deputy chief executive officer, and the chief accountant may provide for its termination upon the expiration of the set term.

All permitted causes for termination of employment by an employer are listed in the Labour Code, other federal laws and (subject to narrow exceptions) may not be changed in the employment contract. The instances, when employer may terminate the employment contract include, among others:

- liquidation of the enterprise or downsizing of its staff;
- employee's failure to comply with his (her) duties due to his (her) confirmed incompetence;
- systematic failure of employee to perform his (her) duties without reasonable excuse;
- any single gross violation by employee (the Labour Code contains the exhaustive list of such violations); and
- delivery of false documents by the employee in connection with the execution of the employment contract.

An employee dismissed from an enterprise due to downsizing or liquidation is entitled to receive compensation including a severance payment and, depending on the circumstances, salary payments for a certain period of time.

The Labour Code also provides protections for specified categories of employees. For example, except for certain cases established by the Labour Code, an employer cannot dismiss minors, expectant mothers, mothers with a child under the age of three, single mothers with a child under the age of 14 or disabled child under the age of 18 or other persons caring for a child under the age of 14 or disabled child under the age of 18 without a mother.

Work time

The Labour Code generally sets a working week of 40 hours. Any time worked beyond 40 hours per week, as well as work on public holidays and weekends, must be compensated at a higher rate. Annual paid vacation leave under the Code is generally 28 calendar days. Certain categories of employees who perform work in harmful conditions may be entitled to an additional paid vacation ranging from seven to 36 working days. Other categories of employees having the same right to an additional paid vacation are set forth in the Labour Code and other federal laws.

The retirement age in the Russian Federation is generally 60 years for men and 55 years for women.

Strikes

The Labour Code defines a strike as the temporary and voluntary refusal of workers to perform their work duties with the intention of settling a collective labour dispute. Russian legislation contains several requirements to lawful strikes. Participation in a lawful strike may not be considered by an employer as employee's failure to perform his (her) duties and may not be serve as a ground for termination of such employee. However, employers are generally not required to pay wages to striking employees for the duration of the strike. Participation in an unlawful strike may serve as an adequate ground for termination.

Trade Unions

Although recent Russian labour regulations have curtailed the authority of trade unions, they still retain significant influence over employees and, as such, may affect the operations of large industrial companies in the Russian Federation.

The activities of trade unions are generally governed by Federal Law No. 10-FZ "On Trade Unions, Their Rights and Guaranties of Their Activity" of 12 January 1996, as amended (the "**Trade Union Law**") and the Labour Code.

The Trade Union Law defines a trade union as a voluntary public association of individuals with common professional and other interests, which is established for the purposes of representing and protecting the rights and interests of its members. National trade union associations, which coordinate activities of trade unions throughout the Russian Federation, are also permitted.

As part of their activities, trade unions may:

- negotiate collective bargaining agreements (between the trade unions and employers, federal, regional or local governmental authorities or other entities);
- monitor compliance with labour laws, collective bargaining and other agreements;
- access work sites and offices and request information relating to labour issues from the management of companies, federal, regional and local authorities;
- represent their members and other employees in individual and collective labour disputes with management;
- participate in strikes; and
- address proposals of temporary suspension of mass layoffs that must be considered by local authorities.

Russian laws require that companies cooperate with trade unions and do not interfere with their activities. Trade unions and their officers enjoy certain guarantees.

If a trade union discovers any violation of work condition requirements, notification is sent to the employer with a request to cure the violation and to suspend the works if there is an immediate threat to lives or health of employees. A trade union may apply to state authorities and labour inspectors and prosecutors to ensure that an employer does not violate Russian labour laws. Trade unions may also initiate collective labour disputes, which may lead to strikes.

Although the Trade Union Law provides that those who violate the rights and guarantees provided to trade unions and their officers may be subject to disciplinary, administrative and criminal liability, no specific sanctions for these violations are set forth in Russian legislation. However, a violation of the Labour Code (including sections establishing rights of trade unions) is an administrative violation and may subject an offender company and its officers to administrative liability (including temporary suspension of operations).

THE ISSUER

General

The Issuer is a public limited liability company (*société anonyme*), incorporated on 2 May 2012 in the Grand Duchy of Luxembourg (“**Luxembourg**”) under the name SISTEMA INTERNATIONAL FUNDING S.A., for an unlimited period under the Luxembourg Law of 10 August, 1915 on commercial companies, as amended. The Issuer operates under Luxembourg law. The Issuer has its registered office at 2, Boulevard Konrad Adenauer, L-1115 Luxembourg, Grand Duchy of Luxembourg, with telephone number (+352) 421-22-464 and fax number (+352) 421-22-718. The Issuer is registered with the Register of Commerce and Companies in Luxembourg under number B 168486. Any person interested in inspecting the Issuer’s articles of association (the “**Articles**”) may do so at the website of the Register of Commerce and Companies in Luxembourg and at the registered office of the Issuer.

Corporate Purpose of the Issuer

Article 3 of the Articles provides that the corporate object of the Issuer is:

- is the holding of participations directly or indirectly, in any form whatsoever, in Luxembourg and foreign companies, the acquisition by purchase, subscription, or in any other manner as well as the transfer by sale, exchange or otherwise of stock, bonds, debentures, notes and other securities of any kind and the ownership, administration, development and management of its portfolio. The Company may also hold interests in partnerships;
- borrow in any form and proceed to the issue of public or private bonds and debentures in relation to which it may apply for a listing on any stock exchange. In connection with the issuance of bonds or other debt instruments or the taking of loans, it may give security in any form over part or all of its assets for the benefit of bondholders, lenders or security agents representing them. It may lend funds including the proceeds of such borrowings and issues to its subsidiaries, affiliated companies or to any other company. It may also give guarantees in favour of its subsidiaries, affiliated companies or any other companies;
- in a general fashion it may grant assistance to affiliated companies, take any controlling and supervisory measures and carry out any operation which it may deem useful in the accomplishment and development of its corporate purpose.

Business Activity

The Issuer has not previously carried on any business or activities other than those incidental to its incorporation, the issue of the Notes, the Loan, the authorisation and the issue of the Notes and activities incidental to the exercise of its rights and compliance with its obligations under the Notes, the Loan Agreement, the Subscription Agreement, the Agency Agreement, the Trust Deed and the other documents and agreements entered into in connection with the issue of the Notes and the Loan.

The Issuer is organised as a special purpose company. The Issuer is established to raise capital by the issue of debt securities and to use amounts equal to the proceeds of each such issuance to make loans to Sistema.

Corporate Administration

The Directors (as defined in “*Management*” below) have been appointed as directors (“*administrateurs*”) of the Issuer. Certain administrative, corporate and related services will be provided to the Issuer by Deutsche Bank Luxembourg S.A. in its capacity as corporate administrator (“*société de domiciliation*”) pursuant to a domiciliation and administrative services agreement dated 2 May 2012.

Capital

As of the date of this Prospectus, the subscribed share capital of the Issuer amounts to thirty-one thousand Euros (€31,000) divided into thirty-one thousand (31,000) registered shares with a nominal value of one Euro (€ 1) each. All of the shares are fully paid up.

Sole Shareholder

The issued and outstanding shares in the Issuer’s share capital are owned and controlled by its sole shareholder, Stichting Holding Sistema, a foundation established under the laws of the Netherlands, in the process of being

registered with the Trade Register of the Amsterdam Chamber of Commerce and having its statutory office at De entree 99-197, 1101 HE Amsterdam Zuidoost, The Netherlands.

Management

The Issuer is managed by its board of directors, composed of three directors who were appointed by the sole shareholder. The current directors (the “**Directors**”) of the Issuer are:

- Mr Daniel BLEY, born on June 17, 1979 in Ettelbruck, Grand-Duchy of Luxembourg, private employee, with professional address at 2, Boulevard Konrad Adenauer, L-1115 Luxembourg;
- Mrs Anja LAKOUDI, born on December 23, 1977 in Schlema, Germany, private employee, with professional address at 2, Boulevard Konrad Adenauer, L-1115 Luxembourg;
- Mrs Heike KUBICA, born on July, 23, 1974 in Lutherstadt Eisleben, Germany, private employee, with professional address at 2, Boulevard Konrad Adenauer, L-1115 Luxembourg.

Real Estate Assets

The Issuer does not own any real estate assets.

Business Year

The business year of the Issuer begins on the first day of January and ends on the last day of December of each year. The first business year of the Issuer begins on the date of incorporation of the Issuer and ends on 31 December 2012.

The annual general meeting of the Issuer shall be held at the registered office of the Issuer or at such other place as may be specified in the notice convening the meeting on the 1st Tuesday of June of each year, at 2 p.m. If such day is a public holiday, the meeting will be held on the next following business day.

Statutory Auditor

The statutory auditor of the Issuer is Deloitte Audit S.à r.l., with registered office at 560, rue de Neudorf, L-2220 Luxembourg, Grand-Duchy of Luxembourg, and registered with the Register of Commerce and Companies in Luxembourg under number B 67895. No external auditor has been appointed.

Financial Statements

Since its date of incorporation, the Issuer has not commenced operations and no financial statements have been made up as of the date of this Prospectus.

Financial statements will be published by the Issuer on an annual basis. These statements will not be approved by an external auditor.

Any future published financial statements prepared by the Issuer (which will be in respect of the period ending on 31 December in each year) will be available from the Paying Agent in Luxembourg.

The Issuer will not produce interim financial statements.

Capitalisation

The following table sets forth the unaudited capitalisation of the Issuer as at the date of this Prospectus on an historical basis and as adjusted to give effect to the offering:

	<u>Actual</u> <i>(Unaudited)</i> <i>(in U.S.\$ thousands)</i>	<u>As adjusted</u>
Liabilities		
The Notes	—	500,000
Shareholders’ equity		
Issued and fully subscribed share capital	<u>40⁽¹⁾</u>	<u>40⁽¹⁾</u>
Total capitalisation	<u><u>40</u></u>	<u><u>500,040</u></u>

(1) The U.S. dollar equivalent of EUR 31,000 was calculated on the basis of the exchange rate of 1.29 U.S. dollars per euro as at the date of this Prospectus.

Other than as detailed above, the Issuer does not have any loan capital or borrowings (whether secured or unsecured, guaranteed or unguaranteed), contingent liabilities or guarantees.

Litigation

There are no, and have not been, any legal or arbitration proceedings against or affecting the Issuer, nor is the Issuer aware of any pending or threatened proceedings of such kind, which may have, or have had, since its incorporation on 2 May 2012, prior to the date of this Prospectus a significant effect on the financial position of the Issuer.

No Conflict of Interests

Neither the statutory auditors nor the Directors have any conflict or potential conflict of interests between their duties to the Issuer and their private interests and/or other duties.

THE LOAN AGREEMENT

This Agreement is made on 16 May 2012 between:

- (1) **SISTEMA JOINT STOCK FINANCIAL CORPORATION** (the “**Borrower**” or “**Sistema**”); and
- (2) **SISTEMA INTERNATIONAL FUNDING S.A.**, a société anonyme, established under the laws of Grand Duchy of Luxembourg, having its registered office at 2, boulevard Konrad Adenauer, L-1115 Luxembourg and being registered with the Registre de Commerce et des Sociétés in Luxembourg under number B 168486 (the “**Lender**”).

Whereas:

- (A) The Lender has at the request of the Borrower agreed to make available to the Borrower a loan facility in the amount of U.S.\$500,000,000 on the terms and subject to the conditions of this Agreement.
- (B) It is intended that the Lender will issue loan participation notes for the sole purpose of financing the loan facility.

Now it is hereby agreed as follows:

1 Definitions and Interpretation

1.1 Definitions

In this Agreement (including the recitals), the following terms shall have the meanings indicated:

“**Acquired Indebtedness**” means Indebtedness of a Person or any of its Subsidiaries existing at the time such Person becomes a Subsidiary or at the time it merges or consolidates with the Borrower or any of its Subsidiaries or is assumed in connection with the acquisition of assets from such Person and in each case not Incurred in connection with, or in anticipation or contemplation of, such acquisition, merger or consolidation, including any Indebtedness Refinancing such Indebtedness that does not increase the aggregate principal amount (or accreted amount, if less) thereof as of the date of Refinancing;

“**Account**” means the non-interest bearing account in the name of the Lender with the Principal Paying Agent, account number 27729100 (or such other account as may from time to time be agreed between the Lender and the Trustee pursuant to the Trust Deed and notified to the Borrower in writing at least five Business Days in advance of such change);

“**Accounting Standards**” means IFRS, U.S. GAAP or any other internationally recognised set of accounting standards deemed equivalent to IFRS by the relevant regulators for the time being;

“**Advance**” means the advance made or to be made by the Lender under Clause 3 of the sum equal to the amount of the Facility, as from time to time reduced by prepayment or repayment;

“**Affiliate**” means, with respect to any specified Person, any other Person who directly or indirectly through one or more intermediaries controls, or is controlled by, or is under common control with, such specified Person. The term “control” means the possession, directly or indirectly, of the power to direct or cause the direction of the management and policies of a Person, whether through the ownership of voting securities, by contract or otherwise. For purposes of this definition, the terms “controlling”, “controlled by” and “under common control with” have correlative meanings;

“**Affiliate Transaction**” means any transaction or a series of related transactions (including, without limitation, the purchase, sale, lease or exchange of any property or the rendering of any service) of Sistema and/or its Subsidiaries with, or for the benefit of, any of the Borrower’s or such Subsidiaries, as the case may be, Affiliates;

“**Agency**” means any agency, authority, central bank, department, government, legislature, minister, official or public statutory Person (whether autonomous or not) of, or of the government of, any state or supra-national body;

“**Agency Agreement**” means the agency agreement relating to the Notes dated on or around the date hereof between the Lender, the Borrower, the Trustee, the Principal Paying Agent and the other agents named therein, from time to time modified, amended, restated or supplemented;

“**Agents**” has the meaning given to it in the Trust Deed;

“**Agreement**” means this loan agreement as originally executed or as it may be amended and (or) from time to time restated and (or) supplemented;

“**Asset Sale**” means any direct or indirect sale, disposition, issuance, conveyance, transfer, lease, assignment or other transfer (each, a “**disposition**”) by the Borrower or any Principal Subsidiary of:

- (a) any Capital Stock (other than Capital Stock of the Borrower); or
- (b) any property or assets (other than cash, Cash Equivalents or Capital Stock) of the Borrower or any Principal Subsidiary.

Notwithstanding the preceding, the following items shall not be deemed to be Asset Sales:

- (a) a disposition of inventory, equipment or accounts receivable in the ordinary course of business;
- (b) a disposition to the Borrower or a Subsidiary, including a Person that is or will become a Subsidiary immediately after the disposition;
- (c) any single transaction or series of related transactions that involves assets having a Fair Market Value of less than U.S.\$100,000,000;
- (d) any issuance of Capital Stock by a Principal Subsidiary solely to existing holders of its Capital Stock pursuant to a bonus issue or rights offering, the effect of which does not result in a reduction of Sistema’s total voting power of its Voting Stock of such Principal Subsidiary;
- (e) a disposition of any Notes or other publicly traded debt securities of the Borrower or its Subsidiaries previously purchased by the Borrower or its Principal Subsidiaries; and
- (f) the sale or other disposition of cash or Cash Equivalents on an arm’s length basis;

“**Authorised Signatory**” means, in relation to the Borrower, any Person who is duly authorised (in such manner as may be reasonably acceptable to the Lender or the Trustee as the case may be) and in respect of whom the Lender has received a certificate signed by a director or another Authorised Signatory of the Borrower setting out the name and signature of such Person and confirming such Person’s authority to act;

“**Assumed Liabilities**” means any liabilities, as shown on the Borrower’s most recent consolidated balance sheet, of the Borrower or any Subsidiary (other than contingent liabilities and liabilities of the Borrower that are by their terms subordinated to the Borrower’s obligations under the Loan) that are assumed by the transferee in connection with an Asset Sale;

“**Bankruptcy Law**” means any law of any jurisdiction for the relief of debtors as now or hereafter constituted, including, without limitation, any such law in the Russian Federation and, with respect to the United States, Title 11 of the United States Code and any similar federal or state law;

“**Bankruptcy Law Event of Default**” means:

- (a) the entry by a court of competent jurisdiction of: (i) a decree or order for relief in respect of any Bankruptcy Party in an involuntary case or proceeding under any Bankruptcy Law or (ii) a decree or order (A) adjudging any Bankruptcy Party a bankrupt or insolvent, (B) approving as properly filed a petition seeking reorganisation, arrangement, adjustment or composition of, or in respect of, any Bankruptcy Party under any Bankruptcy Law (other than on a solvent basis), (C) appointing a Custodian of any Bankruptcy Party or of any substantial part of the property of any Bankruptcy Party, or (D) ordering the winding-up or liquidation of the affairs of any Bankruptcy Party, and in each case, the continuance of any such decree or order for relief or any such other decree or order unstayed and in effect for a period of 60 consecutive calendar days; or
- (b) (i) the commencement by any Bankruptcy Party of a voluntary case or proceeding under any Bankruptcy Law or of any other case or proceeding to be adjudicated a bankrupt or insolvent, (ii) the consent by any Bankruptcy Party to the entry of a decree or order for relief in respect of any Bankruptcy Party in an involuntary case or proceeding under any Bankruptcy Law or to the commencement of any bankruptcy or insolvency case or proceeding against any Bankruptcy Party, (iii) the filing by any Bankruptcy Party of a petition or answer or consent seeking reorganisation or relief under any Bankruptcy Law (other than on a solvent basis), (iv) the consent by any Bankruptcy Party to the filing of such petition or to the appointment of or taking possession by a Custodian of any Bankruptcy Party or of any substantial part of the property of any Bankruptcy Party, (v) the making by any Bankruptcy Party of an assignment for the benefit of all of its creditors generally, (vi) the admission by any Bankruptcy Party in writing of its inability to pay its debts generally as they become due, or (vii) the approval by stockholders of the Borrower of any plan or proposal for the liquidation or dissolution of the Borrower, or (viii) the taking of corporate action by any Bankruptcy Party in furtherance of any action referred to in sub-Clauses (i) - (vii) above;

“**Bankruptcy Party**” means the Borrower and any Core Subsidiary;

“**Board of Directors**” means, as to any Person, the board of directors, management committee or similar governing body of such Person or any duly authorised committee thereof;

“**Business Day**” means a day on which (a) U.S. dollar deposits may be dealt in on the London inter-bank market and commercial banks and foreign exchanges markets are open in London, and (b) if on that day a payment is to be made hereunder, commercial banks generally are open for business in Luxembourg, Moscow, New York City and in the city where the Specified Office (as defined in the Agency Agreement) of the Principal Paying Agent is located;

“**Calculation Date**” means 30 June and 31 December in each year;

“**Capitalised Lease Obligations**” means, as to any Person, the obligations of such Person under a lease that are required to be classified and accounted for as capital lease obligations under Accounting Standards to which the then most recent published audited consolidated financial statements of the Group comply, as consistently applied. For the purposes of this definition, the amount of such obligations at any date shall be the capitalised amount of such obligations at such date, determined in accordance with such Accounting Standards;

“**Capital Markets Indebtedness**” means any Indebtedness of a Person which: (a)(i) is in the form of or represented by any bond, note, debenture stock, loan stock, certificate or other debt instrument issued by such Person which is listed or quoted on any stock exchange outside of the Russian Federation or (ii) is in the form of a loan to such Person which is financed by the issuance of any of the foregoing forms of debt in (a)(i) above, where such issuance is by a special purpose company or a bank or any other entity and the rights to payment of the holders of such forms of debt are limited to payments actually made by such Person pursuant to such loan; and (b) in the case of the debt referred to in (a)(i) above or the debt financing a loan referred to in (a)(ii) above, was initially issued and distributed (as to more than 50 per cent. of the original principal amount of such debt) outside the Russian Federation;

“**Capital Stock**” means:

- (a) with respect to any Person that is a corporation, any and all shares, interests, participations or other equivalents (however designated and whether or not voting) of corporate stock, including each class of Common Stock and Preferred Stock of such Person;
- (b) with respect to any Person that is not a corporation, any and all partnership or other equity or ownership interests of such Person; and
- (c) any warrants, rights or options to purchase any of the instruments or interests referred to in paragraph (a) or (b) above;

“**Cash Equivalents**” means:

- (a) marketable direct obligations issued by, or unconditionally guaranteed by, the government of any of the United States of America, the United Kingdom, France, Germany, Japan, Italy or Canada (the “**G7 Countries**”) or the Russian Federation or issued by any agency thereof and backed by the full faith and credit of any of the G7 Countries or the Russian Federation, in each case maturing within one year from the date of acquisition thereof;
- (b) marketable direct obligations issued by any political subdivision or public instrumentality of any of the G7 Countries or the Russian Federation maturing within one year from the date of acquisition thereof and, at the time of acquisition, having a rating of at least BBB from Standard & Poor’s Rating Service, a division of the McGraw-Hill Companies, Inc. (“**S&P**”) or an equivalent rating from Fitch Ratings Ltd. (“**Fitch**”) or Moody’s Investors Service Limited, or its successors and assigns (“**Moody’s**”);
- (c) commercial paper maturing no more than one year from the date of creation thereof and, at the time of acquisition, having a rating of at least A-1 from S&P, at least F1 by Fitch or at least P-1 from Moody’s;
- (d) certificates of deposit or bankers’ acceptances maturing within one year from the date of acquisition thereof issued by any bank organised under the laws of any of the G7 Countries or the Russian Federation or any political subdivision thereof having at the date of acquisition thereof a rating of at least AA- from S&P or an equivalent rating from Fitch or Moody’s;
- (e) cash deposits held with (i) any bank being a member of the Group; or (ii) any bank organised under the laws of any of the G7 Countries or the Russian Federation or any political subdivision thereof having at

the date of the relevant calculation or determination a rating of at least BB- from S&P or an equivalent rating from Fitch or Moody's, which deposit may be withdrawn on no more than thirty days' notice;

- (f) repurchase obligations with a term of not more than seven days for underlying securities of the types described in paragraph (a) above entered into with any bank meeting the qualifications specified in paragraph (d) above; and
- (g) investments in money market funds which invest at least 80 per cent. of all their assets in securities of the types described in paragraphs (a) to (d) inclusive and paragraph (f) above;

"Change of Control" means the occurrence of one or more of the following events:

- (a) any Person or Group other than a Permitted Holder is or becomes the "beneficial owner", directly or indirectly, in the aggregate of more than 50 per cent. of the total voting power of the Voting Stock of the Borrower (including a Successor, if applicable), whether by virtue of the issuance, sale or other disposition of Capital Stock of the Borrower or a direct or indirect holder of Capital Stock of the Borrower, a merger or consolidation involving the Borrower or such Person or Group, a sale of all or substantially all of the Borrower's assets determined on a consolidated basis by the Borrower or of assets of such Person or Group, any voting trust agreement or other agreement to which the Borrower or any such Person or Group is a party or is subject, or otherwise; or
- (b) the approval by the holders of Capital Stock of the Borrower of any plan or proposal for the liquidation or dissolution of the Borrower, whether or not otherwise in compliance with the Conditions or the Loan Agreement; or
- (c) the Borrower consolidates with, or merges with or into, another Person other than a Permitted Holder, or the Borrower sells, conveys, assigns, transfers, leases or otherwise disposes of all or substantially all of the assets of the Borrower, determined on a consolidated basis, to any Person other than a Permitted Holder, and in each case other than a transaction where immediately after such transaction the Person or Persons that "beneficially owned" immediately prior to such transaction a majority of the total then outstanding Voting Stock of the Borrower "beneficially own", directly or indirectly, a majority of the total voting power of the then outstanding Voting Stock of the surviving or transferee Person;

For purposes of this definition only:

- (i) **"beneficial owner"** shall have the meaning specified in Rules 13d-3 and 13d-5 under the Exchange Act, except that any Person or Group shall be deemed to have "beneficial ownership" of all securities that such Person or Group has the right to acquire, whether such right is exercisable immediately, only after the passage of time or, except in the case of the Permitted Holders, upon the occurrence of a subsequent condition;
- (ii) **"Person"** and **"Group"** shall have the meanings for "person" and "group" as used in Sections 13(d) and 14(d) of the Exchange Act; and
- (iii) the Permitted Holders or any other Person or Group shall be deemed to beneficially own any Voting Stock of a corporation held by any other corporation (the **"parent corporation"**) so long as the Permitted Holders or such other Person or Group, as the case may be, beneficially own, directly or indirectly, in the aggregate at least a majority of the voting power of the Voting Stock of the parent corporation;

"Change of Control Put Event" means the occurrence of a Change of Control;

"Change of Control Put Option" means the put option granted to Noteholders pursuant to the Conditions upon a Change of Control Put Event;

"Change of Control Put Period" has the meaning given to it in the Conditions;

"Change of Control Put Settlement Date" means the fifth Business Day after the expiration of the Change of Control Put Period;

"Closing Date" means 18 May 2012 (or such later date not later than 1 June 2012 as may be agreed between the Lender and the Borrower);

"Commission" means the United States Securities and Exchange Commission, as from time to time constituted, created under the Exchange Act, or, if at any time after the execution of this Agreement such Commission is not existing and performing the duties now assigned to it under applicable law, then the body performing such duties at such time;

“**Common Stock**” of any Person means any and all shares, interests or other participations in, and other equivalents (however designated and whether voting or non-voting) of such Person’s common equity interests and includes, without limitation, all series and classes of such common equity interests, whether outstanding on the Closing Date or issued after the Closing Date and includes, without limitation, all series and classes of such common equity interests;

“**Conditions**” means the terms and conditions of the Notes;

“**Consolidated Depreciation, Depletion and Amortisation Expense**” means, at any Calculation Date, the aggregate depreciation, depletion and amortisation expenses of the Borrower and its consolidated Subsidiaries for the Measurement Period ending on the Calculation Date, determined by reference to the audited annual consolidated financial statements or unaudited interim consolidated financial statements of the Borrower (as applicable);

“**Consolidated Net Indebtedness**” means, at any Calculation Date, Consolidated Total Indebtedness less cash and Cash Equivalents of the Borrower and its consolidated Subsidiaries determined by reference to the audited annual consolidated financial statements or unaudited interim consolidated financial statements of the Borrower (as applicable);

“**Consolidated OIBDA**” means, at any Calculation Date, Consolidated Operating Income plus Consolidated Depreciation, Depletion and Amortisation Expense;

“**Consolidated Operating Income**” means, at any Calculation Date, the aggregate operating income (or loss), of the Borrower and its consolidated Subsidiaries for the Measurement Period ending on the Calculation Date, determined by reference to the audited annual consolidated financial statements or unaudited interim consolidated financial statements of the Borrower (as applicable) before taking into account (to the extent included in the consolidated operating income of the Group):

- (a) any gains and/or any losses from the sale of any interest in any Subsidiary of the Borrower;
- (b) any extraordinary, one-off, non-recurring or exceptional items recognized as such in the Borrower’s consolidated financial statements, including those arising on or resulting from (i) the restructuring of the activities of an entity and reversals of any provisions for the cost of restructuring; (ii) disposals or revaluations of non-current assets; and (iii) impairment of assets,
- (c) the cumulative effect of a change in accounting principles,

but so that no amount shall be added or deducted more than once;

“**Consolidated Total Indebtedness**” means in relation to any Calculation Date an amount equal to the aggregate amount (without duplication) of all Indebtedness of the Borrower and its consolidated Subsidiaries determined by reference to the audited annual consolidated financial statements or unaudited interim consolidated financial statements of the Borrower (as applicable);

“**Core Subsidiary**” shall mean any Subsidiary (excluding OJSC “MTS Bank”) (a) whose sales, as shown by its latest financial statements (consolidated with its Subsidiaries), are at least 35 per cent. of the consolidated sales of the Group (excluding the contribution of the sales of OJSC “MTS Bank”), as shown by the Borrower’s latest consolidated financial statements; or (b) whose total assets, as shown by its latest financial statements (consolidated with its Subsidiaries), are at least 35 per cent. of the consolidated total assets of the Group (excluding the contribution of the assets of OJSC “MTS Bank”), as shown by the Borrower’s latest consolidated financial statements; provided that if a Core Subsidiary transfers any of its assets to another Core Subsidiary which would result in such Core Subsidiary ceasing to be a Core Subsidiary, such Subsidiary and such other Subsidiary shall both be tested under this definition on a consolidated basis until such times as they are not Core Subsidiaries on a consolidated basis. The determination of a Core Subsidiary shall be made by reference to audited financial statements to the extent available, failing which to unaudited financial statements. Such financial statements shall be prepared in accordance with Accounting Standards. In the event that no such financial statements on a consolidated basis are available, Sistema shall determine, acting in good faith, whether or not a Subsidiary is a Core Subsidiary within the meaning of this definition;

“**Currency Agreement**” means, in respect of any Person, any foreign exchange contract, currency swap agreement or other similar agreement as to which such Person is a party;

“**Custodian**” means any receiver, trustee, assignee, liquidator, custodian or similar official under any Bankruptcy Law;

“**Disqualified Capital Stock**” means that portion of any Capital Stock which, by its terms (or by the terms of any security into which it is convertible or for which it is exchangeable at the option of the holder

thereof), or upon the happening of any event, matures or is mandatorily redeemable, or is redeemable at the sole option of the holder thereof on or prior to the day being 6 months after the scheduled final repayment date under the Loan;

“**Event of Default**” has the meaning given to it in Clause 10.1;

“**Exchange Act**” means the U.S. Securities Exchange Act of 1934;

“**Fair Market Value**” means, with respect to any asset or form of consideration, the price (after taking into account any liabilities relating to such assets) which could be negotiated in an arm’s-length free market transaction, for cash, between a willing seller and a willing and able buyer, neither of which is under any compulsion to complete the transaction provided that the Fair Market Value of any such asset or assets or form of consideration with a fair market value of greater than U.S.\$30,000,000 shall be determined conclusively by the chief financial officer or chief executive officer of the Borrower acting in good faith;

“**Facility**” means the U.S.\$500,000,000 term loan facility granted by the Lender to the Borrower pursuant to this Agreement as specified in Clause 2;

“**Global Certificate**” means the Rule 144A Global Certificate or, as the context may require, the Regulation S Global Certificate and “**Global Certificates**” shall be construed accordingly;

“**Group**” (other than for the purposes of the definition of “**Change of Control**”) means the Borrower and its Subsidiaries taken as a whole;

“**Guarantee**” means any obligation, contingent or otherwise, of any Person directly or indirectly guaranteeing any Indebtedness of any other Person;

- (a) to purchase or pay, or advance or supply funds for the purchase or payment of, such Indebtedness of such other Person; or
- (b) entered into for purposes of assuring in any other manner the obligee of such Indebtedness of the payment thereof or to protect such obligee against loss in respect thereof, in whole or in part;

provided, that “**Guarantee**” shall not include endorsements for collection or deposit in the ordinary course of business. “**Guarantee**” used as a verb has a corresponding meaning;

“**Hedging Obligations**” means the obligations of any Person pursuant to any Interest Rate Agreement or Currency Agreement;

“**IFRS**” means International Financial Reporting Standards (formerly International Accounting Standards) issued by the International Accounting Standards Board (“**IASB**”) and interpretations issued by the International Financial Reporting Interpretations Committee of the IASB (as amended, supplemented or re-issued from time to time);

“**Incur**” means, with respect to any Indebtedness or other obligation of any Person, to create, issue, incur (including by conversion, exchange or otherwise), assume, Guarantee or otherwise become liable in respect of such Indebtedness or other obligation on the balance sheet of such Person (and “**Incurrence**”, “**Incurred**” and “**Incurring**” shall have meanings correlative to the preceding);

“**Indebtedness**” means with respect to any Person, without duplication;

- (a) the principal amount (or, if less, the accreted value) of all obligations of such Person for borrowed money;
- (b) the principal amount (or, if less, the accreted value) of all obligations of such Person evidenced by bonds, debentures, notes or other similar instruments;
- (c) all Capitalised Lease Obligations of such Person;
- (d) all obligations of such Person issued or assumed as the deferred purchase price of property, all conditional sale obligations and all obligations under any title retention agreement (but excluding trade accounts payable and other accrued liabilities arising in the ordinary course of business that are not overdue by 90 days or more or are being contested in good faith by appropriate proceedings promptly instituted and diligently conducted);
- (e) all letters of credit, banker’s acceptances or similar credit transactions, including reimbursement obligations in respect thereof;
- (f) to the extent not otherwise included as Indebtedness under any other paragraph of this definition, Guarantees and other contingent obligations of such Person in respect of Indebtedness referred to in paragraphs (a) to (e) inclusive above and paragraphs (h) and (i) below;

- (g) all Indebtedness of any other Person of the type referred to in clauses (a) through (f) which is secured by any Lien on any property or asset of such Person, the amount of such Indebtedness being deemed to be the lesser of the Fair Market Value of such property or asset or the amount of the Indebtedness so secured;
- (h) all obligations under Hedging Obligations of such Person calculated on a mark-to-market basis; and
- (i) all Disqualified Capital Stock issued by such Person with the amount of Indebtedness represented by such Disqualified Capital Stock being equal to the greater of its voluntary or involuntary liquidation preference and its maximum fixed repurchase price, but excluding accrued dividends, if any; provided, that:
 - (i) if the Disqualified Capital Stock does not have a fixed repurchase price, such maximum fixed repurchase price shall be calculated in accordance with the terms of the Disqualified Capital Stock as if the Disqualified Capital Stock were purchased on any date on which Indebtedness shall be required to be determined pursuant to the Loan; and
 - (ii) if the maximum fixed repurchase price is based upon, or measured by, the fair market value of the Disqualified Capital Stock, the fair market value shall be the Fair Market Value thereof; but

excluding any Indebtedness constituted by deposits received by such Person in the ordinary course of its banking activities;

“Independent Financial Advisor” means an accounting firm, appraisal firm, investment banking firm or consultant of international recognised standing that is, in the judgement of the Borrower’s Board of Directors, qualified to perform the task for which it has been engaged and which is independent in connection with the relevant transaction;

“Interest Payment Date” means 17 May and 17 November of each year;

“Interest Period” has the meaning given to it in Clause 4.2;

“Interest Rate Agreement” of any Person means any interest rate protection agreement (including, without limitation, interest rate swaps, caps, floors, collars, derivative instruments and similar agreements) and/or other types of interest hedging agreements;

“Investment Grade Status” means the following ratings being assigned to the long-term unsubordinated and unsecured debt of the Borrower by at least two of the following rating agencies: (i) S&P of BBB- or higher, (ii) Fitch of BBB- or higher or (iii) Moody’s of Baa3 or higher;

“Investments” means, with respect to any person, any:

- (a) direct or indirect loan or other extension of credit (including, without limitation, a Guarantee) to any other Person;
- (b) capital contribution to (by means of any transfer of cash or other property to others or any payment for property or services for the account or use of others) to any other Person; or
- (c) any purchase or acquisition by such Person of any Capital Stock, bonds, notes, debentures or other securities or evidence of Indebtedness issued by any other Person;

“Lien” means any lien, mortgage, deed of trust, pledge, security interest, charge or encumbrance of any kind (including any conditional sale or other title retention agreement, any lease in the nature thereof and any agreement to give any security interest);

“Loan”, at any time, means an amount equal to the aggregate principal amount of the Facility advanced by the Lender pursuant to this Agreement and outstanding at such time;

“Marketable Securities” means publicly traded debt or equity securities that are listed or admitted to trading on a national securities exchange in one or more of the G7 countries, Ireland, Luxembourg or the Russian Federation;

“Measurement Period” means a period of 12 consecutive months ending on a Calculation Date falling after the Closing Date;

“Noteholder” means, in relation to a Note, the Person in whose name such Note is for the time being registered in the relevant register of the Noteholders (or, in the case of a joint holding, the first named holder thereof);

“Notes” means the U.S.\$500,000,000 6.95 per cent. loan participation notes due 2019 proposed to be issued by the Lender pursuant to the Trust Deed for the purpose of financing the Loan;

“Officers’ Certificate” means a certificate signed, in the case of the Borrower, by one or more officers of the Borrower, at least one of whom shall be the chief executive officer, a director, a chief financial officer, chief legal officer or general director of the Borrower;

“Ongoing Fees Side Letter” means the letter entered into between the Borrower, the Lender, Trustee and the Agents on 16 May 2012 relating, amongst other things, to the ongoing indemnification and remuneration of the Trustee and the Agents;

“Opinion of Counsel” means a written opinion from legal counsel who is acceptable to the Trustee, which counsel may be an employee of or counsel to the Borrower;

“Permitted Holders” means Vladimir Evtushenkov, his spouse(s), heirs, descendants and legatees and legal representatives of any of the foregoing and any trust of which one or more of the foregoing are beneficiaries and any Person directly or indirectly controlling or controlled by or under direct or indirect common control with any of the foregoing;

“Permitted Liens” means any of the following:

- (a) statutory Liens of landlords and Liens of carriers, warehousemen, mechanics, suppliers, materialmen, repairmen and other Liens imposed by law incurred in the ordinary course of business for sums not yet delinquent or being contested in good faith;
- (b) any Lien securing letters of credit issued in the ordinary course of business consistent with past practice in connection therewith, or to secure the performance of tenders, statutory obligations, surety and appeal bonds, performance bonds, bids, leases, government contracts and return-of-money bonds and other similar obligations (exclusive of obligations for the payment of borrowed money);
- (c) any interest or title of a lessor under any Capitalised Lease Obligation of any Subsidiary; provided, that such Liens do not extend to any property which is not leased property subject to such Capitalised Lease Obligation;
- (d) purchase money Liens securing Purchase Money Indebtedness Incurred to finance the acquisition of property or other assets of a Subsidiary; provided, that:
 - (i) (the related Purchase Money Indebtedness shall not exceed the cost of such property or other assets and shall not be secured by any property or other assets of the Borrower or any of its Subsidiaries other than the property or other assets so acquired; and
 - (ii) the Lien securing such Indebtedness shall be created within no more than 90 days of such acquisition;
- (e) Liens upon specific items of inventory or other goods and proceeds of a Subsidiary securing such Subsidiary’s obligations in respect of bankers’ acceptances issued or created for the account of such Person to facilitate the purchase, shipment or storage of such inventory or other goods;
- (f) Liens encumbering deposits made to secure obligations arising from statutory, regulatory, contractual, or warranty requirements of the Borrower or a Subsidiary, including rights of netting and set-off;
- (g) Liens securing Hedging Obligations of any Subsidiary that relate to Indebtedness that is permissibly secured under “Limitation on Liens” by the same assets as secure such Hedging Obligations;
- (h) Liens existing on the Closing Date including Liens over assets or property securing any Indebtedness Refinancing any Indebtedness existing on the Closing Date and secured by Liens over the same assets or property, where such Refinancing does not increase the aggregate principal amount (or accreted amount, if less) of the relevant Indebtedness as of the date of Refinancing;
- (i) Liens securing Acquired Indebtedness, provided that:
 - (i) such Liens secured such Acquired Indebtedness at the time of and prior to the Incurrence of such Acquired Indebtedness by the Borrower or a Subsidiary and were not granted in connection with, or in anticipation of the Incurrence of such Acquired Indebtedness by the Borrower or a Subsidiary; and
 - (ii) such Liens do not extend to or cover any property of the Borrower or any Subsidiary other than the property that secured the Acquired Indebtedness prior to the time such Indebtedness became Acquired Indebtedness of the Borrower or a Subsidiary and are no more favourable to the lienholders than the Liens securing the Acquired Indebtedness prior to the Incurrence of such Acquired Indebtedness by the Borrower or a Subsidiary.

- (j) Liens on real property of the Borrower or a Subsidiary in the ordinary course of such Person's real estate business incurred to finance the acquisition, construction or lease by such Person of such property, including additions and improvements thereto;
- (k) Liens to secure Project Finance Indebtedness, provided that any such Lien is limited in recourse to the property or assets constructed using the proceeds of such Project Finance Indebtedness, any revenues generated by such property or assets and/or the property, assets or Capital Stock of the entity receiving the proceeds of such Project Finance Indebtedness; and
- (l) Liens against or upon the properties or assets of the Borrower or any Subsidiary, whether owned on the Issuer Date or acquired after the Closing Date, or any proceeds therefrom, provided that immediately after giving effect to such Lien, the net book value of all the properties and assets against which such Lien and all other Liens under this paragraph (1) is less than 20 per cent. of the Borrower's consolidated total assets as stated in its most recent audited or unaudited interim balance sheet, as the case may be, prepared in accordance with Accounting Standards to which the then most recent published audited consolidated financial statements of the Group comply, as consistently applied;

"Person" (other than for the purposes of the definition of **"Change of Control"**) means an individual, partnership, corporation, limited liability company, unincorporated organisation, trust or joint venture, or a governmental agency or political subdivision thereof;

"Potential Event of Default" means any event which is, or after notice or passage of time or after making any determination under this Agreement (or any combination of the foregoing) would be, an Event of Default;

"Preferred Stock" of any Person means any Capital Stock of such Person that has preferential rights over any other Capital Stock of such Person with respect to dividends, distributions or redemptions or upon liquidation;

"Principal Paying Agent" has the meaning given to it in the Agency Agreement;

"Principal Subsidiary" shall mean any Subsidiary (excluding OJSC "MTS Bank" and Sistema Shyam TeleServices Limited) (a) whose sales, as shown by its latest financial statements (consolidated with its Subsidiaries), are at least 10 per cent. of the consolidated sales of the Borrower together with its Subsidiaries, as shown by its latest consolidated financial statements; or (b) whose total assets, as shown by its latest financial statements (consolidated with its Subsidiaries), are at least 10 per cent. of the consolidated total assets of the Borrower and its consolidated Subsidiaries, as shown by its latest consolidated financial statements; provided that if a Principal Subsidiary transfers any of its assets to another Subsidiary which would result in such Principal Subsidiary ceasing to be a Principal Subsidiary, such Subsidiary and such other Subsidiary shall both be tested under this definition on a consolidated basis until such times as they are not Principal Subsidiaries on a consolidated basis. The determination of a Principal Subsidiary shall be made by reference to audited financial statements to the extent available, failing which to unaudited financial statements. Such financial statements shall be prepared in accordance with Accounting Standards. In the event that no such financial statements on a consolidated basis are available, Sistema shall determine, acting in good faith, whether or not a Subsidiary is a Principal Subsidiary within the meaning of this definition;

"Project Finance Indebtedness" means Indebtedness of Sistema or a Subsidiary, the proceeds of which are used for the construction of property or assets;

"Public Equity Offering" means an underwritten public offering of Qualified Capital Stock of the Borrower or any of its Subsidiaries or of a direct or indirect holding company for the Borrower or any Subsidiary provided that, in the case of any such offering by any direct or indirect holding company of the Borrower, only to the extent that the net cash proceeds therefrom are invested in the equity capital of the Borrower (other than in or through an investment in Disqualified Capital Stock) and in each case, resulting in gross proceeds to the Borrower of at least U.S.\$200,000,000;

"Public Equity Offering Premium" means an amount equal to the product of (i) the principal amount of the Loan that is being repaid pursuant to Clause 5.6 and (ii) the Rate of Interest;

"Purchase Money Indebtedness" means Indebtedness of the Borrower or any Subsidiary incurred for the purpose of financing all or any part of the purchase price, or other cost of construction or improvement of any property or other assets (including financing provided by the vendor of such property or assets); provided, that the aggregate principal amount of such Indebtedness does not exceed the lesser of the Fair Market Value of such property or such purchase price or cost, including any Refinancing of such Indebtedness that does not increase the aggregate principal amount (or accreted amount, if less) thereof as of the date of Refinancing;

“**Qualified Capital Stock**” means any Capital Stock that is not Disqualified Capital Stock and any warrants, rights or options to purchase or acquire Capital Stock that is not Disqualified Capital Stock and that are not convertible into or exchangeable into Disqualified Capital Stock;

“**Rate of Interest**” has the meaning given to it in Clause 4.1;

“**Refinance**” means, in respect of any security or Indebtedness, to refinance, extend, renew, refund, repay, prepay, redeem, defease or retire, or to issue a security or Indebtedness in exchange or replacement for, such security or Indebtedness in whole or in part. “**Refinanced**” and “**Refinancing**” shall have correlative meanings;

“**Regulation S Global Certificate**” has the meaning given to it in the Trust Deed;

“**Relevant Event**” has the meaning given to it in the Trust Deed;

“**Repayment Date**” means 17 May 2019;

“**Reserved Rights**” has the meaning given to it in the Trust Deed and the Conditions;

“**Rule 144A Global Certificate**” has the meaning given to it in the Trust Deed;

“**Same-Day Funds**” means same day, freely transferable, clearly identifiable cleared U.S. Dollar-funds or such other funds for payment in U.S. Dollars as the Lender may at any time reasonably determine to be customary for the settlement of international transactions in London of the type contemplated hereby;

“**Securities Act**” means the U.S. Securities Act of 1933, as amended;

“**Subscription Agreement**” means the subscription agreement relating to the Notes dated the date hereof between the Lender, the Borrower and the managers named therein;

“**Subsidiary**” means, with respect to any Person, (a) any corporation, association or other business entity of which more than 50 per cent. of the outstanding voting stock is owned, directly or indirectly, by, or, in the case of a partnership, the sole general partner or the managing partner or the only general partners of which are, such Person and one or more subsidiaries of such Person (or a combination thereof) or (b) any corporation, association or other business entity that is required to be consolidated with such Person on its financial statements in accordance with Accounting Standards to which the then most recent published audited consolidated financial statements of the Group comply, as consistently applied;

“**Successor**” means, in the case of a merger, consolidation or combination of a Person, or the sale, assignment, transfer, conveyance or other disposal of all or substantially all of a Person’s assets, the corporation formed by or resulting from such consolidation or merger or which shall have received such assets;

“**Tax**” means any present or future taxes, duties, assessments, fees or other governmental charges imposed or levied by or on behalf of Luxembourg, the Russian Federation, any jurisdiction from or through which a payment is made hereunder or any political subdivision or taxing authority thereof or therein;

“**Trust Deed**” means the trust deed relating to the Notes to be dated the Closing Date between the Lender and the Trustee, as amended from time to time;

“**Trustee**” means Deutsche Trustee Company Limited, as trustee under the Trust Deed and any successor thereto as provided thereunder;

“**Uniform Commercial Code**” means the Uniform Commercial Code as in effect from time to time in the State of New York;

“**Unsecured Account**” means the non-interest bearing account in the name of the Lender with the Principal Paying Agent, account number 27729101;

“**U.S. Dollar Equivalent**” means with respect to any amount denominated in a currency other than U.S. Dollars, at such time for the determination thereof, the amount of U.S. Dollars obtained by converting such other currency involved into U.S. Dollars at the spot rate for the purchase of U.S. Dollars with such other currency as most recently published under “**Currency Rates**” in the section of the *Financial Times* entitled “**Currencies, Bonds & Interest Rates**”;

“**U.S. Dollars**” and “**U.S.\$**” mean the lawful currency of the United States of America;

“**U.S. GAAP**” means generally accepted accounting principles set forth in the opinions and pronouncements of the Accounting Principles Board of American Institute of Certified Public Accountants and statements and pronouncements of the Financial Accounting Standards Board or in such other statements by such other entity as have been approved by a significant segment of the accounting profession, which are in effect from time to time; and

“**Voting Stock**” with respect to any Person, means securities of any class of Capital Stock of such Person entitling the holders thereof (whether at all times or only so long as no senior class of stock has voting power by reason of any contingency) to vote in the election of members of the Board of Directors (or equivalent governing body) of such Person.

1.2 Other Definitions

Unless the context otherwise requires, terms used in this Agreement which are not defined in this Agreement but which are defined in, or are defined by cross-reference to definitions in or other provisions of, the Trust Deed, the Notes (including the Conditions), the Agency Agreement or the Subscription Agreement shall have the meanings given to such terms therein.

1.3 Interpretation

Unless the context or the express provisions of this Agreement otherwise require, the following shall govern the interpretation of this Agreement:

1.3.1 all references to “**Clause**” or “**sub-Clause**” or, “**Paragraph**” are references to a Clause or sub-Clause of this Agreement;

1.3.2 the terms “**hereof**”, “**herein**” and “**hereunder**” and other words of similar import shall mean this Agreement as a whole and not any particular part hereof;

1.3.3 words importing the singular number include the plural and vice versa;

1.3.4 a Potential Event of Default shall be deemed “**continuing**” unless it has been remedied or waived and an Event of Default shall be deemed “**continuing**” unless it has been remedied to the satisfaction of the Lender or waived;

1.3.5 all references to “**taxes**” include all present or future taxes, levies, imposts and duties of any nature and the terms “**tax**” and “**taxation**” shall be construed accordingly; and

1.3.6 the table of contents and the headings are for convenience only and shall not affect the construction hereof.

2 Facility

2.1 Facility

On the terms and subject to the conditions set forth herein, the Lender hereby agrees to lend the Borrower and the Borrower hereby agrees to borrow from the Lender U.S.\$500,000,000.

2.2 Purpose

The net proceeds of the Advance will be used by the Borrower for general corporate purposes and, accordingly, the Borrower shall apply all amounts raised by it hereunder for such purposes, but the Lender shall not be concerned with the application thereof.

2.3 Facility Fee

The Borrower shall pay fees and expenses in the amount of U.S.\$3,320,000 to the Lender in consideration for the arrangement of the Facility (the “**Facility Fee**”) as set forth in Clause 3.2 below.

3 Drawdown

3.1 Drawdown

On the terms and subject to the conditions of this Agreement, on the Closing Date the Lender shall make the Advance to the Borrower and the Borrower shall make a single drawing in the full amount of the Facility.

3.2 Facility Fee

In consideration of the Lender making the Advance to the Borrower, the Borrower hereby agrees to pay to the Lender, in Same-Day Funds, into the Unsecured Account the Facility Fee promptly, but in any event no later than 10.00 a.m. (New York City time) on 18 May 2012.

3.3 Disbursement

Subject to the conditions set forth herein, on the Closing Date the Lender shall transfer the amount of the Advance to the Borrower's account no. 4070284000000007854 with Gazprombank (Open Joint-Stock Company), Moscow, the Russian Federation, SWIFT Code: GAZPRUMM, correspondent account no. 04414534 with Deutsche Bank Trust Company Americas, New York, NY, USA, SWIFT Code: BKTRUS33.

3.4 Ongoing Fees and Expenses

In consideration of the Lender making available the Loan to the Borrower, the Borrower shall pay in one or more instalments on demand to the Lender each year an additional amount equating to all properly incurred and documented ongoing fees, taxes (including, for the avoidance of doubt, any Taxes imposed or charged in accordance with Luxembourg laws or regulations and any amounts payable by the Issuer pursuant to clause 5 of the Trust Deed) and expenses of the Lender (including, without limitation, any corporate service provider fees, stock exchange fees, listing fees, audit fees, legal fees, fees due from the Issuer under the Ongoing Fees Side Letter and the anticipated winding-up expenses of the Lender) as set forth in an invoice from the Lender to the Borrower. Before such payment is made by the Borrower, the Lender shall submit an invoice providing, in reasonable detail, the nature and calculation of the relevant payment or expense.

4 Interest

4.1 Rate of Interest

The Borrower will pay interest in U.S. Dollars to the Lender on the outstanding principal amount of the Loan from time to time at the rate of 6.95 per cent. per annum (the "**Rate of Interest**").

4.2 Payment

Interest at the Rate of Interest shall accrue from day to day, starting from (and including) the Closing Date and shall be paid in arrear not later than 10.00 a.m. (New York City time) one Business Day prior to each Interest Payment Date. Interest on the Loan will accrue to (but excluding) the Repayment Date (or any date upon which the Loan is prepaid pursuant to Clause 5) unless payment of principal due on such date is withheld or refused, in which event interest will continue to accrue (before or after any judgment) at the Rate of Interest to (but excluding) the date on which payment in full of the principal thereof is made. The amount of interest payable in respect of the Loan for any Interest Period shall be calculated by applying the Rate of Interest to the amount of the Loan, dividing the product by two and rounding the resulting figure to the nearest cent (half a cent being rounded down). If interest is required to be calculated for any period of less than a year, it will be calculated on the basis of a year of 360 days consisting of 12 months of 30 days each and, in the case of an incomplete month, the actual number of calendar days elapsed. "**Interest Period**" means each period beginning on (and including) the Closing Date or any Interest Payment Date and ending on (but excluding) the next Interest Payment Date.

5 Repayment and Prepayment

5.1 Repayment

Except as otherwise provided herein, the Borrower shall repay the Loan not later than 10 a.m. (New York City time) one Business Day prior to the Repayment Date.

5.2 Prepayment in the Event of Taxes or Increased Costs

If, as a result of any amendments or clarification to, or change (including a change in interpretation or application) in, or determination under, the double tax treaty between the Russian Federation and Luxembourg or the laws or regulations of the Russian Federation or Luxembourg or of any political sub-division thereof or any authority thereof or therein having power to tax (the "**Taxing Jurisdiction**") or the enforcement of the security provided for in the Trust Deed, the Borrower would thereby be required to make or increase any payment due hereunder as provided in Clause 6.2 or 6.3 (other than, in each case, where the increase in payment is in respect of any amounts due or paid pursuant to Clause 3), or if (for whatever reason) the Borrower would have to or has been required to pay additional amounts pursuant to Clause 8, and in any such case such obligation cannot be avoided by the Borrower taking reasonable

measures available to it, then the Borrower may (without premium or penalty), upon not less than 30 calendar days' but not more than 60 calendar days' prior written notice to the Lender (which notice shall be irrevocable), prepay the Loan in whole (but not in part) at any time.

Prior to giving any such notice in the event of an increase in payment pursuant to Clause 6.2, the Borrower shall deliver to the Lender (with a copy to the Trustee) an Officers' Certificate (on which the Lender and the Trustee will be entitled to rely absolutely and without liability to any Person) confirming that the Borrower would be required to increase the amount payable, supported by an opinion of an independent tax adviser of international repute addressed to the Lender.

5.3 Prepayment in the Event of Illegality

If, at any time, by reason of the introduction of any change after the date of this Agreement in any applicable law, regulation, regulatory requirement or directive of any applicable Agency, the Lender reasonably determines (setting out in reasonable detail the nature and extent of the relevant circumstances and such determination being accompanied if so requested by an Opinion of Counsel satisfactory to the Borrower with the cost of such Opinion of Counsel being borne solely by the Borrower) that it is or would be unlawful or contrary to any applicable law, regulation, regulatory requirement or directive of any Agency for the Lender to allow all or part of the Loan or the Notes to remain outstanding or for the Lender to maintain or give effect to any of its obligations in connection with this Agreement and/or to charge or receive or to be paid interest at the rate then applicable to the Loan (an "**Event of Illegality**"), then upon notice by the Lender to the Borrower in writing, the Borrower and the Lender shall consult in good faith as to a basis which eliminates the application of such Event of Illegality; provided, however, that the Lender shall be under no obligation to continue such consultation if a basis has not been determined within 30 calendar days of the date on which it so notified the Borrower. If such a basis has not been determined within the 30 calendar days, then upon written notice by the Lender to the Borrower and the Trustee, the Borrower shall prepay the Loan in whole (but not in part) on the next Interest Payment Date or on such earlier date as the Lender shall (acting reasonably) certify to be necessary to comply with such requirements (in any event being not earlier than the end of any grace period allowed by applicable laws or regulations).

5.4 Prepayment upon Change of Control Put Event

5.4.1 Promptly, and in any event within 30 calendar days after becoming aware of the occurrence of any Change of Control Put Event, the Borrower shall deliver to the Lender and the Trustee a written notice in the form of an Officers' Certificate (upon which the Lender and the Trustee may rely absolutely and without liability to any Person), which notice shall be irrevocable, stating that a Change of Control Put Event has occurred and stating the circumstances and relevant facts giving rise to such Change of Control Put Event.

5.4.2 If, following a Change of Control Put Event, any Noteholder has exercised its Change of Control Put Option, the Borrower shall on the Change of Control Put Settlement Date, prepay the principal amount of the Loan in an amount which is equal to the aggregate principal amount of the Notes (as notified to the Borrower by the Paying Agents and/or by the Lender) in relation to which the Change of Control Put Option has been duly exercised by the Noteholders in accordance with the Conditions together with interest accrued (if any) in respect thereof to (and excluding) the Change of Control Put Settlement Date.

5.5 Reduction of Loan upon Cancellation of Notes

The Borrower or any Subsidiary of the Borrower may from time to time, in accordance with the Conditions, purchase Notes in the open market or by tender or by a private placement at any price and deliver to the Lender Notes, having an aggregate principal value of at least U.S.\$1,000,000, together with a request for the Lender to present such Notes to the relevant Registrar for cancellation, and may also from time to time procure the delivery to or to the order of the relevant Registrar of instructions to cancel a specified aggregate principal amount of Notes (being at least U.S.\$1,000,000) represented by the Global Certificates (which instructions shall be accompanied by evidence satisfactory to the relevant Registrar that the Borrower is entitled to give such instructions), whereupon the Lender shall, pursuant to Clause 8.1 of the Agency Agreement, request the relevant Registrar to cancel such Notes (or specified aggregate principal amount of Notes represented by the Global Certificates). Upon any such cancellation by or on behalf of the relevant Registrar, the principal amount of the Loan corresponding to the principal amount of such Notes shall be extinguished for all purposes as of the date of such cancellation.

5.6 Optional Prepayment in the Event of a Public Equity Offering

5.6.1 The Borrower may at its option, at any time, or from time to time, on or prior to three year anniversary of the Closing Date, on the occurrence of a Public Equity Offering, on giving not less than 10 calendar days' but not more than 60 calendar days' prior written notice to the Lender (which notice shall be irrevocable), prepay up to 35 per cent. of the principal amount of the Loan then outstanding together with the Public Equity Offering Premium, plus accrued and unpaid interest, if any, and any other amounts due, if any, provided, that:

- (i) after giving effect to any such prepayment the principal amount of the Loan outstanding after the occurrence of such repayment constitutes at least 65 per cent. of the principal amount of the Loan that was outstanding immediately prior to such repayment; and
- (ii) the repayment must occur within 60 days of the date of the completion of such Public Equity Offering or the related greenshoe option, whichever is later.

5.6.2 Notices of prepayment delivered in accordance with Clause 5.6.1 above will specify (i) the date fixed for prepayment (which must be no more than 60 days from the date of closing of the relevant Public Equity Offering), (ii) the amount to be prepaid (which shall be limited by the provisions of Clause 5.6.1) and (iii) any additional amounts payable in accordance with Clause 5.6.1. The Borrower shall deliver to the Lender and the Trustee, together with such notice, an Officers' Certificate (upon which the Lender and the Trustee may rely absolutely and without liability to any Person) that it will have, on the relevant prepayment date, freely available funds in an amount sufficient to prepay the Loan and pay such other amounts as are required under Clause 5.6.1.

5.7 Payment of Other Amounts

If the Loan is to be prepaid by the Borrower pursuant to any of the provisions of Clause 5.2, 5.3, 5.4 or 5.6, the Borrower shall, simultaneously with such prepayment, pay to the Lender accrued interest thereon to (and excluding) the date of actual payment and all other sums payable by the Borrower pursuant to this Agreement in relation to the prepaid amount. For the avoidance of doubt, if the principal amount of the Loan is reduced pursuant to the provisions of Clause 5.5, then no interest shall accrue or be payable during the Interest Period in which such reduction takes place in respect of the amount by which the Loan is so reduced and the Lender shall not be entitled to any interest in respect of the cancelled Notes.

5.8 Provisions Exclusive

The Borrower shall not prepay or repay all or any part of the amount of the Loan except at the times and in the manner expressly provided for in this Agreement. The Borrower shall not be permitted to re-borrow any amounts prepaid or repaid.

6 Payments

6.1 Making of Payments

All payments of principal, interest and additional amounts (other than those in respect of Reserved Rights) to be made by the Borrower under this Agreement shall be made unconditionally by credit transfer to the Lender not later than 10 a.m. (New York City time) one Business Day prior to each Interest Payment Date or the Repayment Date or the date of any payment (as the case may be) in Same-Day Funds to the Account, or as the Trustee may otherwise direct following the occurrence of a Relevant Event.

The Borrower shall, before 10 a.m. (Local Time) on the second Business Day prior to each Interest Payment Date or the Repayment Date or such other date (as the case may be), procure that the bank effecting such payments on its behalf confirms to the Principal Paying Agent or to the Borrower (who shall immediately provide the same to the Principal Paying Agent) by tested telex or authenticated SWIFT the payment instructions relating to such payment.

The Lender agrees with the Borrower that it will not deposit any other moneys into the Account and that no withdrawals shall be made from the Account other than as provided for and in accordance with the Trust Deed and the Agency Agreement.

The parties to the Trust Deed and the Agency Agreement are intended by the parties to this Agreement to have the right under the Contracts (Rights of Third Parties) Act 1999 to enforce the terms of this Clause 6.1.

6.2 No Set-Off, Counterclaim or Withholding; Gross-Up

All payments to be made by the Borrower under this Agreement shall be made in full without set-off or counterclaim and (except to the extent required by law) free and clear of and without deduction for or on account of any Taxes. If the Borrower shall be required by applicable law to make any deduction or withholding from any payment under this Agreement for or on account of any such Taxes, it shall, on the due date for such payment, increase the payment of principal or interest or any other payment due hereunder to such amount as may be necessary to ensure that the Lender receives a net amount in U.S. Dollars equal to the full amount which it would have received had payment not been made subject to such Taxes, and shall promptly account to the relevant authorities for the relevant amount of such Taxes so withheld or deducted within the time allowed for such payment under applicable law, and shall deliver to the Lender without undue delay evidence of such deduction or withholding and of the accounting therefor to the relevant taxing authority. The preceding sentence shall not apply with respect to any Tax that would not have been imposed but for a failure by the Lender (or any financial institution through which payment on the Loan is made) to (i) enter into an agreement described in Section 1471(b)(1) of the U.S. Internal Revenue Code of 1986 (the “Code”) or otherwise comply with Sections 1471 through 1474 of the Code or any regulations promulgated thereunder (or under any implementing legislation adopted by Luxembourg or the Russian Federation) or (ii) provide information sufficient for the Borrower to determine whether the Lender (or financial institution through which payment on the Loan is made) is a U.S. person or should otherwise be treated as holding a “United States account” of the Borrower (or comply with similar requirements under any implementing legislation adopted by Luxembourg or the Russian Federation). If the Lender pays any amount in respect of such Taxes (including penalties or interest) the Borrower shall reimburse the Lender in U.S. Dollars for such properly documented payment on demand. For the avoidance of doubt, this Clause 6.2 shall not apply to any taxes payable on income, profits or gains by the Lender and is without prejudice to any obligations of the Lender contained in Clause 6.6.

6.3 Withholding on the Notes

Without prejudice to the provisions of Clause 6.2, if the Lender notifies the Borrower (setting out in reasonable detail the nature and extent of the obligation with such evidence as the Borrower may reasonably require) that it has become obliged to make any withholding or deduction for or on account of any present or future taxes, duties, assessments or governmental charges of whatever nature imposed, levied, collected, withheld or assessed by or on behalf of Luxembourg or any political subdivision or any authority thereof or therein having the power to tax from any payment which it is obliged to make, or would otherwise be obliged to make but for the imposition of any such withholding or deduction for or on account of such taxes, under or in respect of the Notes in circumstances where the Lender is required to pay additional amounts pursuant to Condition 8 of the Notes, the Borrower agrees to pay into the Account in Same-Day Funds, no later than one Business Day prior to the date on which payment is due to the Noteholders, such additional amounts as are equal to the additional amounts which the Lender would be required to pay in order that the net amounts received by the Noteholders, after such withholding or deduction, will equal the respective amounts which would have been received by the Noteholders in the absence of such withholding or deduction; provided, however, that the Lender shall immediately upon receipt from any Paying Agent of any reimbursement of the sums paid pursuant to this provision, to the extent that any Noteholders are not entitled to such additional amounts pursuant to the Conditions, pay such additional amounts to the Borrower (it being understood that neither the Lender, the Principal Paying Agent or any Paying Agent shall have any obligation to determine whether any Noteholder is entitled to any such additional amounts).

Any notification by the Lender to the Borrower in connection with this Clause 6.3 shall be given as soon as reasonably practicable after the Lender becomes aware of any obligation on it to make any such withholding or deduction.

6.4 Reimbursement

6.4.1 To the extent that the Lender subsequently obtains or uses any tax credit or allowance or other reimbursements relating to a deduction or withholding with respect to which the Borrower has made a payment pursuant to this Clause 6, the Lender shall promptly pay to the Borrower so much of the benefit it received as will leave the Lender in substantially the same position as it would have been had no additional amount been required to be paid by the Borrower pursuant to this Clause 6; provided, however, that the question of whether any such benefit has been received, and accordingly, whether any payment should be made to the Borrower, the amount of any such payment and the timing of any such payment, shall be determined by the Lender (acting reasonably and in consultation with the Borrower). Subject to Clauses 6.5 and 6.6, the Lender shall have the absolute discretion

whether, and in what order and manner, it claims any credits, allowances or refunds available to it, and the Lender shall in no circumstances be obliged to disclose to the Borrower any information regarding its tax affairs or its computations provided that the Lender shall notify the Borrower of any credit, allowance or other reimbursement that the Lender receives.

6.4.2 If as a result of a failure to obtain relief from deduction or withholding of any taxes referred to in Clause 6.2, (a) such taxes are deducted or withheld by the Borrower and pursuant to Clause 6.2 an increased amount is paid by the Borrower to the Lender in respect of such deduction or withholding, and (b) following the deduction or withholding of taxes as referred to above, the Lender as represented by the Borrower applies to the competent taxing authority for a withholding tax refund (it being agreed that the Lender hereby authorises the Borrower to make such application) and such withholding tax is refunded or repaid by the relevant taxing authority to the Lender, the Lender shall as soon as reasonably practicable notify the Borrower of the receipt of such withholding tax refund and promptly transfer the actually received amount of the withholding tax refund in the currency actually received and less any applicable costs to a bank account of the Borrower specified for that purpose by the Borrower.

6.4.3 The Lender agrees promptly, upon becoming aware of such, to notify the Borrower if it ceases to be resident in Luxembourg or if any of its representations set forth in Clause 3 of the Subscription Agreement are no longer true and correct.

6.5 Mitigation

If at any time either party hereto becomes aware of circumstances which would or might, then or thereafter, give rise to an obligation on the part of the Borrower to make any deduction, withholding or payment as described in Clauses 6.2 or 6.3, then, without in any way limiting, reducing or otherwise qualifying the Lender's rights, or the Borrower's obligations, under such Clauses, such party shall as soon as reasonably practicable upon becoming aware of such circumstances notify the other party in writing, and, thereupon the parties shall consider and consult with each other in good faith with a view to finding, agreeing upon and implementing a method or methods by which any such obligation may be avoided or mitigated and, to the extent that both parties can do so without taking any action which in the reasonable opinion of such party is prejudicial to its own position, take such reasonable steps as may be reasonably available to it to avoid such obligation or mitigate the effect of such circumstances. The Borrower agrees to reimburse the Lender upon receipt of an original demand for payment for all reasonable, properly incurred and documented costs and expenses (including but not limited to legal fees) incurred by the Lender in connection with this Clause 6.5.

6.6 Tax Treaty Relief

6.6.1 The Lender shall once in each calendar year, prior to the date on which the very first payment in that calendar year under this Agreement becomes due (for the purpose of this paragraph, the "**First Payment Date**"), at the expense of the Borrower, use commercially reasonable efforts to obtain and deliver to the Borrower, not later than 10 Business Days prior to such First Payment Date, a tax residency certificate issued by the competent authorities of Luxembourg (in the meaning of the Russia—Luxembourg Double Tax Treaty) confirming that the Lender is resident in Luxembourg (in the meaning of the Russia—Luxembourg Double Tax Treaty) in a particular calendar year. The tax residency certificate shall be apostilled and a certified translation shall be delivered at the expense of the Borrower. Provided that the tax residency certificate application has been filed in due time, the Lender shall not be responsible for any failure to provide, or any delays in providing, such tax residency certificate as a result of any action or inaction of any authority of Luxembourg, but shall notify the Borrower as soon as practicable about any such failure or delay with a written description of the actions taken by the Lender to obtain such tax residency certificate.

6.6.2 If Russian legislation regulating the procedures for obtaining an exemption from Russian withholding tax on income changes, the Lender shall (subject to being informed of any such changes by the Borrower) use its reasonable and timely efforts to assist the Borrower to obtain relief from such tax pursuant to the double taxation treaty between the Russian Federation and Luxembourg and the procedures referred to in Clause 6.6.1 will be deemed changed accordingly.

7 Conditions Precedent

7.1 Documents to be Delivered

The obligation of the Lender to make the Advance under this Agreement shall be subject to the receipt by the Lender on or prior to the Closing Date of written evidence that the Persons mentioned in Clause 16.5 have agreed to receive process in the manner specified herein.

7.2 Further Conditions

The obligation of the Lender to make the Advance shall be subject to the further conditions precedent that as at the Closing Date (a) the representations and warranties made and given by the Borrower in the Subscription Agreement shall be true and accurate as if made and given on the Closing Date with respect to the facts and circumstances then existing; (b) the Borrower shall not be in breach of any of the terms, conditions and provisions of this Agreement; (c) the Subscription Agreement, the Agency Agreement and the Trust Deed shall have been executed and delivered; (d) the Lender shall have received the full amount of the proceeds of the issue of the Notes pursuant to the Subscription Agreement; and (e) the Lender shall have received in full the amount referred to in Clause 2.3.

8 Change in Law or Increase in Cost

8.1 Compensation

In the event that after the date of this Agreement there is any change in or introduction of any tax, law, regulation, regulatory requirement or official directive (whether or not having the force of law but, if not having the force of law, the observance of which is in accordance with the generally accepted financial practice of financial institutions in the country concerned) or in the interpretation or application thereof by any Person charged with the administration thereof and/or any compliance by the Lender in respect of the Loan or the Facility with any request, policy or guideline (whether or not having the force of law but, if not having the force of law, the observance of which is in accordance with the generally accepted financial practice of financial institutions in the country concerned) from or of any central bank or other fiscal, monetary or other authority, agency or any official of any such authority, which:

8.1.1 subjects or will subject the Lender to any Taxes with respect to payments of principal of or interest on the Loan or any other amount payable under this Agreement (other than any Taxes payable by the Lender on its overall net income, any taxes referred to in Clause 6.2, or any Taxes referred to in Clause 6.3);

8.1.2 increases or will increase the taxation of or changes or will change the basis of taxation of payments to the Lender of principal of or interest on the Loan or any other amount payable under this Agreement (other than any such increase or change which arises by reason of any increase in the rate of tax payable by the Lender on its overall net income or as a result of any Taxes referred to in Clause 6.2 or any Taxes referred to in Clause 6.3); or

8.1.3 imposes or will impose on the Lender any other condition affecting this Agreement, the Facility or the Loan,

and if as a result of any of the foregoing:

- (i) the cost to the Lender of making, funding or maintaining the Loan or the Facility is increased;
- (ii) the amount of principal, interest or additional amounts payable to or received by the Lender hereunder is reduced; or
- (iii) the Lender makes any payment or foregoes any interest or other return on or calculated by reference to the gross amount of any sum receivable by it from the Borrower hereunder or makes any payment or foregoes any interest or other return on or calculated by reference to the gross amount of the Loan,

then, subject to the following and in each such case:

- (i) the Lender shall, as soon as practicable after becoming aware of such increased cost, reduced amount or payment made or foregone, give written notice to the Borrower together with a certificate signed by one or more directors of the Lender or by any Persons empowered by the authorised signatories of the Lender on behalf of the Lender describing in reasonable detail the introduction or change or request which has occurred and the country or jurisdiction concerned and the nature and date thereof and demonstrating the connection between such introduction,

change or request and such increased cost, reduced amount or payment made or foregone, setting out in reasonable detail the basis on which such amount has been calculated, and providing all relevant supporting documents evidencing the matters set out in such certificate; and

- (ii) upon demand by the Lender to the Borrower, the Borrower, in the case of sub-Clauses (i) and (iii) above, shall pay to the Lender such additional amount as shall be necessary to compensate the Lender for such increased cost, and, in the case of sub-Clause (ii) above, at the time the amount so reduced would otherwise have been payable, pay to the Lender such additional amount as shall be necessary to compensate the Lender for such reduction, payment or forgone interest or other return; provided however, that the amount of such increased cost, reduced amount or payment made or forgone shall be deemed not to exceed an amount equal to the proportion which is directly attributable to this Agreement, and provided, further, that the Lender will not be entitled to such additional amount where such reduction, payment or forgone interest or other return arises as a result of the negligence or wilful default of the Lender,

provided that this Clause 8.1 will not apply to or in respect of any matter for which the Lender has already been compensated under Clauses 3.4, 6.2, 6.3 and 6.5.

8.2 Mitigation

In the event that the Lender becomes entitled to make a claim pursuant to Clause 8.1, the Lender shall consult in good faith with the Borrower and shall use reasonable efforts (based on the Lender's reasonable interpretation of any relevant tax, law, regulation, requirement, official directive, request, policy or guideline) to reduce, in whole or in part, the Borrower's obligations to pay any additional amount pursuant to Clause 8.1 except that nothing in this Clause 8.2 shall obligate the Lender to incur any costs or expenses in taking any action hereunder which, in the reasonable opinion of the Lender, is prejudicial to it unless the Borrower agrees to reimburse the Lender such costs or expenses.

9 Covenants

So long as the Loan or any other sum owing hereunder remains outstanding:

9.1 Limitations on Liens

The Borrower will not, and will not permit any of its Principal Subsidiaries to, directly or indirectly, grant, create, impose or assume any Liens of any kind (except for Permitted Liens) against or upon any of their respective properties or assets, whether now owned or hereafter acquired, or any proceeds therefrom, to secure any Indebtedness unless contemporaneously therewith effective provision is made to secure the amounts outstanding under the Loan equally and rateably with such Indebtedness (or, in the event that such Indebtedness is subordinated in right of payment to the Loan in priority to such Indebtedness) with a Lien on the same properties and assets securing such Indebtedness for so long as such Indebtedness is secured by such Lien.

9.2 Maintenance of Net Leverage Ratio

The Borrower shall ensure that the ratio of Consolidated Net Indebtedness to Consolidated OIBDA (the "**Net Leverage Ratio**") is 3.5:1 or lower as at each Calculation Date.

9.3 Limitation on Asset Sales

The Borrower will not, and will not permit any of its Principal Subsidiaries to consummate an Asset Sale unless the Borrower or the applicable Principal Subsidiary, receives (or is entitled to receive in accordance with the terms of such Asset Sale) consideration at the time of the Asset Sale at least equal to the Fair Market Value; and

9.3.1 at least 50 per cent. of the consideration shall be in the form of cash, Cash Equivalents, Capital Stock, Marketable Securities, or Assumed Liabilities; or

9.3.2 where more than 50% of consideration for an Asset Sale is in the form of assets other than the ones mentioned in 9.3.1, a favourable opinion as to the fairness of such Asset Sale has been obtained by Borrower from an Independent Financial Advisor and such opinion has been filed with the Trustee.

9.4 Affiliate Transactions

9.4.1 The Borrower will not, and will not permit any of its Subsidiaries to, directly or indirectly, enter into any Affiliate Transaction, unless the terms of such Affiliate Transaction are no less favourable to the Borrower, relevant Subsidiary or the Group taken as a whole than those that could reasonably be expected to be obtained at such time in a comparable transaction on an arm's length basis from a Person that is not an Affiliate of the Borrower and at Fair Market Value.

9.4.2 Clause 9.4.1 shall not apply to:

- (i) transactions with or among the Borrower and any of its Subsidiaries or between or among Subsidiaries;
- (ii) transactions between, on the one hand, the Borrower or any of its Subsidiaries and, on the other hand, any Person which is an Affiliate of the Borrower only as a consequence of any Investments in such Person, or control of such Person, by the Borrower or any of its Subsidiaries;
- (iii) reasonable fees and compensation paid to, and any indemnity provided on behalf of, officers, directors, employees, consultants or agents of the Borrower or any Subsidiary as determined conclusively by the chief financial officer or chief executive officer of the Borrower acting in good faith;
- (iv) any transactions undertaken pursuant to any contractual obligations or rights in existence on the Closing Date or any amendment thereto after the Closing Date (so long as such amendment is not disadvantageous to the Noteholders in any material respect);
- (v) compensation or employee benefit arrangements with any officer or director of the Borrower or any of its Subsidiaries arising out of any employment contract entered into in the ordinary course of business;
- (vi) loans and advances to officers, directors and employees of the Borrower or any Subsidiary for travel, entertainment, moving and other relocation expenses, in each case made in the ordinary course of business and not exceeding U.S.\$10,000,000 outstanding at any one time;
- (vii) sales of Capital Stock of the Borrower (other than Disqualified Capital Stock of the Borrower) to Affiliates of the Borrower; and
- (viii) transactions with customers, clients, suppliers, purchasers or sellers of goods or services, in each case, in the ordinary course of business and otherwise in compliance with this Agreement which are on terms at least as favourable to the Borrower, the relevant Subsidiary or the Group taken as a whole as might reasonably be obtained at such time from an unaffiliated party.

9.5 Reporting

9.5.1 The Borrower will deliver to the Lender and the Trustee as soon as they become available, but in any event within 180 days after the end of each of its financial years, copies of the Borrower's consolidated financial statements for such financial year, in each case audited and prepared in accordance with applicable Accounting Standards consistently applied.

9.5.2 The Borrower shall as soon as the same become available, but in any event within 120 days after the end of the first half of each of its financial years, deliver to the Lender and the Trustee copies of the Borrower's consolidated financial statements for such period, in each case reviewed and prepared in accordance with Accounting Standards consistently applied.

9.5.3 Subject to any restrictions under applicable law (including regarding insider dealing or market abuse), the Borrower hereby undertakes that it will deliver to the Lender and the Trustee, without undue delay on request, such additional information as it or the Trustee reasonably requires for the purposes of the discharge of the duties and discretions vested in it under this Loan Agreement or Trust Deed, including, without limitation (a) an Officers' Certificate certifying (i) those Subsidiaries which would be treated as Principal Subsidiaries and Core Subsidiaries pursuant to this Agreement and (ii) as to the Notes held by or on behalf of the Borrower or any member of the Group as at the date of such certificate, such Officers' Certificate to be provided within 14 days of the Borrower's consolidated accounts being made available in accordance with Clauses 9.5.1 and 9.5.2 or any request, and (b) a notification whenever it or any member of the Group has purchased and retained Notes for its own account.

The Borrower consents that any information provided to the Lender pursuant to this Clause 9.5 may also be provided to the Trustee, if so requested by the Trustee, without violating any duty of confidentiality or secrecy that the Lender may owe to the Borrower under the laws of Luxembourg.

10 Events of Default

10.1 If one or more of the following events of default (each, an “Event of Default”) shall occur and for as long as it is continuing, the Lender shall be entitled to the remedies set forth in Clause 10.3:

10.1.1 the Borrower fails to make any payment of interest or additional amounts payable hereunder when the same becomes due and payable and such failure continues for a period of 30 calendar days; or

10.1.2 the Borrower fails to make any payment of principal when the same becomes due and payable hereunder, including a failure to prepay the Loan, fully or partially, pursuant to Clause 5.4 of this Agreement (Prepayment upon Change of Control Put Event) and such failure continues for a period of 5 Business Days; or

10.1.3 the Borrower fails in the performance or observance of any of its other obligations under this Agreement and except where such failure is not capable of remedy, such failure remains unremedied for the period of 30 calendar days after written notice thereof, addressed to the Borrower by the Lender, has been delivered to the Borrower; or

10.1.4 an event of default occurs (and is not remedied or waived within the applicable grace period) under:

(i) any Indebtedness of the Borrower (other than the Notes) or under any indenture, trust deed or other instrument under which any such Indebtedness has been issued or by which it is governed or

(ii) any Capital Markets Indebtedness of any Core Subsidiary;

which event of default either:

(iii) results in the acceleration of the payment of such Indebtedness or Capital Markets Indebtedness, as applicable; or

(iv) constitutes the failure to make any payment of principal or interest on such Indebtedness or Capital Markets Indebtedness, as applicable, when such payments become due; and

the amount of Indebtedness or Capital Markets Indebtedness, as applicable, falling under paragraph (iii) above or the amount unpaid falling under paragraph (iv) above exceeds in the aggregate (for the Borrower or the relevant Core Subsidiary) U.S.\$50,000,000; or

10.1.5 a Bankruptcy Law Event of Default occurs.

10.2 Notice of Default

The Borrower shall deliver to the Lender and the Trustee (i) on each Interest Payment Date; (ii) within seven Business Days of any written request by the Lender; or (iii) promptly upon becoming aware of the occurrence thereof, written notice in the form of an Officers’ Certificate stating whether any Potential Event of Default or Event of Default has occurred, its status and what action the Borrower is taking or proposes to take with respect thereto.

10.3 Default Remedies

If any Event of Default shall occur and be continuing, the Lender may, by notice in writing to the Borrower, (a) declare the obligations of the Lender hereunder to be terminated, whereupon such obligations shall terminate; and (b) declare the Loan to be immediately due and payable by the Borrower and declare all other amounts accrued and/or payable hereunder by the Borrower up to (and including) the date of such termination to be immediately due and payable, whereupon all such amounts shall become immediately due and payable, all without diligence, presentment, demand of payment, protest or notice of any kind, which are expressly waived by the Borrower; provided, however, that if a Bankruptcy Law Event of Default occurs with respect to the Borrower, the obligations of the Lender hereunder shall immediately terminate, and all amounts payable hereunder by the Borrower that would otherwise be due after the occurrence of such event shall become immediately due and payable, all without diligence, presentment, demand of payment, protest or notice of any kind, which are expressly waived by the Borrower.

10.4 Rights Not Exclusive

The rights provided for herein are cumulative and are not exclusive of any other rights, powers, privileges or remedies provided by law.

10.5 Investment Grade Status

Unless a Potential Event of Default or Event of Default has occurred and is continuing, Clause 10.1.4 will not apply for as long as the Investment Grade Status continues.

11 Indemnity

11.1 Indemnification

The Borrower undertakes to the Lender, that if the Lender or its director, officer, employee or agent (other than the Agents) (each an “**indemnified party**”) incurs any loss, liability, cost, claim, charge, expense (including, without limitation, taxes and properly incurred legal fees, costs and expenses), demand or damage (a “**Loss**”) as a result of or in connection with the execution or performance of this Agreement (or enforcement of any rights or remedies hereunder), and/or the issue, distribution, listing and/or exercise of any powers, rights or remedies in respect of the Notes, the Borrower shall pay to the Lender on demand an amount equal to such documented Loss and all costs, charges and expenses which it or any indemnified party may pay or incur in connection with investigating, disputing or defending any such action or claim as such costs, charges and expenses are incurred unless such Loss was either caused by such indemnified party’s gross negligence, bad faith, fraud or wilful misconduct or arises out of a breach of the representations and warranties or undertakings of the Lender contained in this Agreement or the Subscription Agreement. The Lender shall not have any duty or obligation whether as fiduciary or trustee for any indemnified party or otherwise, to recover any such payment or to account to any other Person for any amounts paid to it under this Clause 11.1. For the avoidance of doubt, a Loss shall not include any tax, duty, assessment or governmental charge (and any related penalty, interest, fine or other charge) to the extent it is compensated for under any other provision of this Agreement or would have been compensated for under any other provision of this Agreement but was not so compensated solely because it was excluded or limited under the terms of such provision.

11.2 Independent Obligation

Clause 11.1 constitutes a separate and independent obligation of the Borrower from its other obligations under or in connection with this Agreement or any other obligations of the Borrower in connection with the issue of the Notes by the Lender and shall not affect, or be construed to affect, any other provision of this Agreement or any such other obligations.

11.3 Evidence of Loss

A certificate of the Lender setting forth the amount of Loss and specifying in full detail the basis therefor shall, in the absence of manifest error, be conclusive evidence of the amount of such Loss.

11.4 Currency Indemnity

To the fullest extent permitted by law, the obligations of the Borrower under this Agreement in respect of any amount due in the currency (the “**first currency**”) in which the same is payable shall, notwithstanding any payment in any other currency (the “**second currency**”) (whether pursuant to a judgment or otherwise), be discharged only to the extent of the amount in the first currency that the Lender may, acting reasonably and in accordance with normal banking procedures, purchase with the sum paid in the second currency (after any premium and costs of exchange) on the Business Day immediately following the day on which the Lender receives such payment. If the amount in the first currency that may be so purchased for any reason falls short of the amount originally due (the “**Due Amount**”), the Borrower hereby agrees to indemnify and hold harmless the Lender against any deficiency in the first currency. Any obligation of the Borrower not discharged by payment in the first currency shall, to the fullest extent permitted by applicable law, be due as a separate and independent obligation and, until discharged as provided in this Agreement, shall continue in full force and effect.

12 Survival

The obligations of the Borrower pursuant to Clauses 6.2, 6.3, 11 and 13.2 and this Clause 12 shall survive the execution and delivery of this Agreement, the drawdown of the Facility and the repayment of the Loan, in each case by the Borrower.

13 General

13.1 Evidence of Debt

The entries made by the Lender in the accounts maintained by the Lender in accordance with its usual practice and evidencing the amounts from time to time lent by and owing to it hereunder shall, in the absence of manifest error, be *prima facie* evidence of the existence and amounts of the Borrower's obligations recorded hereunder.

13.2 Stamp Duties

13.2.1 The Borrower shall pay all stamp, registration and documentary taxes or similar charges (if any) imposed on the Borrower by any Person in the United Kingdom, the Russian Federation, Luxembourg, Belgium or the United States which may be payable or determined to be payable in connection with the execution, delivery, performance, enforcement, or admissibility into evidence of this Agreement and shall indemnify the Lender against any and all costs and expenses which may be incurred or suffered by the Lender to the extent attributable to the delay or failure by the Borrower to pay such taxes or similar charges upon presentation by the Lender to the Borrower of documentary evidence of such costs and expenses.

13.2.2 The Borrower agrees that if the Lender incurs a liability to pay any stamp, registration and documentary taxes or similar charges (if any) imposed by any Person in the United Kingdom, the Russian Federation, Luxembourg, Belgium or the United States which may be payable or determined to be payable in connection with the execution, delivery, performance, enforcement, or admissibility into evidence of this Agreement and any documents related hereto, the Borrower shall repay the Lender on demand, upon the Lender providing the Borrower with evidence showing that such liability is due or has actually been assessed, an amount equal to such stamp or other documentary taxes or duties and shall indemnify the Lender against any and all costs and expenses which may be incurred or suffered by the Lender to the extent attributable to the delay or failure by the Borrower to procure the payment of such taxes or similar charges.

13.3 Waivers

No failure to exercise and no delay in exercising, on the part of the Lender or the Borrower, any right, power or privilege hereunder and no course of dealing between the Borrower and the Lender shall operate as a waiver thereof, nor shall any single or partial exercise of any right, power or privilege preclude any other or further exercise thereof, or the exercise of any other right, power or privilege. The rights and remedies herein provided are cumulative and not exclusive of any rights or remedies provided by applicable law.

13.4 Prescription

In the event that any Notes become void pursuant to Condition 11, the Lender shall forthwith repay to the Borrower the principal amount of or interest on such Note subject to the Lender having previously received from the Borrower a corresponding amount in respect of principal or interest on the Loan pursuant to this Agreement.

14 Notices

All notices, requests, demands or other communications to or upon the respective parties hereto shall be given or made in the English language by fax or otherwise in writing and shall be deemed to have been duly given or made at the time of delivery, if delivered by hand or courier or if sent by facsimile transmission or by airmail to the party to which such notice, request, demand or other communication is required or permitted to be given or made under this Agreement addressed as follows:

14.1 if to the Borrower:

Sistema Joint Stock Financial Corporation
Bld.1, 13 Mokhovaya St.,
Moscow 125009 Russian Federation
Fax: +7(495)730-03-30
Attention: President

14.2 if to the Lender:

Sistema International Funding S.A.
2, boulevard Konrad Adenauer
L-1115, Luxembourg
Phone: (+352) 421 22 464
Fax: +352 421 22 718
E.mail: heike.kubica@db.com
lux-cs@list.db.com
Attention: The Directors

or to such other address or facsimile number as any party may hereafter specify in writing to the other.

15 Assignment

15.1 General

This Agreement shall inure to the benefit of and be binding upon the parties, their respective Successors and any permitted assignee or transferee of some or all of a party's rights or obligations under this Agreement. Any reference in this Agreement to any party shall be construed accordingly and, in particular, references to the exercise of rights and discretions by the Lender or the forming of an opinion or the making of any determination, following notification to the Borrower of the assignment and/or enforcement of the security, each as referred to in Clause 15.3, shall include references to the exercise of such rights or discretions or the forming of an opinion or the making of any determination by the Trustee (as Trustee). Notwithstanding the foregoing, the Trustee shall not be entitled to participate in any determinations by the Lender, or any discussions between the Lender and the Borrower or any agreements of the Lender or the Borrower, pursuant to Clause 6.4, 6.5 or 8.

15.2 By the Borrower

The Borrower shall not be entitled to assign or transfer all or any part of its rights or obligations hereunder to any other Person.

15.3 By the Lender

Subject to the provisions of Clause 17 of the Trust Deed, the Lender may not assign or transfer, in whole or in part, any of its rights and benefits or obligations under this Agreement other than the Reserved Rights except (i) the charge by way of first fixed charge granted by the Lender in favour of the Trustee (as Trustee) of certain of the Lender's rights and benefits under this Agreement; and (ii) the absolute assignment by the Lender to the Trustee of certain rights, interests and benefits under this Agreement, in each case, pursuant to Clause 4 of the Trust Deed. Nothing herein shall prevent the Trustee from assigning or transferring any rights held by it in relation to or under this Agreement, provided that any such assignment or transfer is in accordance with Clause 26 of the Trust Deed.

16 Law and Jurisdiction

16.1 Governing Law

This Agreement and any non-contractual obligations arising out of or in connection with it shall be governed by, and construed in accordance with, English law.

16.2 Jurisdiction

The parties irrevocably agree that any dispute arising out of or in connection with this Agreement, including a dispute as to the validity, existence or termination of this Agreement or the consequences of its nullity and/or this Clause 16.2 (a “**Dispute**”), shall be resolved:

16.2.1 subject to sub-Clause 16.2.2, by arbitration in London, England, conducted in the English language by three arbitrators, in accordance with the rules set down by the LCIA (formerly the London Court of International Arbitration) (“**LCIA Rules**”), which rules are deemed to be incorporated by reference into this sub-Clause 16.2.2, save that Article 5.6 of the LCIA Rules shall be amended as follows: unless the parties agree otherwise, the third arbitrator, who shall act as chairman of the tribunal, shall be nominated by the two arbitrators nominated by or on behalf of the parties. If he is not so nominated within 30 days of the date of nomination of the later of the two party-nominated arbitrators to be nominated, he shall be chosen by the LCIA Court. Save as provided in sub-Clause 16.2.2, the parties agree to exclude the jurisdiction of the English court under Sections 45 and 69 of the Arbitration Act 1996; or

16.2.2 at the sole option of the Lender, by proceedings brought in the courts of England, which courts are to have non-exclusive jurisdiction. If the Lender is in the position of a claimant, it may not exercise this option after the service of a request for arbitration relating to a Dispute. If the Lender is in the position of a respondent and wishes to exercise this option, it must do so by notice to the other parties to the Dispute within 30 days of service on it of the request for arbitration, and in any event before taking any substantive step in the arbitration.

For the avoidance of doubt, sub-Clause 16.2.2 is for the benefit of the Lender alone and shall not limit the right of the Lender to bring proceedings in any other court of competent jurisdiction.

16.3 Appropriate Forum

Each of the parties irrevocably waives any objection which it might now or hereafter have to the courts of England being nominated as the forum to hear and determine any Dispute, and agrees not to claim that any such court is not a convenient or appropriate forum.

16.4 Lender’s Process Agent

The Lender irrevocably appoints Law Debenture Corporate Services Limited (the “**Lender’s Agent**”), now of Fifth Floor, 100 Wood Street, London EC2V 7EX, United Kingdom, as its agent to accept service of process in England in any Dispute (whether that Dispute is to be resolved by arbitration or litigation), provided that:

16.4.1 service upon the Lender’s Agent shall be deemed valid service upon the Lender whether or not the process is forwarded to or received by the Lender;

16.4.2 the Lender shall inform all other parties to this Agreement, in writing, of any change in the address of the Lender’s Agent within 28 days of such change;

16.4.3 if the Lender’s Agent ceases to be able to act as a process agent or to have an address in England, the Lender irrevocably agrees to appoint a new process agent in England acceptable to the other parties to this Agreement and to deliver to the other parties to this Agreement within 14 days a copy of a written acceptance of appointment by the new process agent; and

16.4.4 nothing in this Agreement shall affect the right to serve process in any other manner permitted by law.

16.5 Borrower’s Process Agent

The Borrower irrevocably appoints Law Debenture Corporate Services Limited (the “**Borrower’s Agent**”), now of Fifth Floor, 100 Wood Street, London EC2V 7EX, United Kingdom, as its agent to accept service of process in England in any Dispute (whether that Dispute is to be resolved by arbitration or litigation), provided that:

16.5.1 service upon the Borrower’s Agent shall be deemed valid service upon the Borrower whether or not the process is forwarded to or received by the Borrower;

16.5.2 the Borrower shall inform all other parties to this Agreement and the Trustee, in writing, of any change in the address of the Borrower’s Agent within 28 days of such change;

16.5.3 if the Borrower's Agent ceases to be able to act as a process agent or to have an address in England, the Borrower irrevocably agrees to appoint a new process agent in England acceptable to the other parties to this Agreement and the Trustee and to deliver to the other parties to this Agreement and the Trustee within 14 days a copy of a written acceptance of appointment by the new process agent; and

16.5.4 nothing in this Agreement shall affect the right to serve process in any other manner permitted by law.

16.6 Waiver of Immunity

To the extent the Borrower may, in relation to any Dispute, claim in any jurisdiction, for itself or its assets or revenues, immunity from the jurisdiction of any court or tribunal, service of process, injunctive or other interim relief, or any process for execution of any award or judgment against its property, the Borrower irrevocably waives such immunity.

17 Severability

In case any provision in or obligation under this Agreement shall be invalid, illegal or unenforceable in any jurisdiction, the validity, legality and enforceability of the remaining provisions or obligations, or of such provision or obligation in any other jurisdiction, shall not in any way be affected or impaired thereby.

18 Contracts (Rights of Third Parties) Act 1999

A Person who is not a party to this Agreement has no right under the Contracts (Rights of Third Parties) Act 1999 to enforce any term of this Agreement, save that the Contracts (Rights of Third Parties) Act 1999 shall apply in favour of the Trustee to Clauses 6.1, 9 and 15.

19 Language

The language which governs the interpretation of this Agreement is the English language.

20 Amendments

Except as otherwise provided by its terms, this Agreement may not be varied except by an agreement in writing signed by the parties hereto.

21 Counterparts

This Agreement may be executed in any number of counterparts and by different parties hereto in separate counterparts, each of which when so executed shall be deemed to be an original and all of which when so executed shall constitute one and the same binding agreement between the parties hereto.

22 Limited Recourse and Non Petition

The Borrower hereby agrees that it shall have recourse in respect of any claim against the Lender only to sums in respect of principal, interest or other amounts (if any), as the case may be, actually received from the Borrower (after any tax deduction required by law to be made by the Borrower in respect of such sums and for which the Lender has not received a corresponding additional payment from the Borrower pursuant to this Agreement (also after any tax deduction as may be required by law)) by or for the account of the Lender pursuant to this Agreement (the "**Lender Assets**"), subject always to (i) the Security Interests (as defined in the Trust Deed); and (ii) to the fact that any claims of the Joint Lead Managers (as defined in the Subscription Agreement) shall rank in priority to claims of the Borrower hereunder, and that any such claim by the Joint Lead Managers or the Borrower shall be reduced *pro rata* so that the total of all such claims does not exceed the aggregate value of the Lender Assets after meeting claims secured on them. The Trustee having realised the same, neither the Borrower nor any Person acting on its behalf shall be entitled to take any further steps against the Lender to recover any further sums and no debt shall be owed by the Lender to such Person in respect of any such further sum. In particular, neither the Borrower nor any other Person acting on behalf of any of them shall be entitled at any time to institute proceedings against the Lender, or join with any other Person in bringing, instituting or joining, insolvency proceedings (whether court-based or otherwise) against the Lender.

Neither the Borrower nor any other Person acting on its behalf shall be entitled at any time to institute against the Lender, or join in any institution against the Lender of, any bankruptcy, administration, moratorium, reorganisation, controlled management, arrangement, insolvency, examinership, winding-up or liquidation proceedings or similar insolvency proceedings under any applicable bankruptcy or similar law in connection with any obligation of the Lender under this Agreement, save for lodging a claim in the liquidation of the Lender which is initiated by another party or taking proceedings to obtain a declaration or judgment as to the obligations of the Lender.

The Borrower shall have no recourse against any director, shareholder, or officer of the Lender in respect of any obligations, covenants or agreement entered into or made by the Lender in respect of this Agreement, except to the extent that any such Person acts in bad faith or is negligent.

TERMS AND CONDITIONS OF THE NOTES

The U.S.\$500,000,000 6.95 per cent. Loan Participation Notes due 2019 (the “**Notes**” which expression includes any further Notes issued pursuant to Condition 15 and forming a single series therewith) of SISTEMA INTERNATIONAL FUNDING S.A., a société anonyme, established under the laws of Grand Duchy of Luxembourg, having its registered office at 2, boulevard Konrad Adenauer, L-1115 Luxembourg and being registered with the Registre de Commerce et des Sociétés in Luxembourg under number B 168486 (the “**Issuer**”, which expression shall include any entity substituted for the Issuer pursuant to Condition 10(C)) are constituted by, are subject to, and have the benefit of, a trust deed (the “**Trust Deed**”, which expression includes such trust deed as from time to time modified in accordance with the provisions therein contained and any deed or other document expressed to be supplemental thereto, as from time to time so modified) dated 18 May 2012 and made between the Issuer and Deutsche Trustee Company Limited (the “**Trustee**”, which expression shall include any trustees or trustee for the time being under the Trust Deed) as trustee for the Noteholders (as defined below).

The Issuer has authorised the creation, issue and sale of the Notes for the sole purpose of financing a U.S.\$500,000,000 7 year loan (the “**Loan**”) to Sistema Joint Stock Financial Corporation (the “**Borrower**”). The terms of the Loan are recorded in a loan agreement (as amended, modified, restated or supplemented from time to time, the “**Loan Agreement**”) dated 16 May 2012 between the Issuer (as lender) and the Borrower.

In each case where amounts of principal, interest and additional amounts (if any) are stated herein or in the Trust Deed to be payable in respect of the Notes, the obligations of the Issuer to make any such payment shall constitute an obligation only to account to the Noteholders on each date upon which such amounts of principal, interest and additional amounts (if any) are due in respect of the Notes, for an amount equivalent to sums of principal, interest and additional amounts (if any) actually received by or for the account of the Issuer pursuant to the Loan Agreement, less any amounts in respect of the Reserved Rights (as defined below). Noteholders must therefore solely and exclusively rely on the covenant to pay under the Loan Agreement, the benefit of the Security Interests (as defined below) and the credit and financial standing of the Borrower. Noteholders shall have no recourse (direct or indirect) to any other asset of the Issuer.

Pursuant to the Trust Deed, the Issuer has charged by way of first fixed charge in favour of the Trustee for the benefit of itself and the Noteholders, *inter alia*, certain of its rights and interests as Lender under the Loan Agreement as security for its payment obligations in respect of the Notes and under the Trust Deed (the “**Charge**”) and has assigned absolutely certain of its rights and interest under the Loan Agreement to the Trustee (the “**Assigned Rights**” and, together with the Charge, the “**Security Interests**”) in each case excluding the Reserved Rights. “**Reserved Rights**” are the rights excluded from the Charge and the Assigned Rights, being all and any rights, interests and benefits of the Issuer in respect of the obligations of the Borrower under Clauses 2.3, 3.2, 3.4, 5.3 (other than the right to receive any amount payable under such Clause), 6.2 (to the extent that the Borrower shall reimburse the Issuer on demand for any amount paid by the Issuer in respect of taxes, penalties or interest), 6.3 (to the extent that the Issuer has received amounts to which the Noteholders are not entitled), 6.4, 6.5, 6.6, 8, 11, 12 and 13.2 (to the extent the Borrower shall reimburse the Issuer for any amount paid by the Issuer in respect of such taxes, charges or costs) of the Loan Agreement.

In certain circumstances, the Trustee can (subject to it being indemnified and/or secured and/or pre-funded to its satisfaction) be required by Noteholders holding at least one quarter of the principal amount of the Notes outstanding (as defined in the Trust Deed) or by an Extraordinary Resolution (as defined in the Trust Deed) of the Noteholders to exercise certain of its powers under the Trust Deed (including those arising in respect of the Security Interests).

Payments in respect of the Notes will be made (subject to the receipt of the relevant funds from the Borrower) pursuant to an agency agreement (as amended, modified, restated or supplemented from time to time, the “**Agency Agreement**”) dated 16 May 2012 and made between the Borrower, the Issuer, Deutsche Bank AG, London Branch, as the principal paying agent (the “**Principal Paying Agent**”, which expression shall include any successors), Deutsche International Corporate Services (Ireland) Limited as the Irish paying agent (the “**Irish Paying Agent**”, which expressions shall include any successors, and the Irish Paying Agent together with the U.S. Paying Agent (as defined below), Luxembourg Paying Agent (as defined below) and the Principal Paying Agent, the “**Paying Agents**”) and Deutsche Bank Luxembourg S.A. as the registrar in respect of the Regulation S Notes (as defined in the Trust Deed) and Deutsche Bank Trust Company Americas as the registrar in respect of the Rule 144A Notes (as defined in the Trust Deed) each a “**Registrar**” and Deutsche Bank Luxembourg S.A. as Luxembourg paying agent and a transfer agent (the “**Luxembourg Paying Agent**” and a “**Transfer Agent**”, which expressions shall include any successors, and together with the other Paying Agents, the Transfer Agents

and the Registrar, the “**Agents**”) and Deutsche Bank Trust Company Americas, acting in the capacity of the U.S. paying agent and a transfer agent (the “**U.S. Paying Agent**” and a “**Transfer Agent**”) and the Trustee.

Copies of the Trust Deed, the Loan Agreement and the Agency Agreement are available for inspection and collection by Noteholders during normal business hours at (i) the principal office of the Trustee being, at the date hereof, Winchester House, 1 Great Winchester Street, London EC2N 2DB; and (ii) the Specified Office (as defined in the Agency Agreement) of the Principal Paying Agent and the Irish Paying Agent.

Certain provisions of these terms and conditions (the “**Conditions**”) are summaries or restatements of, and are subject to, the detailed provisions of the Trust Deed, the Loan Agreement (the form of which is scheduled to and incorporated in the Trust Deed) and the Agency Agreement. Noteholders are entitled to the benefit of, are bound by, and are deemed to have notice of, all the provisions thereof and are deemed to have notice of all of the provisions of the Loan Agreement that are applicable to them.

Capitalised expressions used but not defined herein shall have the meaning given to them in the Trust Deed.

1 STATUS

The Notes are limited recourse secured obligations of the Issuer.

The sole purpose of the issue of the Notes is to provide the funds for the Issuer to make the Loan. The Notes constitute the obligation of the Issuer to apply the proceeds from the issue of the Notes solely for making the Loan and to account to the Noteholders for an amount equivalent to sums of principal, interest and additional amounts (if any) actually received by or for the account of the Issuer pursuant to the Loan Agreement, less any amount in respect of the Reserved Rights.

The Trust Deed provides that payments in respect of the Notes equivalent to the sums actually received by or for the account of the Issuer by way of principal, interest or additional amounts (if any) pursuant to the Loan Agreement, less any amount in respect of the Reserved Rights, will be made *pro rata* among all Noteholders (subject to Condition 7), on the Business Day (as defined in the Loan Agreement) after, and in the currency of, and subject to the conditions attaching to, the equivalent payment pursuant to the Loan Agreement. The Issuer shall not be liable to make any payment in respect of the Notes other than as expressly provided herein and in the Trust Deed. As provided therein, neither the Issuer nor the Trustee shall be under any obligation to exercise in favour of the Noteholders any rights of set-off or of banker’s lien or to combine accounts or counterclaim that may arise out of other transactions between the Issuer and the Borrower.

Noteholders have notice of, and have accepted, these Conditions and the contents of the Trust Deed, the Agency Agreement and the Loan Agreement. It is hereby expressly provided that, and Noteholders are deemed to have accepted that:

- (a) neither the Issuer nor the Trustee makes any representation or warranty in respect of, or shall at any time have any responsibility for, or, save as otherwise expressly provided in the Trust Deed, the Loan Agreement (in the case of the Issuer) or in Condition 1(f) below, liability or obligation in respect of, the performance and observance by the Borrower of its obligations under the Loan Agreement or the recoverability of any sum of principal, interest or additional amounts, if any, due or to become due from the Borrower under the Loan Agreement;
- (b) neither the Issuer nor the Trustee shall at any time have any responsibility for, or obligation or liability in respect of, the condition (financial or otherwise), creditworthiness, affairs, status, nature or prospects of the Borrower;
- (c) neither the Issuer nor the Trustee shall at any time be liable for any representation or warranty or any act, default or omission of the Borrower under or in respect of the Loan Agreement;
- (d) neither the Issuer nor the Trustee shall at any time have any responsibility for, or liability or obligation in respect of, the performance and observance by the Agents of their respective obligations under the Agency Agreement;
- (e) the financial servicing and performance of these Conditions depend upon performance by the Borrower of its obligations under the Loan Agreement and the Borrower’s credit and financial standing;
- (f) the Issuer and the Trustee shall be entitled to rely on certificates of the Borrower (and where applicable, certification by third parties), whether or not addressed to, or obtained by, the Issuer or the

Trustee, in respect of whether the Borrower is complying with its obligations under the Loan Agreement, and shall not be responsible for investigating any aspect of the Borrower's performance under the Loan Agreement and, subject as further provided in the Trust Deed, neither the Issuer as Lender under the Loan Agreement nor the Trustee will be liable for any failure to make any investigations which might be made by an Issuer or a security holder (as applicable) in relation to the property which is subject to the Security Interests and held by way of security for the Notes, and shall not be bound to enquire into or be liable for any defect or failure in the right or title of the Issuer to the property which is subject to the Security Interests whether such defect or failure was known to the Trustee or might have been discovered upon examination or enquiry or whether capable of remedy or not, nor will it have any liability for the enforceability of the security created by the Security Interests whether as a result of any failure, omission or defect in registering or filing or otherwise protecting or perfecting such security; the Trustee has no responsibility for the value of such security;

- (g) neither the Trustee nor the Issuer shall at any time be required to expend or risk its own funds or otherwise incur any financial liability in the performance of its obligations or duties or the exercise of any right, power, authority or discretion pursuant to these Conditions until the Issuer or the Trustee, as the case may be, has actually received from the Borrower the funds that are necessary to cover the costs and expenses in connection with such performance or exercise, or has been (in its sole discretion) sufficiently assured that it will receive such funds; and
- (h) the Issuer will not be liable for any shortfall in respect of amounts payable by or resulting from any withholding or deduction or for any payment on account of tax required to be made by the Issuer on or in relation to any sum received by it under the Loan Agreement, which will or may affect payments made or to be made by the Borrower under the Loan Agreement, save to the extent that it has received additional amounts from the Borrower under the Loan Agreement in respect of such withholding or deduction or payment, and the Issuer shall, furthermore, not be obliged to take any actions or measures as regards such deduction or withholding or payment, other than those set out in the Loan Agreement. The Trustee shall have no liability for any such shortfall in respect of any such deduction, withholding or payment.

Under the Trust Deed, the obligations of the Issuer in respect of the Notes rank *pari passu* and rateably without any preference among themselves.

In the event that the payments under the Loan Agreement are made by the Borrower to, or to the order of, the Trustee or (subject to the provisions of the Trust Deed) the Principal Paying Agent, they will *pro tanto* and equally to the amounts so paid by the Borrower satisfy the obligations of the Issuer in respect of the Notes (unless, upon due presentation of a Note, payment is improperly withheld or refused).

Save as otherwise expressly provided herein and in the Trust Deed, no proprietary or other direct interest in the Issuer's rights under or in respect of the Loan Agreement or the Loan exists for the benefit of the Noteholders. Subject to the terms of the Trust Deed, no Noteholder will have any entitlement to enforce any rights or remedies under or in respect of the Loan Agreement or have direct recourse to the Borrower, except through action by the Trustee pursuant to the relevant Security Interests granted to the Trustee in the Trust Deed. Neither the Issuer nor, following the enforcement of the Security Interests created in the Trust Deed, the Trustee shall be required to take any action, step or proceedings to enforce payment under the Loan Agreement unless it has been indemnified and/or secured and/or pre-funded to its satisfaction.

Notwithstanding any other provision hereof, the obligations of the Issuer under the Notes shall be solely to make payments of amounts in aggregate equal to each sum actually received by or for the account of the Issuer (after deduction or withholding of such taxes or duties as may be required to be made by the Issuer by law in respect of such sum or in respect of the Notes and for which the Issuer has not received a corresponding payment (also after deduction or withholding of such taxes or duties as may be required to be made by the Issuer in respect thereof) pursuant to the Loan Agreement) from the Borrower in respect of principal, interest or, as the case may be, additional amounts under the Loan Agreement (less any amounts in respect of the Reserved Rights), the right to receive which will, *inter alia*, be subject to the Security Interests. Accordingly, all payments to be made by the Issuer under the Notes will be made only from and to the extent of such sums received or recovered by or on behalf of the Trustee (following a Relevant Event (as defined in the Trust Deed) or by the Issuer (if applicable) following an Event of Default (as defined in the Loan Agreement)). Noteholders shall look solely to such sums for payments to be made by the Issuer under the Notes, the obligation of the Issuer to make payments in respect of the Notes will be limited to such sums and Noteholders will have no further recourse to the Issuer or any of the Issuer's other assets in respect thereof. In the event that the amount due and payable by the Issuer under the Notes exceeds the sums so

received or recovered, the right of any person to claim payment of any amount exceeding such sums shall be extinguished, and Noteholders may take no further action to recover such amounts.

None of the Noteholders or the other creditors (nor any other person acting on behalf of any of them) shall be entitled at any time to institute against the Issuer, or join in any institution against the Issuer of, any bankruptcy, administration, moratorium, reorganisation, controlled management, arrangement, insolvency, examinership, winding-up or liquidation proceedings or similar insolvency proceedings under any applicable bankruptcy or similar law in connection with any obligation of the Issuer relating to the Notes or otherwise owed to the creditors for so long as the Notes are outstanding, save for lodging a claim in the liquidation of the Issuer which is initiated by another party or taking proceedings to obtain a declaration or judgment as to the obligations of the Issuer.

No Noteholder shall have any recourse against any director, shareholder, or officer of the Issuer in respect of any obligations, covenants or agreement entered into or made by the Issuer in respect of the Notes, other than in the case of fraud.

2 FORM AND DENOMINATION

The Notes are issued in registered form without coupons attached in the denomination of U.S.\$200,000 or higher integral multiples of U.S.\$1,000 in excess thereof (each an “**Authorised Holding**”).

3 REGISTER, TITLE AND TRANSFERS

A. REGISTER

The Registrars will each maintain a register (each, a “**Register**”) in respect of the Notes outside the United Kingdom in accordance with the provisions of the Agency Agreement on which shall be entered the names and addresses of the Noteholders and the particulars of the Notes held by them and of all transfers and redemptions of Notes. In these Conditions, the “holder” of a Note means the person in whose name such Note is for the time being registered in the Register (or, in the case of a joint holding, the first named thereof) and “Noteholder” shall be construed accordingly. A certificate (each a “**Certificate**”) will be issued to each Noteholder in respect of its registered holding. Each Certificate will be serially numbered with an identifying number which will be recorded in the Register. Each Noteholder shall be entitled to receive only one Certificate in respect of its entire holding.

The Issuer also will maintain a register (the “**Issuer’s Register**”) at its registered office. After each change to the relevant Register, the relevant Registrar will provide the Issuer with an up-to-date copy of the relevant Register. In case of any inconsistency between the relevant Register and the Issuer’s Register, the Issuer’s Register shall prevail.

B. TITLE

Title to the Notes will pass by transfer and registration in the relevant Register and the Issuer’s Register. The holder of each Note shall (except as otherwise required by law or as ordered by a court of competent jurisdiction) be treated as the absolute owner of such Note for all purposes (whether or not it is overdue and regardless of any notice of ownership, trust or any other interest therein, any writing on the Certificate relating thereto (other than the endorsed form of transfer) or any notice of any previous loss or theft of such Certificate) and no person shall be liable for so treating such holder.

C. TRANSFERS

Subject to the terms of the Agency Agreement and to Conditions 3(F) and 3(G) below, a Note may be transferred in whole or in part upon surrender of the relevant Certificate, with the endorsed form of transfer duly completed, at the Specified Office of the relevant Registrar or any Transfer Agent, together with such evidence as the relevant Registrar or the Transfer Agent may reasonably require to prove the title of the transferor and the authority of the individuals who have executed the form of transfer; provided, however, that a Certificate may not be transferred unless the principal amount of Notes transferred and (where not all of the Notes held by a holder are being transferred) the principal amount of the balance of Notes not transferred are Authorised Holdings. Where not all the Notes represented by the surrendered Certificate are the subject of the transfer, a new Certificate in respect of the balance of the Notes will be issued to the transferor.

No transfer of a Certificate will be valid unless and until entered on the Register and the Issuer's Register. A Note may be registered only in the name of, and transferred only to, a named person (or persons, not exceeding four in number) or a nominee.

D. REGISTRATION AND DELIVERY OF CERTIFICATES

Within five business days of the surrender of a Certificate in accordance with Condition 3(C) above, the relevant Registrar will register the transfer in question and deliver a new Certificate of a like principal amount to the Notes transferred to each relevant holder for collection at its Specified Office or (at the request and risk of such relevant holder) by uninsured first class mail (airmail if overseas) to the address specified for the purpose by such relevant holder. In this Condition 3(D), "**business day**" means a day on which commercial banks are open for business (including dealings in foreign currencies) in the city where the relevant Registrar or the relevant Transfer Agent has its Specified Office.

E. NO CHARGE

The transfer of a Note will be effected without charge by or on behalf of the Issuer, the relevant Registrar or the relevant Transfer Agent but subject to the person making such application for transfer paying or procuring the payment of (or the giving of such indemnity as the Issuer, the relevant Registrar or the relevant Transfer Agent, as the case may be, may require in respect of) any tax or other duty of whatsoever nature which may be levied or imposed in connection with such transfer.

F. CLOSED PERIODS

The Noteholders may not require transfers to be registered during the period starting on the Record Date and ending on the due date for any payment of principal or interest in respect of the Notes.

G. REGULATIONS CONCERNING TRANSFERS AND REGISTRATION

All transfers of Notes and entries on the Register are subject to the detailed regulations concerning the transfer of Notes scheduled to the Agency Agreement. The regulations may be changed by the Issuer with the prior written approval of the Trustee and the Registrar. A copy of the current regulations will be mailed (free of charge) by the Registrar to any Noteholder who requests in writing a copy of such regulations and is available at the Specified Offices of the Transfer Agents.

4 RESTRICTIVE COVENANT

As provided in the Trust Deed, so long as any of the Notes remains outstanding (as construed in accordance with the Trust Deed), the Issuer will not, without the prior written consent of the Trustee or an Extraordinary Resolution, agree to any amendments to or any modification, rescission, cancellation, termination or waiver of, or authorise any breach by the Borrower of or proposed breach by the Borrower of, the terms of the Loan Agreement (other than in respect of Reserved Rights), and will act at all times in accordance with any instructions of the Trustee from time to time with respect to the Loan Agreement, except as otherwise expressly provided in the Trust Deed or the Loan Agreement, as the case may be. Any such amendment, modification, waiver, rescission, cancellation, termination or authorisation made with the consent of the Trustee shall be binding on the Noteholders and, unless the Trustee agrees otherwise, any such amendment or modification shall be notified by the Issuer to the Noteholders in accordance with Condition 14.

Save as provided above, so long as any Note remains outstanding, the Issuer, without the prior written consent of the Trustee, shall not, *inter alia*, incur any other indebtedness for borrowed moneys other than issues of notes on a limited recourse basis for the sole purpose of making loans to the Borrower, engage in any business (other than entering into any agreements related to the Notes or any other issue of notes as aforesaid and performing any acts incidental to or necessary in connection therewith, including the holding of any security), making the Loan to the Borrower pursuant to the Loan Agreement or any future loans to the Borrower as aforesaid and performing any act incidental to or necessary in connection therewith), declare any dividends, have any subsidiaries or employees (save for its directors), purchase, own, lease or otherwise acquire any real property (including office premises or like facilities), consolidate or merge with any other person or convey or transfer its properties or assets substantially as an entity (to the extent the same is within the control of the Issuer) to any person (otherwise than as contemplated in these Conditions

and the Trust Deed), issue any further shares (to the extent the same is within the control of the Issuer) or make any distribution to its shareholders, give any guarantee or assume any other liability or, except where required under the laws of Luxembourg, petition for any winding-up or bankruptcy.

5 INTEREST

On each Interest Payment Date, or as soon thereafter as the same is received, the Issuer shall account to the Noteholders for an amount equivalent to amounts of interest actually received by or for the account of the Issuer pursuant to the Loan Agreement, which interest under the Loan is equal to 6.95 per cent. per annum (as set out in Clause 4 of the Loan Agreement). Each period from (and including) 18 May 2012 (the “**Issue Date**”) or any Interest Payment Date to (but excluding) the next (or first) Interest Payment Date is herein called an “**Interest Period**”.

If interest is required to be calculated for any period of less than a year, it will be calculated on the basis of a year of 360 days consisting of 12 months of 30 days each and, in the case of an incomplete month, the actual number of days elapsed.

Interest shall cease to accrue on each Note on the due date for redemption unless, upon due presentation, payment is improperly withheld or refused, in which event interest shall accrue (as well after as before judgment) at the rate of interest and at the time as set out in Clause 4 of the Loan Agreement, provided that the Issuer shall account to the relevant Noteholder for an amount equivalent to amounts of interest actually received by or for the account of the Issuer pursuant to the Loan Agreement.

In this Condition 5, “**Interest Payment Date**” means 17 May and 17 November of each year.

6 REDEMPTION

A. SCHEDULED REDEMPTION

Unless previously prepaid or repaid, the Borrower will be required to repay the Loan one Business Day prior to 17 May 2019 (the “**Repayment Date**”) and, subject to such repayment, as set forth in the Loan Agreement, all Notes then outstanding will on the Repayment Date, or as soon thereafter as such repayment of the Loan is actually received, be redeemed or repaid by the Issuer at 100 per cent. of the principal amount thereof, together with accrued interest.

B. EARLY REDEMPTION

If the Loan should become repayable in whole (and be repaid in whole) pursuant to the terms and conditions of the Loan Agreement in advance of the Repayment Date, all Notes then remaining outstanding will thereupon become due and redeemable or repayable at par together with accrued interest and (subject to the Loan being repaid together with accrued interest) shall be redeemed or repaid on the date specified in the Loan Agreement and the Issuer will endeavour to give not less than eight days’ notice thereof to the Trustee and the Noteholders in accordance with Condition 14.

Under the Loan Agreement:

- (i) the Borrower may prepay the Loan in whole (but not in part) in the circumstances set out in Clause 5.2 of the Loan Agreement; and
- (ii) the Issuer may require the Borrower to prepay the Loan in whole (but not in part) in the circumstances set out in Clause 5.3 of the Loan Agreement.

To the extent that the Issuer receives amounts of principal, interest or additional amounts, if any (other than amounts in respect of the Reserved Rights) from the Borrower under the Loan Agreement following prepayment of the Loan, the Issuer shall pay an amount equal to such amounts on the business day (as defined in Condition 7) following receipt of such amounts, subject as provided in Condition 7.

C. CANCELLATION

Clause 5.5 of the Loan Agreement provides that the Borrower or any Subsidiary (as defined in the Loan Agreement) of the Borrower may, among other things, from time to time deliver to the Issuer Notes, having an aggregate principal value of at least U.S.\$1,000,000 together with a request for the

Issuer to present such Notes to the Registrar for cancellation, whereupon the Issuer shall, pursuant to the Agency Agreement, request the Registrar to cancel such Notes. Upon any such cancellation by or on behalf of the Registrar, the principal amount of the Loan corresponding to the principal amount of such Notes surrendered for cancellation shall be extinguished for all purposes as of the date of such cancellation, together with accrued interest (if any) thereon, and no further payment shall be made or required to be made by the Issuer in respect of such Notes.

The Issuer may compel any beneficial owner of Notes initially sold pursuant to Rule 144A under the U.S. Securities Act of 1933 (the “**Securities Act**”) to sell its interest in such Notes, or may sell such interest on behalf of such holder, if such holder is a U.S. person that is not a qualified institutional buyer (as defined in Rule 144A under the Securities Act) and a qualified purchaser (as defined in Section 2(a)(51) of the U.S. Investment Company Act of 1940).

D. CHANGE OF CONTROL

If a Change of Control Put Event (shall have occurred, the holder of a Note will have the option (the “**Change of Control Put Option**”) to require the Issuer to redeem such Note on the Change of Control Put Settlement Date (as defined below) its principal amount together with accrued interest (if any) to (and excluding) the Change of Control Put Settlement Date.

Promptly upon the Issuer becoming aware (either by receiving written notice from the Borrower or otherwise) that a Change of Control Put Event has occurred, the Issuer shall give notice (a “**Change of Control Put Event Notice**”) to the Noteholders in accordance with Condition 14, specifying the details relating to the occurrence of the Change of Control Put Event and the procedure for exercising the Change of Control Put Option.

In order to exercise the Change of Control Put Option, the holder of a Note must deliver no later than 30 days after the Change of Control Put Event Notice is given (the “**Change of Control Put Period**”), to the Specified Office of the Principal Paying Agent, evidence satisfactory to the Principal Paying Agent of such holder’s entitlement to such Note and a duly completed put option exercise notice (a “**Change of Control Put Option Notice**”) specifying the principal amount of the Notes in respect of which the Change of Control Put Option is exercised, in the form obtainable from the Principal Paying Agent. The Principal Paying Agent will provide such Noteholder with a non-transferable receipt. On the Business Day following the end of the Change of Control Put Period, the Principal Paying Agent shall notify in writing the Issuer and the Borrower of the exercise of the Change of Control Put Option specifying the aggregate principal amount of the Notes to be redeemed in accordance with the Change of Control Put Option. Provided that the Notes that are the subject of any such Change of Control Put Option Notice have been delivered to the Principal Paying Agent prior to the expiry of the Change of Control Put Period, then the Issuer shall (subject to the receipt of sufficient funds to do so from the Borrower under the Loan Agreement) redeem all such Notes on the date falling five Business Days from the last day of the Change of Control Put Period (the “**Change of Control Put Settlement Date**”). No Change of Control Put Option Notice, once delivered in accordance with this Condition 6(D), may be withdrawn.

“**Change of Control Put Event**” means the occurrence of a Change of Control (as defined in the Loan Agreement).

E. OPTIONAL REDEMPTION AT THE OPTION OF THE BORROWER IN THE EVENT OF A PUBLIC EQUITY OFFERING

Clause 5.6 of the Loan Agreement provides that the Borrower may at its option, at any time, or from time to time, on or prior to the three year anniversary of the Closing Date (as defined in the Loan Agreement), on the occurrence of a Public Equity Offering (as defined in the Loan Agreement), on giving not less than 10 calendar days’ and not more than 60 calendar days’ prior written notice to the Issuer (which notice shall be irrevocable), prepay up to 35 per cent. of the principal amount of the Loan then outstanding together with the Public Equity Offering Premium (as defined in the Loan Agreement), plus accrued and unpaid interest, if any, and any other amounts due, if any, provided, that:

- (i) after giving effect to any such prepayment the principal amount of the Loan outstanding immediately after the occurrence of such repayment constitutes at least 65 per cent. of the principal amount of the Loan that was outstanding immediately prior to such repayment; and
- (ii) the repayment must occur within 60 days of the date of closing of such Public Equity Offering or the related greenshoe option, whichever is later

(the “**Equity Call Option**”).

The notice to be given by the Borrower (the “**Equity Call Option Notice**”) shall specify the date fixed for prepayment of the Loan, the principal amount of the Loan to be repaid and any additional amounts to be paid. The date for the redemption of the Notes following the exercise of the Equity Call Option (the “**Equity Call Redemption Date**”) shall be the next following Business Day after the date for prepayment of the Loan. Immediately on receipt of the Equity Call Option Notice, the Issuer shall forward it to the Noteholders (in accordance with Condition 14), the Trustee and the Principal Paying Agent. The Issuer shall, subject to receipt of the relevant amounts from the Borrower under the Loan and subject to the terms of this Condition 6(E), redeem the Notes in the principal amount corresponding to the principal amount of the Loan so repaid on the Equity Call Redemption Date together with the accrued and unpaid interest and any other amounts due. The Issuer’s obligations in respect of this Condition 6(E) to redeem and make payment for the Notes shall constitute an obligation only to account to Noteholders on the Equity Call Redemption Date for an amount equivalent to the sums received by or for the account of the Issuer pursuant to the Loan Agreement.

The Trustee shall select the Notes (which must be an Authorised Holding and provided that any unpurchased portion of any Note surrendered is an Authorised Holding) to be redeemed pursuant to this Condition 6(E) on a pro rata basis, or, if the rules of any applicable stock exchange from time to time require, by lot or by such other method as the Trustee in its sole discretion deems fair and appropriate, provided that such method is in compliance with the rules of any stock exchange on which the Notes are listed.

The Issuer will comply, to the extent applicable, with any securities laws or regulations in connection with the redemption of Notes pursuant to this Condition 6(E). To the extent that the provisions of any securities laws or regulations conflict with provisions of this Condition 6(E), the Issuer will comply with the applicable securities laws and regulations and will not be deemed to have breached its obligations hereunder by virtue of any conflict.

7 PAYMENTS

A. PRINCIPAL

Payments of principal shall be made by U.S. Dollar cheque drawn on, or, upon application by a holder of a Note to the Specified Office of the Principal Paying Agent not later than the fifteenth day before the due date for any such payment, by transfer to a U.S. Dollar account maintained by the payee with a bank in New York City upon surrender of the relevant Notes at the specified office of the Principal Paying Agent.

B. INTEREST

Payments of interest shall be made by U.S. Dollar cheque drawn on, or, upon application by a holder of a Note to the Specified Office of the Principal Paying Agent not later than the fifteenth day before the due date for any such payment (the “**Record Date**”), by transfer to a U.S. Dollar account maintained by the payee with a bank in New York City, and (in the case of interest payable on full redemption) upon surrender (or, in the case either of an interest payment prior to full redemption or of part redemption only, endorsement) of the relevant Notes at the specified office of any Paying Agent.

C. PAYMENTS SUBJECT TO FISCAL LAWS

All payments in respect of the Notes are subject in all cases to any applicable fiscal or other laws and regulations in the place of payment, but without prejudice to the provisions of Condition 8. No commissions or expenses shall be charged to the Noteholders in respect of such payments.

D. PAYMENTS ON BUSINESS DAYS

If the due date for payments of interest or principal is not a business day, the holder of a Note shall not be entitled to payment of the amount due until the next following business day and shall not be entitled to any further interest or other payment in respect of any such delay. In this Condition 7, “**business day**” means a day on which (a) U.S. dollar deposits may be dealt in on the London inter-bank market and commercial banks and foreign exchange markets are open in London, and (b) if on that day a payment is to be made hereunder, commercial banks generally are open for business in Luxembourg, New York City and in the city where the Specified Office of the Principal Paying Agent is located.

E. RECORD DATE

Each payment in respect of a Note will be made to the person shown as the holder in the Register at the opening of business (in the place of the Registrar's Specified Office) on the relevant Record Date. Where payment in respect of a Note is to be made by cheque, the cheque will be mailed to the address shown as the address of the holder in the Register at the opening of business on the relevant Record Date.

F. ACCRUED INTEREST

In addition, if the due date for redemption or repayment of a Note is not an Interest Payment Date, interest accrued from the preceding Interest Payment Date or, as the case may be, from the date of issuance of the Notes, shall be payable only as and when actually received by or for the account of the Issuer pursuant to the Loan Agreement.

G. PAYMENTS BY BORROWER

Save as may be directed by the Trustee at any time after the Security Interests become enforceable, the Issuer will require the Borrower to make all payments of principal, interest and additional amounts, if any, to be made pursuant to the Loan Agreement to an account in the name of the Issuer with the Principal Paying Agent. Pursuant to the Charge, the Issuer will charge by way of first fixed charge all its rights, title and interest in and to all sums of money (with the exception of sums relating to the Reserved Rights) then or in the future deposited in such account in favour of the Trustee for the benefit of the Trustee and the Noteholders.

H. SUCCESSOR PAYING AGENTS

The Agency Agreement provides that the Issuer may at any time, with the prior written approval of the Trustee, appoint a successor Registrar or Principal Paying Agent and/or additional or successor Paying Agents or Transfer Agents provided that the Issuer maintains (i) a Principal Paying Agent; (ii) for so long as the Notes are listed and/or admitted to trading on any stock exchange, a Paying Agent as may be required by the rules and regulations of such stock exchange; (iii) a Registrar having a Specified Office outside the United Kingdom; and (iv) a Paying Agent in a European Union member state that will not be obliged to withhold or deduct tax pursuant to any law implementing European Council Directive 2003/48/EC or any other directive regarding the taxation of savings (the "**European Union Savings Directive**") or any law implementing or complying with, or introduced in order to conform to, the European Union Savings Directive. Any such variation, termination or appointment of successor or other Agents shall only take effect (other than in the case of insolvency, when it shall be of immediate effect) after not more than 45 days' and not less than 30 days' notice thereof shall have been given to the continuing Agents, the Borrower, the Trustee and to the Noteholders in accordance with Condition 14.

I. FRACTIONS

Each payment by the Issuer to a Noteholder will be rounded down to the nearest cent.

8 TAXATION

All payments in respect of the Notes by or on behalf of the Issuer shall be made free and clear of, and without deduction or withholding for or on account of, any present or future taxes, duties, assessments or governmental charges of whatever nature imposed, levied, collected, withheld or assessed by or on behalf of Luxembourg or any political subdivision or any authority thereof or therein having the power to tax, unless the deduction or withholding of such taxes or duties is required by law.

In the event any such taxes are required to be deducted or withheld, the Issuer shall, subject as provided below, make such additional payments as shall result in the receipt by the Noteholders of such amount as would have been received by them if no such withholding or deduction had been required. However, the Issuer shall only make such additional payments to the extent and at such time as it shall receive equivalent sums from the Borrower under the Loan Agreement. To the extent that the Issuer receives any such equivalent sum, the Issuer shall account to the relevant Noteholder for an additional amount equivalent to a *pro rata* proportion of such additional amount (if any) as is actually received and retained (net of tax) by, or

for the account of, the Issuer pursuant to the provisions of the Loan Agreement on the date of, in the currency of, and subject to any conditions attaching to the payment of such additional amount to the Issuer; provided that no such additional amount will be payable in respect of any Note:

- (a) to a Noteholder or beneficial owner who (i) is able to avoid such deduction or withholding by satisfying any statutory requirements or by making a declaration of non-residence or other claim for exemption to the relevant tax authority; or (ii) is liable for such taxes or duties by reason of his having some connection with Luxembourg other than the mere holding of such Notes or the receipt of payments in respect thereof (including being resident or national of, or carrying on a business or maintaining a permanent establishment in, or being physically present in Luxembourg);
- (b) in respect of any tax that would not have been imposed but for a failure by the Noteholder or beneficial owner (or any financial institution through which the Noteholder or beneficial owner holds any Note or through which payment on the Note is made) to (i) enter into an agreement described in Section 1471(b)(1) of the U.S. Internal Revenue Code of 1986 (the “Code”) or otherwise comply with Sections 1471 through 1474 of the Code or any regulations promulgated thereunder (or under any implementing legislation adopted by Luxembourg) or (ii) provide information sufficient for the Issuer to determine whether the Noteholder or beneficial owner (or financial institution through which the Noteholder or beneficial owner holds any Note or through which payment on the Note is made) is a U.S. person or should otherwise be treated as holding a “United States account” of the Issuer (or comply with similar requirements under any implementing legislation adopted by Luxembourg);
- (c) in respect of a Certificate presented for payment of principal or interest on redemption more than 30 days after the Relevant Date except to the extent that such additional payment would have been payable if such Certificate had been presented for payment on such 30th day;
- (d) where such withholding or deduction is imposed on a payment to an individual or an entity and is required to be made pursuant to the European Union Savings Directive or any other directive implementing the conclusions of the ECOFIN Council meeting of 26-27 November 2000 or any subsequent meeting of the ECOFIN Council, or any law or regulation implementing or complying with, or introduced in order to conform to, such directives, including the Luxembourg laws of 21 June 2005 and of 23 December 2005; or
- (e) in respect of a Note held by or on behalf of a Noteholder who would have been able to avoid such withholding or deduction by arranging to receive the relevant payment through another Paying Agent in a Member State of the European Union.

As used herein, “**Relevant Date**” means (i) the date on which the equivalent payment under the Loan Agreement first becomes due but (ii) if the full amount payable by the Borrower has not been received by, or for the account of, the Issuer pursuant to the Loan Agreement on or prior to such date, means the date on which such full amount shall have been so received and notice to that effect shall have been duly given to the Noteholders by or on behalf of the Issuer in accordance with Condition 14.

Any reference herein or in the Trust Deed to payments in respect of the Notes shall be deemed also to refer to any additional amounts which may be payable in accordance with the Trust Deed and this Condition 8 or any undertaking given in addition thereto or in substitution therefor pursuant to the Trust Deed. If the Issuer becomes resident for tax purposes in any taxing jurisdiction other than or in addition to Luxembourg, references in these Conditions to Luxembourg shall be construed as references to Luxembourg and/or such other jurisdiction.

9 ENFORCEMENT

The Trust Deed provides that only the Trustee (subject to Condition 1) may pursue remedies under general law, the Trust Deed or the Notes to enforce the rights of the Noteholders and no Noteholder will be entitled to pursue such remedies unless the Trustee (having become bound to do so in accordance with the terms of the Trust Deed) fails or neglects to do so within a reasonable period and such failure or neglect is continuing.

The Trust Deed also provides that, at any time after an Event of Default has occurred and for so long as it is continuing or at any time after a Relevant Event has occurred, the Trustee may, at its discretion, and shall, if requested to do so by Noteholders whose Notes constitute at least 25 per cent. in aggregate principal amount of the Notes then outstanding, or if directed to do so by an Extraordinary Resolution and, in either case, subject to it being indemnified and/or secured and/or pre-funded to its satisfaction, institute such actions, steps or proceedings as it may think fit to enforce the rights of the Noteholders and the provisions of the

Trust Deed, including to (i) declare all amounts payable under the Loan Agreement by the Borrower to be immediately due and payable (in the case of an Event of Default); and/or (ii) exercise any rights under the Security Interests created in the Trust Deed in favour of the Trustee (in the case of a Relevant Event). Upon repayment of the Loan following an Event of Default and a declaration as provided herein, the Notes will be, subject to the provisions of the Trust Deed and these Conditions, redeemed or repaid at their principal amount, together with accrued interest thereon and thereupon shall cease to be outstanding.

10 MEETINGS OF NOTEHOLDERS; MODIFICATION; WAIVER; SUBSTITUTION OF THE ISSUER

A. MEETINGS OF NOTEHOLDERS

The Trust Deed contains provisions for convening meetings of Noteholders to consider any matter affecting their interests hereunder, including any modification of, or any arrangement in respect of, the Notes, the Loan Agreement or the Trust Deed. Noteholders will, in respect of any vote by poll, be entitled to one vote per U.S.\$1,000 in principal amount of each Note held or owned by them or in respect of which they are a proxy or a representative. The Trust Deed provides that special quorum provisions apply for meetings of Noteholders convened for the purpose of amending certain terms concerning, *inter alia*, the amount payable on, and the currency of payment in respect of, the Notes and the amounts payable and currency of payment under the Loan Agreement. Any resolution duly passed at a meeting of Noteholders will be binding on all the Noteholders, whether present or not.

The Trust Deed provides that a Written Resolution (as defined in the Trust Deed) passed by holders of in aggregate not less than 75 per cent. of the aggregate principal amount outstanding of the Notes shall have effect as an Extraordinary Resolution.

B. MODIFICATION AND WAIVER

The Trustee may agree, without the consent of the Noteholders (, to any modification of the Notes and the Trust Deed, the Agency Agreement or the Loan Agreement which in the opinion of the Trustee is of a formal, minor or technical nature, is made to correct a manifest error or (in the opinion of the Trustee and save as provided in the Trust Deed) is not materially prejudicial to the interests of the Noteholders. The Trustee may also waive or authorise or agree to the waiving or authorising of any breach or proposed breach by the Issuer of the Conditions, or the Trust Deed or by the Borrower of the terms of the Loan Agreement or determine that any event which would or might otherwise give rise to (i) an Event of Default under the Loan Agreement or (ii) a Relevant Event shall not be treated as such, if in the sole opinion of the Trustee, to do so would not be materially prejudicial to the interests of the Noteholders (as a class); provided always that (subject to certain exceptions) the Trustee may not exercise such power of waiver in contravention of a request given by the holders of at least 25 per cent. in aggregate principal amount of the Notes then outstanding or of any express direction by an Extraordinary Resolution of the Noteholders. Any such modification, waiver or authorisation shall be binding on the Noteholders and, unless the Trustee agrees otherwise, shall be notified to the Noteholders as soon as practicable thereafter in accordance with Condition 14.

C. SUBSTITUTION

The Trust Deed contains provisions to the effect that the Issuer may, having obtained the prior written consent of the Borrower and the Trustee (which latter consent may be given without the consent of the Noteholders) and subject to having complied with certain requirements as set out therein, including the substitute obligor's rights under the Loan Agreement being charged and assigned, respectively, to the Trustee as security for the payment obligations of the substitute obligor under the Trust Deed and the Notes, substitute any entity in place of the Issuer as creditor under the Loan Agreement, as issuer and principal obligor in respect of the Notes and as obligor under the Trust Deed. Not later than 14 days after compliance with the aforementioned requirements, notice thereof shall be given by the Issuer to the Noteholders in accordance with Condition 14 or the Issuer shall use its best endeavours to ensure that the substitute obligor does so.

D. EXERCISE OF POWERS

In connection with the exercise of any of its powers, trusts, authorities or discretions, the Trustee shall have regard to the interests of the Noteholders as a class and, in particular, shall not be obliged to have

regard to the consequences of such exercise for individual Noteholders resulting from their being for any purpose domiciled or resident in, or otherwise connected with, or subject to the jurisdiction of, any particular territory. No Noteholder is entitled to claim from the Issuer, the Borrower or the Trustee any indemnification or payment in respect of any tax consequence of any such exercise upon individual Noteholders.

11 PRESCRIPTION

Notes will become void unless presented for payment within ten years (in the case of principal) or five years (in the case of interest) from the due date for payment in respect thereof.

12 TRUSTEE AND AGENTS

The Trust Deed contains provisions for the indemnification of the Trustee and for its relief from responsibility in certain circumstances, including provisions relieving it from taking any steps or actions including proceedings to enforce payment unless indemnified and/or secured and/or pre-funded to its satisfaction, and to be paid its costs and expenses in priority to the claims of Noteholders. In addition, the Trustee is entitled to enter into business transactions with the Issuer and/or the Borrower and any entity relating to the Issuer and/or the Borrower without accounting for any profit.

The Trustee's responsibilities are solely those of trustee for the Noteholders on the terms of the Trust Deed. Accordingly, the Trustee makes no representations and assumes no responsibility for the validity or enforceability of the Loan Agreement or the security created in respect thereof or for the performance by the Issuer of its obligations under or in respect of the Notes and the Trust Deed or by the Borrower in respect of the Loan Agreement. The Trustee is entitled to assume that the Borrower is performing all of its obligations pursuant to the Loan Agreement (and shall not incur liability for doing so until it has actual knowledge to the contrary).

The Trustee shall have no liability to Noteholders for any shortfall they may suffer if it is liable for tax in respect of any payments received by it or as a result of the Security Interests being enforced by it.

The Trust Deed contains provisions for the appointment of new trustees by the Issuer (subject to approval by an Extraordinary Resolution of Noteholders) and for the removal of a Trustee by a meeting of Noteholders passing an Extraordinary Resolution, provided that in the case of the removal of a Trustee, at all times there remains a trustee (being a trust corporation (as defined in the Trust Deed)) in office after such removal. Any appointment or removal of a Trustee shall be notified to the Noteholders in accordance with Condition 14. The Trustee may also resign its appointment giving not less than three months' notice to the Noteholders provided that such resignation shall not become effective unless there remains a Trustee in office after such resignation.

In acting under the Agency Agreement and in connection with the Notes, the Agents act solely as agents of the Issuer and (to the extent provided therein) the Trustee and do not assume any obligations towards or relationship of agency or trust for or with any of the Noteholders.

Notice of any change in any of the Agents or in their Specified Offices shall promptly be given by the Issuer to the Noteholders in accordance with Condition 14.

13 REPLACEMENT OF CERTIFICATES

If a Certificate shall become mutilated, defaced, lost, stolen or destroyed it may, subject to all applicable laws and regulations and requirements of any stock exchange on which the Notes are from time to time listed or quoted, be replaced at the Specified Office of the Registrar and the Transfer Agent having its Specified Office at 2, boulevard Konrad Adenauer, L-1115 Luxembourg (or any other place of which notice shall have been given to the Noteholders in accordance with Condition 14), on payment of such costs, expenses, taxes and duties as may be incurred in connection therewith and on such terms as to evidence, security and indemnity and otherwise as may reasonably be required by or on behalf of the Issuer or the Trustee. Mutilated or defaced Certificates must be surrendered before replacements will be issued.

14 NOTICES

Notices to the Noteholders will be sent to them by first class mail (or its equivalent) or (if posted to an overseas address) by airmail at their respective addresses on the relevant Register. Any such notice shall be deemed to have been given on the fourth day after the date of mailing. The Issuer shall also ensure that all

notices are duly published (if such publication is required) in a manner which complies with the rules and regulations of any stock exchange or other relevant authority on which the Notes are for the time being listed and/or admitted to trading. Any such notice shall be deemed to have been given on the date of such notice.

In the case by reason of any other cause it shall be impracticable to publish any notice to holders of Notes as provided above, then such notification as shall be given with the approval of the Trustee in accordance with the rules of the stock exchange on which the Notes are for the time being listed or quoted or other relevant authority shall constitute sufficient notice to such holders for every purpose hereunder.

15 FURTHER ISSUES

The Issuer may from time to time, with the consent of the Borrower but without the consent of the Noteholders, create and issue further notes or bonds having the same terms and conditions as the Notes in all respects (or in all respects except for the first payment of interest on them) so as to be consolidated and form a single series with the Notes. Such further Notes shall be issued under a deed supplemental to the Trust Deed. In relation to any further issue which is to be consolidated and form a single series with the Notes, the Issuer will enter into a loan agreement with the Borrower on the same terms as the Loan Agreement and supplemental to the Loan Agreement, or may amend and restate the same with the Borrower on substantially the same terms as the Loan Agreement. The Issuer will provide a fixed charge in favour of the Trustee in respect of certain of its rights and interests under such loan agreement and will assign absolutely certain of its rights under such loan agreement, which will secure both the Notes and such further Notes and which will supplement the Security Interests in relation to the existing Notes or may amend and supplement the Security Interests for such purpose. Any such further securities intended to be consolidated and form a single series with the Notes or any other outstanding securities constituted by the Trust Deed or any deed supplemental to it shall, and any other securities may (with the prior written consent of the Trustee), be constituted by a deed supplemental to the Trust Deed containing such provisions as the Trustee may reasonably require. The Trust Deed contains provisions for convening a single meeting of the Noteholders and the holders of securities of other series where the Trustee so decides. Application will be made for such further notes or bonds to be listed and admitted to trading on the stock exchange on which the Notes are from time to time listed or quoted. Any further securities forming a single series with the outstanding securities of any series (including the Notes) will have a separate CUSIP number unless (i) the further securities have no more than a de minimis amount of original issue discount for U.S. federal income tax purposes or (ii) the issuance of such further securities would be fungible with the Notes for U.S. federal income tax purposes.

16 CONTRACTS (RIGHTS OF THIRD PARTIES) ACT 1999

No person shall have any right to enforce any term or condition of the Notes under the Contracts (Rights of Third Parties) Act 1999.

17 GOVERNING LAW

The Notes and the Trust Deed and any non-contractual obligations arising out of or in connection with them shall be governed by, and construed in accordance with, English law. The provisions of Articles 86 to 94-8 of the Luxembourg law on commercial companies of 10 August 1915, as amended, are excluded. The Issuer has submitted in the Trust Deed to the jurisdiction of the courts of England and has appointed an agent for the service of process in England.

SUMMARY OF THE PROVISIONS RELATING TO THE NOTES IN GLOBAL FORM

The following is a summary of the provisions to be contained in the Trust Deed to constitute the Notes and in the Global Certificates which will apply to, and in some cases modify, the Conditions while the Notes are represented by the Global Certificates.

The Global Certificates

The Regulation S Notes will be evidenced on issue by the Regulation S Global Certificate deposited with, and registered in the name of a nominee for a common depository for Euroclear and Clearstream, Luxembourg. Beneficial interests in the Regulation S Global Certificate may be held only through Euroclear or Clearstream, Luxembourg at any time. See “—*Book-Entry Procedures for the Global Certificates.*” By acquisition of a beneficial interest in the Regulation S Global Certificate, the purchaser thereof will be deemed to represent, among other things, that it is not a U.S. person, that it is located outside the United States and that, prior to the expiration of the “distribution compliance period” (as such term is defined in Rule 902 of Regulation S), it will not offer, sell, pledge or otherwise transfer such interest only (a) to a non-U.S. person in an offshore transaction in accordance with Rule 903 or Rule 904 of Regulation S or (b) in accordance with Rule 144A to a person that it and any person acting on its behalf reasonably believe is a QIB that is also a QP purchasing for its own account or the account of a QIB that is also a QP, in each case in accordance with any applicable securities laws of any state of the United States. See “*Transfer Restrictions.*”

The Rule 144A Notes will be evidenced on issue by the Rule 144A Global Certificate deposited with a custodian for, and registered in the name of Cede & Co. as a nominee for DTC. Beneficial interests in the Rule 144A Global Certificate may only be held through DTC at any time. See “—*Book-Entry Procedures for the Global Certificates.*” By acquisition of a beneficial interest in the Rule 144A Global Certificate, the purchaser thereof will be deemed to represent, among other things, that it is a QIB that is also a QP and that, if in the future it determines to transfer such beneficial interest, it will transfer such interest in accordance with the procedures and restrictions contained in the Agency Agreement. See “*Transfer Restrictions.*”

Beneficial interests in Global Certificates will be subject to certain restrictions on transfer set forth therein and in the Trust Deed and the Agency Agreement, and the Rule 144A Global Certificate will bear the applicable legend regarding the restrictions set forth under “*Transfer Restrictions.*” Beneficial interest in the Regulation S Global Certificate may be transferred to a person who takes delivery in the form of an interest in the Rule 144A Global Certificate in denominations greater than or equal to the minimum denominations applicable to interests in the Rule 144A Global Certificate only and only upon receipt by the Registrar of a written certification (in the form provided in the Agency Agreement) to the effect that the transferor reasonably believes that the transferee is a QIB that is also a QP and that such transaction is in accordance with any applicable securities laws of any State of the United States or any other jurisdiction. Beneficial interests in the Rule 144A Global Certificate may be transferred to a person who takes delivery in the form of an interest in the Regulation S Global Certificate only upon receipt by the Registrar of a written certification (in the form provided in the Agency Agreement) from the transferor to the effect that the transfer is being made to a non-U.S. person and in accordance with Regulation S.

Any beneficial interest in the Regulation S Global Certificate that is transferred to a person who takes delivery in the form of an interest in the Rule 144A Global Certificate will, upon transfer, cease to be an interest in the Regulation S Global Certificate and become an interest in the Rule 144A Global Certificate, and, accordingly, will thereafter be subject to all transfer restrictions and other procedures applicable to beneficial interests in the Rule 144A Global Certificate for as long as it remains such an interest. Any beneficial interest in the Rule 144A Global Certificate that is transferred to a person who takes delivery in the form of an interest in the Regulation S Global Certificate will, upon transfer, cease to be an interest in the Rule 144A Global Certificate and become an interest in the Regulation S Global Certificate and, accordingly, will thereafter be subject to all transfer restrictions and other procedures applicable to beneficial interests in the Regulation S Global Certificate for so long as it remains such an interest. No service charge will be made for any registration of transfer or exchange of the Notes, but the Registrar may require payment of a sum sufficient to cover any tax or other governmental charge payable in connection therewith.

Except in the limited circumstances described below, owners of beneficial interests in Global Certificates will not be entitled to receive physical delivery of Definitive Certificates. The Notes are not issuable in bearer form.

The Regulation S Global Certificate is evidence of entitlement only and it is not a document of title.

In addition, the Global Certificates will contain a provision which modifies the Conditions as they apply to the Notes evidenced by the Global Certificates. The following is a summary of those provisions:

Payments

All payments in respect of Notes represented by a Global Certificate will be made to, or to the order of, the person whose name is entered on the Register at the close of business on the Clearing System Business Day immediately prior to the date for payment, where “**Clearing System Business Day**” means Monday to Friday inclusive except 25 December and 1 January.

Meetings

The holder of the Global Certificates and any proxy appointed by it will be treated as being one person for the purposes of any quorum requirements of, or the right to demand a poll at, a meeting of the Noteholders and, in any such meeting, as having one vote in respect of each Note represented by the Global Certificates for which it may be exchanged.

Purchase and Cancellation

Cancellation of any Notes evidenced by the Global Certificates required by the Conditions to be cancelled following its redemption will be effected by reduction in the principal amount of the Notes in the Register and notation of the Global Certificates.

Trustee’s Powers

In considering the interests of the Noteholders, the Trustee may, to the extent it considers it appropriate to do so in the circumstances, (a) have regard to such information as may have been made available to it by or on behalf of the relevant clearing system or its operator as to the identity of its accountholders (either individually or by way of category) with entitlements in respect of the Notes; and (b) consider such interests on the basis that such accountholders were the holders of the Notes in respect of which the Global Certificates are issued.

Notices

Notwithstanding Condition 14, so long as the Global Certificates are held by or on behalf of DTC, Euroclear, Clearstream, Luxembourg or any other clearing system (an “**Alternative Clearing System**”), notices to the Noteholders represented by the Global Certificate may be given by delivery of the relevant notice to DTC, Euroclear, Clearstream, Luxembourg or (as the case may be) such Alternative Clearing System, provided that whilst the Notes are listed on the Irish Stock Exchange, notices will also be given in accordance with the guidelines of the Irish Stock Exchange.

Prescription

Claims in respect of principal, interest and other amounts payable in respect of the Global Certificates will become void unless they are presented for payment within a period of 10 years (in the case of principal) and five years (in the case of interest or any other amounts) from the due date for payment in respect thereof.

Redemption at the Option of Noteholders

The option of the Noteholders provided for in Condition 6(D) may be exercised by the holder of the Global Certificates giving notice to the Principal Paying Agent within the time limits relating to the deposit of Notes as set out in Condition 6(D), substantially in the form of the Change of Control Put Exercise Notice available from the Principal Paying Agent and stating the principal amount of the Notes in respect of which the option is exercised and at the same time presenting the Global Certificates to the Principal Paying Agent for annotation.

Without prejudice to the above provisions, for so long as all of the Notes are represented by the Global Certificates and the Global Certificates are held on behalf of Euroclear and/or Clearstream, Luxembourg or by or on behalf of a custodian for DTC, the option of the Noteholders provided for in Condition 6(D) may be exercised by an accountholder giving notice to the Principal Paying Agent in accordance with the standard procedure of Euroclear, Clearstream, Luxembourg or DTC, as the case may be, (which may include notice being given on his instruction by Euroclear, Clearstream, Luxembourg or DTC, as the case may be, or any common depository or

custodian for it to the Principal Paying Agent by electronic means) and in a form acceptable to Euroclear, Clearstream, Luxembourg or DTC, as the case may be, of the principal amount of the Notes in respect of which such option is exercised and at the same time presenting or procuring the presentation of the Global Certificates to the Principal Paying Agent for notation accordingly within the time limits set forth in that Condition.

Enforcement

For the purposes of enforcement of the provisions of the Trust Deed against the Trustee, the persons named in a certificate of the holder of the Notes in respect of which the Global Certificates are issued shall be recognised as the beneficiaries of the trusts set out in the Trust Deed to the extent of the principal amount of their interest in the Notes set out in the certificate of the holder as if they were themselves the holders of the Notes in such principal amounts.

Exchange for Definitive Certificates

Exchange

Subject to receipt by the Issuer of the funds necessary to cover the costs therefor from Sistema JSFC, each Global Certificate will be exchangeable, free of charge to the holder, on or after its Exchange Date (as defined below), in whole but not in part, for the Notes in definitive form if: (i) the relevant Global Certificate is held by or on behalf of (A) DTC, and DTC notifies the Issuer that it is no longer willing or able to discharge properly its responsibilities as depositary with respect to such Global Certificate or ceases to be a “clearing agency” registered under the Exchange Act or if at any time it is no longer eligible to act as such, and the Issuer is unable to locate a qualified successor within 90 days of receiving notice or becoming aware of such ineligibility on the part of DTC or (B) Euroclear or Clearstream, Luxembourg, as the case may be, is closed for business for a continuous period of 14 days (other than by reason of holidays, statutory or otherwise) or announces an intention permanently to cease business or does in fact do so, by the holder giving notice to the Registrar or any Transfer Agent, or (ii) the Issuer would suffer a material disadvantage in respect of the Notes as result of a change in the laws or regulations (taxation or otherwise) of any jurisdiction referred to in Condition 8 which would not be suffered were the Notes in definitive form and a certificate to such effect signed by two Directors of the Issuer is delivered to the Trustee, by the Issuer giving notice to the Registrar or any Transfer Agent and the Noteholders, of its intention to exchange the relevant Global Certificate for Definitive Certificates on or after the Exchange Date (as defined below) specified in the notice.

On or after the Exchange Date the holder of the relevant Global Certificate may surrender such Global Certificate to or to the order of the Registrar or any Transfer Agent. In exchange for the relevant Global Certificate, as provided in the Agency Agreement, the Registrar will deliver or procure the delivery of, an equal aggregate principal amount of duly executed and authenticated Definitive Certificates in or substantially in the form set out in the relevant Schedule to the Trust Deed.

The Registrar will not register the transfer of, or exchange of interests in, a Global Certificate for Definitive Certificates for a period of 15 calendar days ending on the date for any payment of principal or interest in respect of the Notes.

If only one of the Global Certificates (the “**Exchanged Global Certificate**”) becomes exchangeable for Definitive Certificates in accordance with the above paragraphs, transfers of the Notes may not take place between, on the one hand, persons holding Definitive Certificates issued in exchange for beneficial interests in the Exchanged Global Certificate and, on the other hand, persons wishing to purchase beneficial interests in the other Global Certificate.

“**Exchange Date**” means a day falling not later than 90 days after that on which the notice requiring exchange is given and on which banks are open for business in the city in which the specified office of the Registrar or the relevant Transfer Agent is located.

Delivery

In such circumstances, the relevant Global Certificate shall be exchanged in full for Definitive Certificates and the Issuer will, at the cost of the Issuer (but against such indemnity as the Registrar or any relevant Transfer Agent may require in respect of any tax or other duty of whatever nature which may be levied or imposed in connection with such exchange), cause sufficient Definitive Certificates to be executed and delivered to the

Registrar for completion, authentication and dispatch to the relevant Noteholders. A person having an interest in a Global Certificate must provide the Registrar with (a) a written order containing instructions and such other information as the Issuer and the Registrar may require to complete, execute and deliver such Notes and (b) in the case of the Rule 144A Global Certificate only, a fully completed, signed certification substantially to the effect that the exchanging holder is not transferring its interest at the time of such exchange or, in the case of simultaneous sale pursuant to Rule 144A, a certification that the transfer is being made in compliance with the provisions of Rule 144A to a QIB that is also a QP. Definitive Certificates issued in exchange for a beneficial interest in the Rule 144A Global Certificate shall bear the legend applicable to transfer pursuant to Rule 144A, as set out under “Transfer Restrictions.”

Legends

The holder of a Definitive Certificate may transfer the Notes evidenced thereby in whole or in part in the applicable minimum denomination by surrendering it at the specified office of the Registrar or any Transfer Agent, together with the completed form of transfer thereon. Upon the transfer, exchange or replacement of a Rule 144A Definitive Certificate bearing the legend referred to under “Transfer Restrictions,” or upon specific request for removal of the legend on a Rule 144A Definitive Certificate, the Issuer will deliver only Rule 144A Definitive Certificates that bear such legend, or will refuse to remove such legend, as the case may be, unless there is delivered to the Issuer and the Registrar the relevant transfer certificate (in the form provided in the Agency Agreement) and such satisfactory evidence, which may include an opinion of counsel, as may reasonably be required by the Issuer that neither that legend nor the restrictions on transfer set forth therein are required to ensure compliance with the provisions of the Securities Act and the Investment Company Act.

Book-Entry Procedures for the Global Certificates

Euroclear, Clearstream, Luxembourg and DTC

Custodial and depository links have been established between Euroclear, Clearstream, Luxembourg and DTC to facilitate the initial issue of the Notes and cross-market transfers of the Notes associated with secondary market trading. See “—*Book-Entry Ownership—Settlement and Transfer of the Notes.*”

Euroclear and Clearstream, Luxembourg

Euroclear and Clearstream, Luxembourg each hold securities for their customers and facilitate the clearance and settlement of securities transactions through electronic book-entry transfer between their respective accountholders. Indirect access to Euroclear and Clearstream, Luxembourg is available to other institutions which clear through or maintain a custodial relationship with an accountholder of either system. Euroclear and Clearstream, Luxembourg provide various services including safekeeping, administration, clearance and settlement of internationally-traded securities and securities lending and borrowing. Euroclear and Clearstream, Luxembourg also deal with domestic securities markets in several countries through established depository and custodial relationships. Euroclear and Clearstream, Luxembourg have established an electronic bridge between their two systems across which their respective customers may settle trades with each other. Their customers are worldwide financial institutions including underwriters, securities brokers and dealers, banks, trust companies and clearing corporations. Investors may hold their interests in such Global Certificates directly through Euroclear or Clearstream, Luxembourg if they are accountholders (“**Direct Participants**”) or indirectly (“**Indirect Participants**”) and together with Direct Participants, (“**Participants**”) through organisations which are accountholders therein.

DTC

DTC has advised the Issuer as follows: DTC is a limited purpose trust company organised under the laws of the State of New York, a “banking organisation” under the laws of the State of New York, a member of the U.S. Federal Reserve system, a “clearing corporation” within the meaning of the New York Uniform Commercial Code and a “clearing agency” registered pursuant to the provisions of Section 17A of the Exchange Act. DTC was created to hold securities for its participants and facilitate the clearance and settlement of securities transactions between Participants through electronic computerised book-entry changes in accounts of its participants, thereby eliminating the need for physical movement of certificates. Participants include securities brokers and dealers, banks, trust companies, clearing corporations and certain other organisations. Indirect access to DTC is available to others, such as banks, securities brokers, dealers and trust companies, that clear through or maintain a custodial relationship with a DTC Direct Participant, either directly or indirectly.

Investors may hold their interests in the Rule 144A Global Certificate directly through DTC if they are Direct Participants in the DTC system, or as Indirect Participants through organisations which are Direct Participants in such system.

DTC has advised the Issuer that it will take any action permitted to be taken by a holder of the Notes only at the direction of one or more Direct Participants and only in respect of such portion of the aggregate principal amount of the relevant Rule 144A Global Certificates as to which such participant or participants has or have given such direction. However, in the circumstances described under “Exchange for Definitive Certificates,” DTC will surrender the relevant Rule 144A Global Certificates for exchange for individual Rule 144A Definitive Certificates (which will bear the legend applicable to transfers pursuant to Rule 144A).

Book-Entry Ownership

Euroclear and Clearstream, Luxembourg

The Regulation S Global Certificate will have an ISIN and a Common Code and will be registered in the name of a nominee for, and deposited with Deutsche Bank AG, London Branch as common depository on behalf of, Euroclear and Clearstream, Luxembourg.

DTC

The Rule 144A Global Certificate will have an ISIN and a CUSIP number and will be deposited with Deutsche Bank Trust Company Americas, as custodian (the “**DTC Custodian**”) for, and registered in the name of Cede & Co. as nominee of, DTC. The DTC Custodian and DTC will electronically record the principal amount of the Notes held within the DTC System.

Relationship of Participants with Clearing Systems

Each of the persons shown in the records of Euroclear, Clearstream, Luxembourg or DTC as the holder of a Note evidenced by a Global Certificate must look solely to Euroclear, Clearstream, Luxembourg or DTC (as the case may be) for his share of each payment made by the Issuer to the holder of such Global Certificate and in relation to all other rights arising under the Global Certificate, subject to and in accordance with the respective rules and procedures of Euroclear, Clearstream, Luxembourg or DTC (as the case may be). The Issuer expects that, upon receipt of any payment in respect of the Notes evidenced by a Global Certificate, the common depository by whom such Note is held, or nominee in whose name it is registered, will immediately credit the relevant participants’ or accountholders’ accounts in the relevant clearing system with payments in amounts proportionate to their respective beneficial interests in the principal amount of the relevant Global Certificate as shown on the records of the relevant clearing system or its nominee. The Issuer also expects that payments by Direct Participants in any clearing system to owners of beneficial interests in any Global Certificate held through such Direct Participants in any clearing system will be governed by standing instructions and customary practices. Save as aforesaid, such persons shall have no claim directly against the Issuer in respect of payments due on the Notes for so long as the Notes are evidenced by such Global Certificate and the obligations of the Issuer will be discharged by payment to the registered holder, as the case may be, of such Global Certificate in respect of each amount so paid. None of the Issuer, the Trustee or any Agent will have any responsibility or liability for any aspect of the records relating to or payments made on account of ownership interests in any Global Certificate or for maintaining, supervising or reviewing any records relating to such ownership interests.

Settlement and Transfer of the Notes

Subject to the rules and procedures of each applicable clearing system, purchases of the Notes held within a clearing system must be made by or through Direct Participants, which will receive a credit for such Notes on the clearing system’s records. The ownership interest of each actual purchaser of each such Note (the “**Beneficial Owner**”) will in turn be recorded on the Direct and Indirect Participants’ records. Beneficial Owners will not receive written confirmation from any clearing system of their purchase, but Beneficial Owners are expected to receive written confirmations providing details of the transaction, as well as periodic statements of their holdings, from the Direct or Indirect Participant through which such Beneficial Owner entered into the transaction. Transfers of ownership interests in the Notes held within the clearing system will be effected by entries made on the books of Participants acting on behalf of Beneficial Owners. Beneficial Owners will not receive certificates representing their ownership interests in such Notes, unless and until interests in any Global Certificate held within a clearing system are exchanged for Definitive Certificate.

No clearing system has knowledge of the actual Beneficial Owners of the Notes held within such clearing system and their records will reflect only the identity of the Direct Participants to whose accounts such Notes are credited, which may or may not be the Beneficial Owners. The Participants will remain responsible for keeping account of their holdings on behalf of their customers. Conveyance of notices and other communications by the clearing systems to Direct Participants, by Direct Participants to Indirect Participants, and by Direct Participants and Indirect Participants to Beneficial Owners, will be governed by arrangements among them, subject to any statutory or regulatory requirements as may be in effect from time to time.

The laws of some jurisdictions may require that certain persons take physical delivery in definitive form of securities. Consequently, the ability to transfer interests in a Global Certificate to such persons may be limited. Because DTC can only act on behalf of Direct Participants, who in turn act on behalf of Indirect Participants, the ability of a person having an interest in the Rule 144A Global Certificate to pledge such interest to persons or entities that are not participants in DTC, or otherwise take actions in respect of such interest, may be affected by a lack of physical certificate in respect of such interest.

Trading between Euroclear and/or Clearstream, Luxembourg Participants

Secondary market sales of book-entry interests in the Notes held through Euroclear or Clearstream, Luxembourg to purchasers of book-entry interests in the Notes held through Euroclear or Clearstream, Luxembourg will be conducted in accordance with the normal rules and operating procedures of Euroclear and Clearstream, Luxembourg and will be settled using the procedures applicable to conventional eurobonds.

Trading between DTC Participants

Secondary market sales of book-entry interests in the Notes between DTC participants will occur in the ordinary way in accordance with DTC rules and will be settled using the procedures applicable to United States corporate debt obligations in DTC's Same Day Funds Settlement system in same day funds, if payment is effected in U.S. dollars, or free of payment, if payment is not effected in U.S. dollars. Where payment is not effected in U.S. dollars, separate payment arrangements outside DTC are required to be made between the DTC participants.

Trading between DTC seller and Euroclear/Clearstream, Luxembourg purchaser

When book-entry interests in the Notes are to be transferred from the account of a DTC participant holding a beneficial interest in the Rule 144A Global Certificate to the account of a Euroclear or Clearstream, Luxembourg accountholder wishing to purchase a beneficial interest in the Regulation S Global Certificate (subject to the certification procedures provided in the Agency Agreement), the DTC participant will deliver instructions for delivery to the relevant Euroclear or Clearstream, Luxembourg accountholder to DTC by 12:00 p.m., New York time, on the settlement date. Separate payment arrangements are required to be made between the DTC participant and the relevant Euroclear or Clearstream, Luxembourg participant. On the settlement date, the custodian of the Rule 144A Global Certificate will instruct the Registrar to (i) decrease the amount of the Notes registered in the name of Cede & Co. and evidenced by the Rule 144A Global Certificate of the relevant class and (ii) increase the amount of the Notes registered in the name of the nominee of the common depository for Euroclear and Clearstream, Luxembourg and evidenced by the Regulation S Global Certificate. Book-entry interests will be delivered free of payment to Euroclear or Clearstream, Luxembourg, as the case may be, for credit to the relevant accountholder on the first business day following the settlement date.

Trading between Euroclear/Clearstream, Luxembourg seller and DTC purchaser

When book-entry interests in the Notes are to be transferred from the account of a Euroclear or Clearstream, Luxembourg accountholder to the account of a DTC participant wishing to purchase a beneficial interest in the Rule 144A Global Certificate (subject to the certification procedures provided in the Agency Agreement), the Euroclear or Clearstream, Luxembourg participant must send to Euroclear or Clearstream, Luxembourg delivery free of payment instructions by 7:45 p.m., Brussels or Luxembourg time, one business day prior to the settlement date. Euroclear or Clearstream, Luxembourg, as the case may be, will in turn transmit appropriate instructions to the common depository for Euroclear and Clearstream, Luxembourg and the Registrar to arrange delivery to the DTC participant on the settlement date. Separate payment arrangements are required to be made between the DTC participant and the relevant Euroclear or Clearstream, Luxembourg accountholder, as the case may be. On the settlement date, the common depository for Euroclear and Clearstream, Luxembourg will (a) transmit appropriate instructions to the custodian of the Rule 144A Global Certificate who will in turn deliver such book-entry interests in the Notes free of payment to the relevant account of the DTC participant and (b) instruct the

Registrar to (i) decrease the amount of the Notes registered in the name of the nominee of the common depositary for Euroclear and Clearstream, Luxembourg and evidenced by the Regulation S Global Certificate; and (ii) increase the amount of the Notes registered in the name of Cede & Co. and evidenced by the Rule 144A Global Certificate.

Although Euroclear, Clearstream, Luxembourg and DTC have agreed to the foregoing procedures in order to facilitate transfers of beneficial interest in Global Certificates among participants and accountholders of Euroclear, Clearstream, Luxembourg and DTC, they are under no obligation to perform or continue to perform such procedure, and such procedures may be discontinued at any time. None of the Issuer, the Trustee or any Agent will have the responsibility for the performance by Euroclear, Clearstream, Luxembourg or DTC or their respective Direct or Indirect Participants of their respective obligations under the rules and procedures governing their operations.

SUBSCRIPTION AND SALE

Deutsche Bank AG, London Branch, Morgan Stanley & Co. International plc and VTB Capital plc (together the “**Joint Lead Managers**”) have, pursuant to a subscription agreement dated 16 May 2012 (the “**Subscription Agreement**”) and made between the Issuer, Sistema and the Joint Lead Managers upon the terms and subject to the conditions therein, severally but not jointly agreed to subscribe and pay for the Notes at the issue price of 100% of their principal amount.

The Joint Lead Managers are entitled to certain commissions and reimbursement of certain expenses from the Issuer. The Issuer is required to be put in funds in respect of such commissions and expenses of the Joint Lead Managers by Sistema. The Joint Lead Managers are entitled in certain circumstances to be released and discharged from their obligations under the Subscription Agreement prior to the closing of the issue of the Notes.

Selling Restrictions

United States of America

The Notes and the Loan have not been and will not be registered under the Securities Act or the securities laws of any State or other jurisdiction of the United States, and may not be offered or sold within the United States or to, or for the account or benefit of, U.S. persons except pursuant to an exemption from, or in a transaction not subject to, the registration requirements of the Securities Act. Terms used in this paragraph have the meanings given to them by Regulation S.

Each Joint Lead Manager has severally agreed that, except as permitted by the Subscription Agreement, it will not offer or sell the Notes (i) as part of their distribution at any time or (ii) otherwise until 40 days after the later of the commencement of the offering and the date the Notes are issued, within the United States or to, or for the account or benefit of, U.S. persons, and it will have sent to each dealer to which it sells the Notes (other than a sale pursuant to Rule 144A) during the distribution compliance period a confirmation or other notice setting forth the restrictions on offers and sales of the Notes within the United States or to, or for the account or benefit of, U.S. persons. Terms used in this paragraph have the meanings given to them by Regulation S.

In addition, until 40 days after the commencement of the offering of the Notes, an offer or sale of the Notes within the United States by a dealer that is not participating in the offering may violate the registration requirements of the Securities Act if such offer or sale is made otherwise than in accordance with Rule 144A.

The Notes are being offered and sold outside of the United States to non-U.S. persons in reliance upon Regulation S. The Subscription Agreement provides that the Joint Lead Managers may directly or through their respective U.S. broker-dealer affiliates only, arrange for the offer and resale of the Notes within the United States to QIBs who are QPs in reliance on Rule 144A.

The Issuer and the Joint Lead Managers reserve the right to reject any offer to purchase the Notes, in whole or in part, for any reason. This Prospectus does not constitute an offer to any person in the United States or to any U.S. person other than any QIB who is also a QP and to whom an offer has been made directly by one of the Joint Lead Managers or its U.S. broker-dealer affiliate. Distribution of this Prospectus by any non-U.S. person outside the United States or by any QIB that is a QP within the United States to any U.S. person or to any other person within the United States, other than any QIB that is a QP and those persons, if any, retained to advise such non-U.S. person or QIB that is a QP with respect thereto, is unauthorised and any disclosure without the prior written consent of the Issuer of any of its contents to any such U.S. person or other person within the United States, other than any QIB that is a QP and those persons, if any, retained to advise such non-U.S. person or QIB that is a QP, is prohibited.

United Kingdom

Each Joint Lead Manager has severally represented, warranted and agreed that:

- (a) it has only communicated or caused to be communicated and will only communicate or cause to be communicated an invitation or inducement to engage in investment activity (within the meaning of Section 21 of the Financial Services and Markets Act 2000 (the “**FSMA**”)) received by it in connection with the issue or sale of the Notes in circumstances in which Section 21(1) of FSMA does not apply to the Issuer or Sistema; and

- (b) it has complied and will comply with all applicable provisions of FSMA with respect to anything done by it in relation to the Notes in, from or otherwise involving the United Kingdom.

The Russian Federation

Each Joint Lead Manager has severally represented, warranted and agreed that the Notes will not be offered, transferred or sold as part of their initial distribution or at any time thereafter to or for the benefit of any persons (including legal entities) resident, incorporated, established or having their usual residence in the Russian Federation or to any person located within the territory of the Russian Federation unless and to the extent otherwise permitted under Russian law.

Luxembourg

The Notes may not be offered to the public in Luxembourg, except that they may be offered in Luxembourg in the following circumstances:

- (a) in the period beginning on the date of publication of a prospectus in relation to those Notes which have been approved by the Commission de surveillance du secteur financier (“**CSSF**”) in Luxembourg or, where appropriate, approved in another relevant European Union Member State and notified to the CSSF, all in accordance with the Prospectus Directive and ending on the date which is 12 months after the date of such publication;
- (b) at any time to legal entities which are authorised or regulated to operate in the financial markets or, if not so authorised or regulated, whose corporate purpose is solely to invest in securities;
- (c) at any time to any legal entity which has two or more of (1) an average of at least 250 employees during the last financial year; (2) a total balance sheet of more than €43,000,000 and (3) an annual net turnover of more than €50,000,000, as shown in its last annual or consolidated accounts; or
- (d) at any time in any other circumstances which do not require the publication by the Issuer of a prospectus pursuant to Article 3 of the Prospectus Directive (as defined below).

For the purposes of this provision, the expression an offer of Notes to the public in relation to any Notes in Luxembourg means the communication in any form and by any means of sufficient information on the terms of the offer and the Offered Securities to be offered so as to enable an investor to decide to purchase the Notes, as defined in the Luxembourg law of 10 July 2005 on prospectuses for securities and implementing Directive 2003/71/EC of the European Parliament and of the Council of 4 November 2003 on the prospectus to be published when securities are offered to the public or admitted to trading (the “**Prospectus Directive**”), or any variation thereof or amendment thereto.

Switzerland

This Prospectus is not intended to constitute an offer or solicitation to purchase or invest in the Notes described herein. The Notes may not be publicly offered, sold or advertised, directly or indirectly, in, into or from Switzerland and will not be listed on the SIX Swiss Exchange or on any other exchange or regulated trading facility in Switzerland. Neither this Prospectus nor any other offering or marketing material relating to the Notes constitutes a prospectus as such term is understood pursuant to article 652a or article 1156 of the Swiss Code of Obligations or a listing prospectus within the meaning of the listing rules of the SIX Swiss Exchange or any other regulated trading facility in Switzerland or a simplified prospectus or a prospectus as such term is defined in the Swiss Collective Investment Scheme Act, and neither this Prospectus nor any other offering or marketing material relating to the Notes may be publicly distributed or otherwise made publicly available in Switzerland.

Neither this Prospectus nor any other offering or marketing material relating to the offering of Notes, Sistema or the Issuer have been or will be filed with or approved by any Swiss regulatory authority. The Notes are not subject to supervision by any Swiss regulatory authority, e.g. the Swiss Financial Markets Supervisory Authority FINMA, and investors in the Notes will not benefit from protection or supervision by such authority.

Hong Kong

Each Joint Lead Manager has represented and agreed that:

In relation to the Notes, that it has not issued or had in its possession for the purposes of issue, and will not issue or have in its possession for the purposes of issue, whether in Hong Kong or elsewhere, any advertisement,

invitation or document relating to the Notes, which is directed at, or the contents of which are likely to be accessed or read by, the public of Hong Kong (except if permitted to do so under the securities laws of Hong Kong) other than with respect to Notes which are or are intended to be disposed of only to persons outside Hong Kong or only to “professional investors” as defined in the Securities and Futures Ordinance (Cap. 571) of Hong Kong and any rules made under that Ordinance.

Singapore

Each Joint Lead Manager has acknowledged that the Prospectus has not been registered as a prospectus with the Monetary Authority of Singapore. Accordingly, each Joint Lead Manager has severally represented, warranted and agreed that it has not offered or sold any Notes or caused such Notes to be made the subject of an invitation for subscription or purchase and will not offer or sell such Notes or cause such Notes to be made the subject of an invitation for subscription or purchase, and has not circulated or distributed, nor will it circulate or distribute, the Prospectus or any other document or material in connection with the offer or sale, or invitation for subscription or purchase, of such Notes, whether directly or indirectly, to persons in Singapore other than (i) to an institutional investor under Section 274 of the Securities and Futures Act, Chapter 289 of Singapore (the “SFA”); (ii) to a relevant person pursuant to Section 275(1), or any person pursuant to Section 275(1A), and in accordance with the conditions specified in Section 275 of the SFA; or (iii) otherwise pursuant to, and in accordance with the conditions of, any other applicable provision of the SFA.

TRANSFER RESTRICTIONS

Because of the following restrictions, you are advised to consult legal counsel prior to making any offer, resale or other transfer offered hereby.

Rule 144A Notes

Each purchaser of the Notes within the United States pursuant to Rule 144A, by accepting delivery of this Prospectus, will be deemed to have represented, agreed and acknowledged that:

- (i) It is (a) a QIB that is also a QP, (b) not a broker-dealer which owns and invests on a discretionary basis less than U.S.\$25 million in securities of unaffiliated issuers, (c) not a participant-directed employee plan, such as a 401(k) plan, (d) acting for its own account, or for the account of another QIB that is also a QP, (e) not formed for the purpose of investing in the Rule 144A Notes or the Issuer, and (f) aware, and each beneficial owner of such Notes has been advised, that the sale of such Rule 144A Notes may be relying on the exemption from the provisions of Section 5 of the Securities Act provided by Rule 144A.
- (ii) It will (a) along with each account for which it is purchasing, hold and transfer beneficial interests in the Rule 144A Notes in a principal amount that is not less than U.S.\$200,000 and (b) provide notice of the transfer restrictions set forth herein to any subsequent transferees. In addition, it understands that the Issuer may receive a list of participants holding positions in the Issuer's securities from one or more book-entry depositaries.
- (iii) It understands that the Rule 144A Notes have not been and will not be registered under the Securities Act and may not be offered, sold, pledged or otherwise transferred except (a) in accordance with Rule 144A to a person that it and any person acting on its behalf reasonably believe is a QIB that is also a QP purchasing for its own account or for the account of one or more QIBs, each of which is also a QP or (b) to a non-U.S. Person within the meaning of Regulation S in an offshore transaction in accordance with Rule 903 or Rule 904 of Regulation S under the Securities Act, and in each case in accordance with any applicable securities laws of any State or another jurisdiction of the United States.
- (iv) It understands that the Issuer has the power under the Trust Deed to compel any U.S. person or any person within the United States who is required to be a QP but is not a QP at the time it acquires the Rule 144A Notes or a beneficial interest therein to transfer its Rule 144A Notes or such beneficial interest immediately to (1) a non-U.S. person in an offshore transaction pursuant to Regulation S under the U.S. Securities Act, or (2) to a person (A) that is within the United States or that is a U.S. person and (B) who is a QP and makes certain representations. Pending such transfer, the Issuer is authorised to suspend the exercise of any special rights, any rights to receive notice of, or attend, a Noteholders' meeting of the Issuer and any rights to receive distributions with respect to the Rule 144A Notes. If the obligation to transfer is not met, the Issuer is irrevocably authorised to transfer the interest in the Rule 144A Notes to, (1) a non-U.S. person in an offshore transaction pursuant to Regulation S, or (2) a person that is in the United States or a U.S. person and who is a QP. The Issuer has the right to refuse to honour the transfer of an interest in the Rule 144a Notes to a U.S. Person who is not a QIB and a QP.
- (v) It understands that the Rule 144A Global Certificate and any Definitive Certificate issued in respect thereof, unless otherwise agreed between the Issuer and the Trustee in accordance with applicable law, will bear a legend to the following effect:

THIS NOTE AND THE LOAN IN RESPECT THEREOF HAVE NOT BEEN AND WILL NOT BE REGISTERED UNDER THE U.S. SECURITIES ACT OF 1933 (THE "SECURITIES ACT") OR WITH ANY SECURITIES REGULATORY AUTHORITY OF ANY STATE OR OTHER JURISDICTION OF THE UNITED STATES AND THIS NOTE MAY NOT BE OFFERED, SOLD, PLEDGED OR OTHERWISE TRANSFERRED EXCEPT (1) IN ACCORDANCE WITH RULE 144A UNDER THE SECURITIES ACT ("RULE 144A") TO A PERSON THAT THE HOLDER AND ANY PERSON ACTING ON ITS BEHALF REASONABLY BELIEVES IS A QUALIFIED INSTITUTIONAL BUYER WITHIN THE MEANING OF RULE 144A (A "QIB") THAT IS ALSO A QUALIFIED PURCHASER (A "QP") WITHIN THE MEANING OF SECTION 2(a)(51) OF THE U.S. INVESTMENT COMPANY ACT OF 1940, AS AMENDED (THE "INVESTMENT COMPANY ACT") PURCHASING FOR ITS OWN ACCOUNT OR FOR THE ACCOUNT OF ONE OR MORE QIBs EACH OF WHICH IS A QP WHOM THE HOLDER HAS INFORMED, IN EACH CASE, THAT SUCH OFFER, SALE, PLEDGE OR OTHER TRANSFER IS BEING MADE IN RELIANCE ON RULE 144A UNDER THE SECURITIES ACT, AND IN AN AMOUNT FOR EACH ACCOUNT OF NOT LESS THAN U.S.\$200,000 PRINCIPAL AMOUNT OF THE NOTES OR (2) IN AN OFFSHORE TRANSACTION TO A PERSON WHO IS NOT A U.S. PERSON WITHIN THE MEANING OF REGULATION S UNDER THE SECURITIES ACT ("REGULATION S") IN ACCORDANCE WITH RULE

903 OR RULE 904 OF REGULATION S, IN EACH CASE IN ACCORDANCE WITH ANY APPLICABLE SECURITIES LAWS OF ANY STATE OF THE UNITED STATES, AND THE HOLDER WILL, AND EACH SUBSEQUENT HOLDER IS REQUIRED TO, NOTIFY ANY PURCHASER FROM IT OF THE NOTES IN RESPECT HEREOF OF THE RESALE RESTRICTIONS REFERRED TO ABOVE. TRANSFERS IN VIOLATION OF THE FOREGOING WILL BE OF NO FORCE OR EFFECT, WILL BE VOID AB INITIO, AND WILL NOT OPERATE TO TRANSFER ANY RIGHTS TO THE TRANSFEREE, NOTWITHSTANDING ANY INSTRUCTIONS TO THE CONTRARY TO THE ISSUER OF THIS NOTE, THE TRUSTEE OR ANY INTERMEDIARY. NO REPRESENTATION CAN BE MADE AS TO THE AVAILABILITY OF ANY EXEMPTION UNDER THE SECURITIES ACT FOR REALES OF THIS NOTE.

IF THE BENEFICIAL OWNER HEREOF IS A U.S. PERSON WITHIN THE MEANING OF REGULATION S, SUCH BENEFICIAL OWNER REPRESENTS THAT (1) IT IS A QIB THAT IS ALSO A QP; (2) IT IS NOT A BROKER DEALER WHICH OWNS AND INVESTS ON A DISCRETIONARY BASIS LESS THAN U.S.\$25,000,000 IN SECURITIES OF UNAFFILIATED ISSUERS; (3) IT IS NOT A PARTICIPANT DIRECTED EMPLOYEE PLAN, SUCH AS A 401(k) PLAN; (4) IT IS HOLDING THE NOTES REPRESENTED HEREBY FOR ITS OWN ACCOUNT OR FOR THE ACCOUNT OF ONE OR MORE QIBs, EACH OF WHICH IS A QP; (5) IT WAS NOT FORMED FOR THE PURPOSE OF INVESTING IN THE ISSUER OR THE NOTES REPRESENTED HEREBY; (6) IT, AND EACH ACCOUNT FOR WHICH IT IS PURCHASING, WILL HOLD AND TRANSFER AT LEAST U.S.\$200,000 IN PRINCIPAL AMOUNT OF THE NOTE AT ANY TIME; (7) IT UNDERSTANDS THAT THE ISSUER MAY RECEIVE A LIST OF PARTICIPANTS HOLDING POSITIONS IN ITS SECURITIES FROM ONE OR MORE BOOK ENTRY DEPOSITARIES AND (8) IT WILL PROVIDE NOTICE OF THE FOREGOING TRANSFER RESTRICTIONS TO ITS SUBSEQUENT TRANSFEREES.

THE BENEFICIAL OWNER HEREOF HEREBY ACKNOWLEDGES THAT IF AT ANY TIME WHILE IT HOLDS AN INTEREST IN THIS NOTE IT IS A U.S. PERSON WITHIN THE MEANING OF REGULATION S THAT IS NOT A QIB AND A QP, THE ISSUER MAY (A) COMPEL IT TO SELL ITS INTEREST IN THIS NOTE TO A PERSON WHO IS (I) A U.S. PERSON WHO IS A QIB AND A QP THAT IS, IN EACH CASE, OTHERWISE QUALIFIED TO PURCHASE THE NOTES REPRESENTED HEREBY IN A TRANSACTION EXEMPT FROM REGISTRATION UNDER THE SECURITIES ACT OR (II) NOT A U.S. PERSON IN AN OFFSHORE TRANSACTION PURSUANT TO REGULATION S OR (B) COMPEL THE BENEFICIAL OWNER TO SELL ITS INTEREST IN THE NOTES REPRESENTED HEREBY TO THE ISSUER OR AN AFFILIATE OF THE ISSUER OR TRANSFER ITS INTEREST IN THIS NOTE TO A PERSON DESIGNATED BY OR ACCEPTABLE TO THE ISSUER AT A PRICE EQUAL TO THE LESSER OF (X) THE PURCHASE PRICE THEREFOR PAID BY THE BENEFICIAL OWNER, (Y) 100% OF THE PRINCIPAL AMOUNT THEREOF OR (Z) THE FAIR MARKET VALUE THEREOF. THE ISSUER HAS THE RIGHT TO REFUSE TO HONOUR A TRANSFER OF AN INTEREST IN THE NOTES REPRESENTED HEREBY TO A U.S. PERSON WHO IS NOT A QIB AND A QP. THE ISSUER HAS NOT BEEN AND WILL NOT BE REGISTERED UNDER THE INVESTMENT COMPANY ACT.

BY ACCEPTING THIS NOTE (OR ANY INTEREST IN THE NOTES REPRESENTED HEREBY) EACH BENEFICIAL OWNER HEREOF, AND EACH FIDUCIARY ACTING ON BEHALF OF THE BENEFICIAL OWNER (BOTH IN ITS INDIVIDUAL AND CORPORATE CAPACITY), WILL BE DEEMED TO REPRESENT, WARRANT AND AGREE THAT, DURING THE PERIOD IT HOLDS ANY INTEREST IN THIS NOTE (1) EITHER (A) IT IS NOT, AND IT IS NOT ACTING ON BEHALF OF (AND FOR SO LONG AS IT HOLDS THIS NOTE (OR ANY INTEREST THEREIN) WILL NOT BE, OR BE ACTING ON BEHALF OF) AN EMPLOYEE BENEFIT PLAN (AS DEFINED IN SECTION 3(3) OF ERISA) SUBJECT TO THE PROVISIONS OF PART 4 OF SUBTITLE B OF TITLE I OF ERISA, A PLAN TO WHICH SECTION 4975 OF THE U.S. INTERNAL REVENUE CODE OF 1986, AS AMENDED (“**CODE**”), APPLIES, OR ANY ENTITY WHOSE UNDERLYING ASSETS INCLUDE “PLAN ASSETS” UNDER SECTION 3(42) OF ERISA, 29 C.F.R. SECTION 2510.3-101 OR OTHERWISE BY REASON OF SUCH AN EMPLOYEE BENEFIT PLAN’S OR PLAN’S INVESTMENT IN SUCH ENTITY (EACH, A “**BENEFIT PLAN INVESTOR**”) OR A GOVERNMENTAL, CHURCH OR NON U.S. PLAN WHICH IS SUBJECT TO ANY FEDERAL, STATE, LOCAL, NON U.S. OR OTHER LAWS OR REGULATIONS THAT ARE SUBSTANTIALLY SIMILAR TO THE FIDUCIARY RESPONSIBILITY AND/OR THE PROHIBITED TRANSACTION PROVISIONS OF ERISA AND/OR SECTION 4975 OF THE CODE (“**SIMILAR LAWS**”) AND/OR LAWS OR REGULATIONS THAT PROVIDE THAT THE ASSETS OF THE ISSUER COULD BE DEEMED TO INCLUDE “PLAN ASSETS” OF SUCH PLAN UNDER SECTION 3(42) OF ERISA, 29 C.F.R. SECTION 2510.3-101 OR OTHERWISE, AND NO PART OF THE ASSETS TO BE USED BY IT TO PURCHASE OR HOLD SUCH NOTES OR ANY INTEREST HEREIN CONSTITUTES THE ASSETS OF ANY BENEFIT

PLAN INVESTOR OR SUCH A GOVERNMENTAL, CHURCH OR NON U.S. PLAN OR (B) IT IS, OR IS ACTING ON BEHALF OF A GOVERNMENTAL, CHURCH OR NON U.S. PLAN, AND SUCH ACQUISITION DOES NOT AND WILL NOT RESULT IN A NON EXEMPT VIOLATION OF ANY SIMILAR LAWS AND WILL NOT SUBJECT THE ISSUER TO ANY LAWS, RULES OR REGULATIONS APPLICABLE TO SUCH PLAN SOLELY AS A RESULT OF THE INVESTMENT IN THE ISSUER BY SUCH PLAN; AND (2) IT WILL NOT SELL OR OTHERWISE TRANSFER THIS NOTE OR ANY INTEREST HEREIN OTHERWISE THAN TO A PURCHASER OR TRANSFEREE THAT IS DEEMED TO MAKE THESE SAME REPRESENTATIONS, WARRANTIES AND AGREEMENTS WITH RESPECT TO ITS PURCHASE, HOLDING AND DISPOSITION OF THIS NOTE. NO PURCHASE BY OR TRANSFER TO A BENEFIT PLAN INVESTOR OF THIS NOTE, OR ANY INTEREST HEREIN, WILL BE EFFECTIVE, AND NEITHER THE ISSUER NOR THE TRUSTEE WILL RECOGNISE ANY SUCH ACQUISITION OR TRANSFER. IN THE EVENT THAT THE ISSUER DETERMINES THAT THIS NOTE IS HELD BY A BENEFIT PLAN INVESTOR, THE ISSUER MAY CAUSE A SALE OR TRANSFER IN THE MANNER DESCRIBED IN THIS PROSPECTUS.

THE ISSUER MAY COMPEL EACH BENEFICIAL OWNER OF THE NOTES REPRESENTED HEREBY THAT IS A U.S. PERSON WITHIN THE MEANING OF REGULATIONS TO CERTIFY PERIODICALLY THAT SUCH BENEFICIAL OWNER IS A QIB AND A QP.

- (vi) It understands and acknowledges that its purchase, holding and disposition of such Notes constitutes a representation and agreement by it that at the time of purchase and throughout the period it holds such Notes or any interest therein (1) either (i) it is not, and is not acting on behalf of (and for so long as it holds such Notes (or any interest therein) will not be, or be acting on behalf of), a Benefit Plan Investor or a governmental, church or non U.S. plan which is subject to any Similar Laws and/or laws or regulations that provide that the assets of the Issuer could be deemed to include “plan assets” of such plan under Section 3(42) of ERISA, the Plan Assets Regulation or otherwise, and no part of the assets used by it to purchase or hold such Note or any interest therein constitutes the assets of such Benefit Plan Investor or such plan, or (ii) it is, or is acting on behalf of, a governmental, church or non U.S. plan, and such purchase or holding of such Note does not and will not result in a non exempt violation of any Similar Laws, and will not subject the Issuer to any laws, rules or regulations applicable to such plan solely as a result of the investment in the Issuer by such plan; and (2) it will not sell or otherwise transfer any note or interest therein to any person without first obtaining these same foregoing representations, warranties and covenants from that person with respect to its acquisition, holding and disposition of such Note.
- (vii) It acknowledges that the Issuer, Sistema, the Registrar, the Joint Lead Managers and their affiliates, and others will rely upon the truth and accuracy of the foregoing acknowledgments, representations and agreements and agrees that, if any of the acknowledgments, representations and agreements deemed to have been made by it by its purchase of the Rule 144A Notes is no longer accurate, it shall promptly notify the Issuer, Sistema and the applicable Joint Lead Manager(s). If it is acquiring any Notes as a fiduciary or agent for one or more investor accounts, it represents that it has sole investment discretion with respect to each such account and that it has full power to make the foregoing acknowledgments, representations and agreements on behalf of each such account.
- (viii) It understands that the Rule 144A Notes will be evidenced by the Rule 144A Global Certificate. Before any interest in the Rule 144A Global Certificate may be offered, sold, pledged or otherwise transferred to a person who takes delivery in the form of an interest in the Regulation S Global Certificate, it will be required to provide a Transfer Agent with a written certification (in the form provided in the Agency Agreement) as to compliance with applicable securities laws.

PROSPECTIVE PURCHASERS ARE HEREBY NOTIFIED THAT SELLERS OF THE NOTES MAY BE RELYING ON THE EXEMPTION FROM THE PROVISIONS OF SECTION 5 OF THE SECURITIES ACT PROVIDED BY RULE 144A.

Regulation S Notes

Each purchaser of the Regulation S Notes outside the United States and each subsequent purchaser of the Regulation S Notes (A) in the case of (i) and (ii) below, prior to the expiration of the distribution compliance period (as such term is defined in Regulation S), and (B) in the case of (iii), (iv), (v), (vi) and (vii) below, throughout the period that it holds such Notes, by accepting delivery of this Prospectus and the Regulation S Notes, will be deemed to have represented, agreed and acknowledged that:

- (ix) It is not a U.S. Person and it is located outside the United States (within the meaning of Regulation S); and it is not an affiliate of the Issuer, Sistema or a person acting on behalf of the Issuer, Sistema or such an affiliate.

- (x) It understands that prior to the expiration of the distribution compliance period for such Notes, it will not offer, sell, pledge or otherwise transfer such Notes except (a) in accordance with Rule 144A in an amount not less than U.S.\$200,000 to a person that it and any person acting on its behalf reasonably believes is a QIB that is also a QP purchasing for its own account or for the account of a QIB that is also a QP, each of which is purchasing not less than U.S.\$200,000 principal amount of the Notes or (b) in an offshore transaction in accordance with Rule 903 or Rule 904 of Regulation S, in each case in accordance with any applicable securities laws of any state of the United States.
- (xi) It understands that the Regulation S Notes will be represented by the Regulation S Global Certificate. Before any interest in the Regulation S Global Certificate may be offered, sold, pledged or otherwise transferred to a person who takes delivery in the form of an interest in the Rule 144A Global Certificate, it will be required to provide a Transfer Agent with a written certification (in the form provided in the Agency Agreement) as to compliance with applicable securities laws.
- (xii) It is, or at the time the Regulation S Notes are purchased it will be, the beneficial owner of such Regulation S Notes.
- (xiii) It understands that the Regulation S Notes have not been and will not be registered under the Securities Act.
- (xiv) It understands that the Regulation S Global Certificate and any Definitive Certificate issued in respect thereof, unless otherwise agreed between the Issuer and the Trustee in accordance with applicable law, will bear a legend to the following effect:

BY ACCEPTING THIS NOTE (OR ANY INTEREST IN THE NOTES REPRESENTED HEREBY) EACH BENEFICIAL OWNER HEREOF, AND EACH FIDUCIARY ACTING ON BEHALF OF THE BENEFICIAL OWNER (BOTH IN ITS INDIVIDUAL AND CORPORATE CAPACITY), WILL BE DEEMED TO REPRESENT, WARRANT AND AGREE THAT, DURING THE PERIOD IT HOLDS ANY INTEREST IN THIS NOTE (1) EITHER (A) IT IS NOT, AND IT IS NOT ACTING ON BEHALF OF (AND FOR SO LONG AS IT HOLDS THIS NOTE (OR ANY INTEREST THEREIN) WILL NOT BE, OR BE ACTING ON BEHALF OF) AN EMPLOYEE BENEFIT PLAN (AS DEFINED IN SECTION 3(3) OF ERISA) SUBJECT TO THE PROVISIONS OF PART 4 OF SUBTITLE B OF TITLE I OF ERISA, A PLAN TO WHICH SECTION 4975 OF THE U.S. INTERNAL REVENUE CODE OF 1986, AS AMENDED (“**CODE**”), APPLIES, OR ANY ENTITY WHOSE UNDERLYING ASSETS INCLUDE “PLAN ASSETS” UNDER SECTION 3(42) OF ERISA, 29 C.F.R. SECTION 2510.3-101 OR OTHERWISE BY REASON OF SUCH AN EMPLOYEE BENEFIT PLAN’S OR PLAN’S INVESTMENT IN SUCH ENTITY (EACH, A “**BENEFIT PLAN INVESTOR**”) OR A GOVERNMENTAL, CHURCH OR NON U.S. PLAN WHICH IS SUBJECT TO ANY FEDERAL, STATE, LOCAL, NON U.S. OR OTHER LAWS OR REGULATIONS THAT ARE SUBSTANTIALLY SIMILAR TO THE FIDUCIARY RESPONSIBILITY AND/OR THE PROHIBITED TRANSACTION PROVISIONS OF ERISA AND/OR SECTION 4975 OF THE CODE (“**SIMILAR LAWS**”) AND/OR LAWS OR REGULATIONS THAT PROVIDE THAT THE ASSETS OF THE ISSUER COULD BE DEEMED TO INCLUDE “PLAN ASSETS” OF SUCH PLAN UNDER SECTION 3(42) OF ERISA, 29 C.F.R. SECTION 2510.3-101 OR OTHERWISE, AND NO PART OF THE ASSETS TO BE USED BY IT TO PURCHASE OR HOLD SUCH NOTES OR ANY INTEREST HEREIN CONSTITUTES THE ASSETS OF ANY BENEFIT PLAN INVESTOR OR SUCH A GOVERNMENTAL, CHURCH OR NON U.S. PLAN OR (B) IT IS, OR IS ACTING ON BEHALF OF A GOVERNMENTAL, CHURCH OR NON U.S. PLAN, AND SUCH ACQUISITION DOES NOT AND WILL NOT RESULT IN A NON EXEMPT VIOLATION OF ANY SIMILAR LAWS AND WILL NOT SUBJECT THE ISSUER TO ANY LAWS, RULES OR REGULATIONS APPLICABLE TO SUCH PLAN SOLELY AS A RESULT OF THE INVESTMENT IN THE ISSUER BY SUCH PLAN; AND (2) IT WILL NOT SELL OR OTHERWISE TRANSFER THIS NOTE OR ANY INTEREST HEREIN OTHERWISE THAN TO A PURCHASER OR TRANSFEREE THAT IS DEEMED TO MAKE THESE SAME REPRESENTATIONS, WARRANTIES AND AGREEMENTS WITH RESPECT TO ITS PURCHASE, HOLDING AND DISPOSITION OF THIS NOTE. NO PURCHASE BY OR TRANSFER TO A BENEFIT PLAN INVESTOR OF THIS NOTE, OR ANY INTEREST HEREIN, WILL BE EFFECTIVE, AND NEITHER THE ISSUER NOR THE TRUSTEE WILL RECOGNISE ANY SUCH ACQUISITION OR TRANSFER. IN THE EVENT THAT THE ISSUER DETERMINES THAT THIS NOTE IS HELD BY A BENEFIT PLAN INVESTOR, THE ISSUER MAY CAUSE A SALE OR TRANSFER IN THE MANNER DESCRIBED IN THE PROSPECTUS.

- (xv) It understands and acknowledges that its purchase, holding and disposition of such Notes constitutes a representation and agreement by it that (1) either (i) it is not, and is not acting on behalf of (and for so long as it holds such Notes or any interest therein will not be, or be acting on behalf of), a Benefit Plan Investor or a governmental, church or non U.S. plan which is subject to any Similar Laws and/or laws or regulations that provide that the assets of the Issuer could be deemed to include “plan assets” of such plan under

Section 3(42) of ERISA, the Plan Assets Regulation or otherwise, and no part of the assets used by it to purchase or hold such Note or any interest therein constitutes the assets of such Benefit Plan Investor or such plan, or (ii) it is, or is acting on behalf of, a governmental, church or non U.S. plan, and such purchase or holding of such Note does not and will not result in a non exempt violation of any Similar Laws, and will not subject the Issuer to any laws, rules or regulations applicable to such plan solely as a result of the investment in the Issuer by such plan; and (2) it will not sell or otherwise transfer any Note or interest therein otherwise than to any person without first obtaining these same foregoing representations, warranties and covenants from that person with respect to its acquisition, holding and disposition of such Note.

(xvi) It acknowledges that the Issuer, Sistema and the Joint Lead Managers and their respective affiliates, and others, will rely upon the truth and accuracy of the above acknowledgements, representations and agreements and agrees that, if any of the acknowledgements, representations or agreements deemed to have been made by it by its purchase of the Regulation S Notes is no longer accurate, it shall promptly notify the Issuer, Sistema and the applicable Joint Lead Manager(s). If it is acquiring any Notes as a fiduciary or agent for one or more investor accounts, it represents that it has sole investment discretion with respect to each such account and that it has full power to make the above acknowledgements, representations and agreements on behalf of each account.

CERTAIN ERISA CONSIDERATIONS

ERISA imposes fiduciary standards and certain other requirements on employee benefit plans subject thereto (collectively “**ERISA Plans**”), including collective investment funds, separate accounts, and other entities or accounts whose underlying assets are treated as assets of such plans pursuant to the U.S. Department of Labour “plan assets” regulation, 29 CFR Section 2510.3-101 (as modified by Section 3(42) of ERISA, the “**Plan Asset Regulation**”) and on those persons who are fiduciaries with respect to ERISA Plans.

Section 406 of ERISA and Section 4975 of the Internal Revenue Code of 1986 (the “**Code**”) prohibit certain transactions involving the assets of an ERISA Plan (as well as those plans that are not subject to ERISA but which are subject to Section 4975 of the Code (together with ERISA Plans, “**Plans**”)) and certain persons (referred to as “**parties in interest**” or “**disqualified persons**”) having certain relationships to such Plans, unless a statutory or administrative exemption applies to the transaction. In particular, an extension of credit between a Plan and a “party in interest” or “disqualified person” may constitute a prohibited transaction. A party in interest or disqualified person who engages in a prohibited transaction may be subject to excise taxes or other liabilities under ERISA and the Code.

The Issuer or the Trustee, directly or through affiliates, may be considered a party in interest or disqualified person with respect to many Plans. Prohibited transactions within the meaning of Section 406 of ERISA or Section 4975 of the Code may arise if the Notes are acquired by a Plan with respect to which the Issuer or the Trustee or any of their respective affiliates is a party in interest or a disqualified person, unless the Notes are acquired pursuant to and in accordance with an applicable exemption. Certain exemptions from the prohibited transaction provisions of Section 406 of ERISA and Section 4975 of the Code may apply depending in part on the type of Plan fiduciary making the decision to acquire a Note and the circumstances under which that decision is made.

Under a “look-through rule” set forth in the Plan Assets Regulation, if a Plan invests in an “equity interest” of an entity and no other exception applies, the Plan’s assets include both the equity interest and an undivided interest in each of the entity’s underlying assets. This rule will only apply where equity participation in an entity by benefit plan investors is “significant.” Equity participation by benefit plan investors is significant if 25% or more of the value of any class of equity interest in the entity is held by benefit plan investors. The term “**benefit plan investor**” includes (a) an employee benefit plan (as defined in Section 3(3) of ERISA), that is subject to Title I of ERISA; (b) a plan defined in Section 4975(e)(1) of the Code that is subject to Section 4975 of the Code; or (c) any entity whose underlying assets include “plan assets” by reason of any such plan’s investment in the entity. The Plan Asset Regulation defines the term “equity interest” as any interest in an entity other than an instrument that is treated as indebtedness under applicable local law and which has no substantial equity features, and specifically includes a beneficial interest in a trust. Where the value of an equity interest in an entity relates solely to identified property of the entity, that property is treated as the sole property of a separate entity.

Because the Notes do not represent an interest in any property of the Issuer other than the Loan, they may be regarded for ERISA purposes as equity interests in a separate entity whose sole asset is the Loan. Further, neither the Trustee nor the Issuer will be able to monitor the Noteholders’ possible status as benefit plan investors. Accordingly, the Notes may not be purchased or held by any benefit plan investor.

While not subject to ERISA, the Code or the Plan Assets Regulation, a governmental, church or non U.S. plan may be subject to federal, state, local, non U.S. or other laws or regulations that are substantially similar to the fiduciary responsibility and/or the prohibited transaction provisions of ERISA and/or Similar Laws and/or laws or regulations that provide that the assets of the Issuer could be deemed to include “plan assets” of such plan under Section 3(42) of ERISA, 29 C.F.R. Section 2510.3-101 or otherwise. Accordingly, the Notes either (a) may not be purchased or held by any such a governmental, church or non U.S. plan or (b) such acquisition does not and will not result in a non exempt violation of any Similar Laws and will not subject the Issuer to any laws, rules or regulations applicable to such plan solely as a result of the investment in the Issuer by such plan.

BY ITS PURCHASE, HOLDING OR DISPOSITION OF THE NOTES (OR ANY INTEREST THEREIN) PURCHASER OR TRANSFEREE, AND EACH FIDUCIARY ACTING ON BEHALF OF SUCH PURCHASER OR TRANSFEREE (BOTH IN ITS INDIVIDUAL AND CORPORATE CAPACITY), WILL BE DEEMED TO REPRESENT, WARRANT AND AGREE THAT, DURING THE PERIOD SUCH PURCHASER OR TRANSFEREE HOLDS ANY INTEREST IN THE NOTES (1) EITHER (A) IT IS NOT, AND IT IS NOT ACTING ON BEHALF OF (AND FOR SO LONG AS IT HOLDS THE NOTES (OR ANY INTEREST THEREIN) WILL NOT BE, OR BE ACTING ON BEHALF OF) AN EMPLOYEE BENEFIT PLAN (AS

DEFINED IN SECTION 3(3) OF ERISA) SUBJECT TO THE PROVISIONS OF PART 4 OF SUBTITLE B OF TITLE I OF ERISA, A PLAN TO WHICH SECTION 4975 OF THE CODE APPLIES, OR ANY ENTITY WHOSE UNDERLYING ASSETS INCLUDE "PLAN ASSETS" UNDER SECTION 3(42) OF ERISA, 29 C.F.R. SECTION 2510.3-101 OR OTHERWISE BY REASON OF A BENEFIT PLAN INVESTOR OR A GOVERNMENTAL, CHURCH OR NON U.S. PLAN WHICH IS SUBJECT TO ANY FEDERAL, STATE, LOCAL, NON U.S. OR OTHER LAWS OR REGULATIONS THAT ARE SUBSTANTIALLY SIMILAR TO THE FIDUCIARY RESPONSIBILITY AND/OR THE PROHIBITED TRANSACTION PROVISIONS OF ERISA AND/OR SIMILAR LAWS AND/OR LAWS OR REGULATIONS THAT PROVIDE THAT THE ASSETS OF THE ISSUER COULD BE DEEMED TO INCLUDE "PLAN ASSETS" OF SUCH PLAN UNDER SECTION 3(42) OF ERISA, 29 C.F.R. SECTION 2510.3-101 OR OTHERWISE, AND NO PART OF THE ASSETS TO BE USED BY IT TO PURCHASE OR HOLD SUCH NOTES OR ANY INTEREST HEREIN CONSTITUTES THE ASSETS OF ANY BENEFIT PLAN INVESTOR OR SUCH A GOVERNMENTAL, CHURCH OR NON U.S. PLAN OR (B) SUCH PURCHASER OR TRANSFEREE IS, OR IS ACTING ON BEHALF OF A GOVERNMENTAL, CHURCH OR NON U.S. PLAN, AND SUCH ACQUISITION DOES NOT AND WILL NOT RESULT IN A NON EXEMPT VIOLATION OF ANY SIMILAR LAWS AND WILL NOT SUBJECT THE ISSUER TO ANY LAWS, RULES OR REGULATIONS APPLICABLE TO SUCH PLAN SOLELY AS A RESULT OF THE INVESTMENT IN THE ISSUER BY SUCH PLAN; AND (2) IT WILL NOT SELL OR OTHERWISE TRANSFER THE NOTES OR ANY INTEREST HEREIN OTHERWISE THAN TO A PURCHASER OR TRANSFEREE THAT IS DEEMED TO MAKE THESE SAME REPRESENTATIONS, WARRANTIES AND AGREEMENTS WITH RESPECT TO ITS PURCHASE, HOLDING AND DISPOSITION OF THIS NOTE. NO PURCHASE BY OR TRANSFER TO A BENEFIT PLAN INVESTOR OF THE NOTES, OR ANY INTEREST HEREIN, WILL BE EFFECTIVE, AND NEITHER THE ISSUER NOR THE TRUSTEE WILL RECOGNISE ANY SUCH ACQUISITION OR TRANSFER. IN THE EVENT THAT THE ISSUER DETERMINES THAT THIS NOTE IS HELD BY A BENEFIT PLAN INVESTOR, THE ISSUER MAY CAUSE A SALE OR TRANSFER IN THE MANNER DESCRIBED HEREIN.

TAXATION

The following is a general description of certain Russian, Luxembourg and United States tax considerations relating to the Notes. It does not purport to be a complete analysis of all tax considerations relating to the Notes, whether in those countries or elsewhere. Prospective purchasers of the Notes should consult their own tax advisers as to which countries' tax laws could be relevant to acquiring, holding and disposing of the Notes and receiving payments of interest, principal and/or other amounts under such Notes and the consequences of such actions under the tax laws of those countries. This summary is based upon the law as in effect on the date of this Prospectus. The information and analysis contained within this section are limited to taxation issues and prospective investors should not apply any information or analysis set out below to other areas, including (but not limited to) the legality of transactions involving the Notes.

The Russian Federation

General

The following is a general summary of certain Russian tax considerations relevant to the purchase, ownership and disposition of the Notes, as well as the taxation of interest on the Loan. The summary is based on the laws of the Russian Federation in effect on the date of this Prospectus, which are subject to change (possibly with retroactive effect). The summary does not seek to address the applicability of, and procedures in relation to, taxes levied by regions, municipalities or other non-federal level authorities of the Russian Federation. Similarly, the summary does not seek to address the availability of double tax treaty relief in respect of the Notes, and prospective investors should note that there may be practical difficulties involved in claiming such double tax treaty relief. Prospective investors should consult their own advisers regarding the tax consequences of investing in the Notes in their own particular circumstances. No representation with respect to the Russian tax consequences to any particular holder is made hereby.

Many aspects of Russian tax law are subject to significant uncertainty. Further, the substantive provisions of Russian tax law applicable to financial instruments may be subject to more rapid and unpredictable change and inconsistency than in jurisdictions with more developed financial markets and more developed taxation systems. In practice, interpretation of tax laws and regulations by different tax inspectorates may be inconsistent or contradictory, and may result in the imposition of conditions, requirements or restrictions that are not explicitly stated by the law. Furthermore, court rulings on tax or other related matters taken by different courts relating to the same or similar circumstances may also be inconsistent or contradictory.

For the purposes of this summary, a “**Non-Resident Holder**” means:

- a legal entity or an organisation in each case not organised under the Russian law which holds and disposes of the Notes otherwise than via its permanent establishment in the Russian Federation (the “**Non-Resident Holder—Legal Entity**”), and
- a Holder who is an individual actually present outside the Russian Federation for an aggregate period of 183 days or more in a period comprised of 12 consecutive months (the “**Non-Resident Holder—Individual**”). Presence in the Russian Federation is not considered interrupted if an individual departs for short periods (less than six months) for medical treatment or education purposes.

A “**Resident Holder**” means any Noteholder who is not a Non-Resident Holder.

Russian tax residency rules may be affected by an applicable double tax treaty. Based on published comments by the Russian authorities, it is anticipated that Russian tax residency rules applicable to legal entities may change in the future.

The Russian tax treatment of interest payments made by Sistema JSFC under the Loan Agreement may affect the holders of the Notes. See “—*Taxation of Interest on the Loan*” below.

Taxation of the Notes

Non-Resident Holders

A Non-Resident Holder of a Note should not be subject to any Russian taxes on receipt from the Issuer of amounts payable in respect of principal or interest on the Notes.

A Non-Resident Holder also generally should not be subject to any Russian taxes in respect of gains or other income realised on the redemption, sale or other disposition of the Notes outside of the Russian Federation, provided that the proceeds from such sale, redemption or other disposition are not received from a source within the Russian Federation (subject to what is stated in “—*Taxation of Interest on the Loan*” below).

Non-Resident Holders—Legal Entities

In the event that proceeds from a sale, redemption or other disposition of the Notes are received from a source within the Russian Federation, a Non-Resident Holder which is a legal entity or organisation should not be subject to withholding tax in the Russian Federation in respect of the proceeds, although there is some residual uncertainty regarding the treatment of any part of such gain realised on the sale or other disposal of the Notes which is attributable to accrued interest. If the payment upon sale or other disposal of the Notes is received from within the Russian Federation, accrued interest may be distinguished from the total gain and be subject to Russian withholding tax at 20%. The separate taxation of the interest accrued may create a tax liability in relation to interest even in a situation where there has been a capital loss on the disposal of the Notes. The withholding tax on any part of the payment relating to interest may potentially be reduced or eliminated under the terms of an applicable double taxation treaty depending on the tax residency of the Non-Resident Holder.

The acquisition of the Notes by Non-Resident Holders—Legal Entities should not constitute a taxable event and there should be no Russian tax implications for the Non-Resident Holders—Legal Entities associated with acquisition of the Notes.

Non-Resident Holders—Individuals

Under Russian tax legislation, taxation of income of Non-resident Holders—Individuals will depend on whether this income is received from Russian or non-Russian sources. Russian tax law gives no clear indication as to how the sale of securities should be sourced, other than that income from the sale of securities “in the Russian Federation” is Russian-source income. As there is no further definition of what should be considered to be a sale “in the Russian Federation,” the Russian tax authorities have a certain amount of freedom to conclude what transactions take place in or outside the Russian Federation, including looking at the place of the transaction, the place of the issuer of the securities, or other similar criteria.

If proceeds from a sale, redemption or other disposition of the Notes are received from a source within the Russian Federation, a Non-Resident Holder who is an individual will generally be subject to personal income tax at a rate of 30% on the gain from such disposal (the gain generally being calculated as the gross proceeds from such disposal less any available cost deduction, including the original purchase price), subject to any available double tax treaty relief. There is a risk that, if the documentation supporting the cost deductions is deemed insufficient by the tax authorities, the deduction will be disallowed and the tax will apply to the gross amount of sales proceeds.

The acquisition of the Notes by Non-Resident Holders—Individuals may constitute a taxable event pursuant to the provisions of the Russian Tax Code relating to the material benefit (deemed income) received by individuals as a result of the acquisition of securities. If the acquisition price of the Notes is below the lower threshold of the range of the fair market value calculated under a specific procedure for the determination of market prices of securities for tax purposes, the difference may be subject to the Russian personal income tax at the rate of 30%. Although the Tax Code does not contain any provisions in relation to how the related material benefit should be sourced, the Russian tax authorities may apply various criteria in order to determine the source of the related material benefit, including looking at the place of conclusion of the acquisition transaction, the location of the issuer of the securities, or other similar criteria.

There is some uncertainty regarding the treatment of the portion of proceeds (if any) attributable to accrued interest. Subject to reduction or elimination pursuant to the provisions of an applicable tax treaty relating to interest income, proceeds attributable to accrued interest may be taxed at a rate of 30%, irrespective of any capital gain or loss on the disposal of the Notes. In addition, there is a risk that the taxable base may be affected by changes in the exchange rates between the currency of acquisition of the Notes, the currency of sale of the Notes and roubles.

In certain circumstances if the disposal proceeds are paid to a Non-Resident Holder—Individual by a licensed broker or an asset manager or other party that is a Russian legal entity or an organisation, or any other person, including a foreign company with a permanent establishment or, arguably, any registered presence in the Russian

Federation or an individual entrepreneur registered in the Russian Federation, who carry out operations under an asset management agreement, brokerage service agreement, agency agreement, a commission agreement or commercial mandate agreement for the benefit of the Non-Resident Holder—Individual, the applicable personal income tax at the rate of 30% should be withheld at source by such person who will be considered as the tax agent. The amount of the tax to be withheld would be calculated as the difference between sales proceeds paid to a Non-Resident Holder—Individual and the amount of duly documented deductions relating to the purchase value of the Notes and other related expenses to the extent that such deductions and expenses can be determined by the entity making the payment of income to a Non-Resident Holder—Individual. Where a sale is made to other legal entities or individuals, generally no Russian personal income tax should be withheld at source by these persons. The Non-Resident Holder—Individual would be required to file a tax return individually, report on the amount of income realised and apply for a deduction in the amount of acquisition expenses confirmed by the supporting documentation. The applicable tax would then have to be paid by the individual on the basis of the filed tax return.

Under certain circumstances gains received and losses incurred by a Non-Resident Holder—Individual as a result of disposition of the Notes and other securities occurring within the same tax year may be aggregated, which would affect the total amount of tax payable by a Non-Resident Holder—Individual in the Russian Federation.

Non-Resident Holders who are individuals and Non-Resident Holders that are legal entities or organisations should consult their own tax advisers with respect to the tax consequences of a disposal of the Notes and the tax consequences of the receipt of proceeds from a source within the Russian Federation in respect of a disposal of the Notes.

Resident Holders

A Resident Holder of the Notes is subject to all applicable Russian taxes in respect of income derived in connection with the acquisition, ownership and disposition of the Notes.

Resident Holders should consult their own tax advisers with respect to the effect that acquisition, holding and disposition of the Notes may have on their tax position.

Tax Treaty Relief

The Russian Federation has concluded double tax treaties with a number of countries and honours some double tax treaties concluded by the former Union of Soviet Socialist Republics. These tax treaties may contain provisions that allow for the reduction or elimination of Russian withholding tax due with respect to income received by a Non-Resident Holder from a source within the Russian Federation, including income from disposition of the Notes. In order to obtain benefits available under the respective tax treaty, a Non-Resident Holder must comply with the certification, information, and reporting requirements in force in the Russian Federation.

Currently a Non-Resident Holder—Legal Entity would need to provide the payer of income with a written confirmation of tax residence issued by the competent (in the meaning of the relevant double tax treaty) authority of the relevant treaty country in advance of payment of income. However, the payer of income in practice may request additional documents confirming the eligibility of the Non—Resident Holder—Legal Entity to the benefits of the double tax treaty. The confirmation should state that the respective Non-Resident Holder—Legal Entity is the resident (in the meaning of the relevant double tax treaty) of the relevant treaty country in a particular calendar year during which the income is paid. This confirmation should be apostilled or legalised and needs to be renewed on an annual basis. In practice a notarised Russian translation of the certificate may be required. There can be no assurance however that the advance treaty relief will be available in practice.

Under Russian domestic tax legislation, in order to enjoy benefits of the applicable tax treaty a Non Resident Holder—Individual must provide to the Russian tax authorities an official confirmation of his or her residency (in the meaning of the relevant double tax treaty) in the relevant treaty country) issued by the competent authorities (in the meaning of the relevant double tax treaty) of above country and a confirmation certified by the tax authorities of above country of income received and the tax paid outside the Russian Federation in relation to income with respect to which treaty benefits are claimed. Such requirements may be imposed even if they directly contradict the provisions of the applicable double tax treaty. Technically, these requirements mean that a Non-Resident Holder—Individual cannot rely on the tax treaty until he or she pays the tax in the jurisdiction of his or her tax residency. Individuals in practice would not be able to obtain the advance treaty relief in relation to

income derived from Russian sources, as it is unlikely that the supporting documentation required for the treaty relief can be provided to the Russian tax authorities and, consequently, approval from the latter can be obtained before the receipt of income by a Non-Resident Holder—Individual occurs.

Refund of Tax Withheld

For a Non-Resident Holder—Legal Entity for which double tax treaty relief is available, if Russian withholding tax on income was withheld by the source of payment, a refund of such tax is possible within three years from the end of the tax period in which the income was paid. In order to obtain a refund, the tax documentation confirming the right of the non-resident recipient of the income to double tax treaty relief is required.

For a Non-Resident Holder—Individual for whom double tax treaty relief is available, if Russian withholding tax on income was withheld by the source of payment, a refund of such tax may be filed within one year after the end of the year in which the tax was withheld.

The Russian tax authorities may, in practice, require a wide variety of documentation confirming the right to benefits under a double tax treaty. Such documentation, in practice, may not be explicitly required by the Russian Tax Code.

Obtaining a refund of Russian tax withheld may be a time-consuming process and can involve considerable practicable difficulties.

Non-Resident Holders should consult their own tax advisors regarding possible tax treaty relief and procedures required to be fulfilled in order to obtain treaty relief with respect to any Russian taxes imposed on income received in connection with the acquisition and disposition of the Notes.

Taxation of Interest on the Loan

In general, payments of interest on borrowed funds by a Russian entity to a non-resident legal entity or organisation are subject to Russian withholding tax at a rate of 20%, subject to reduction or elimination pursuant to the terms of an applicable double tax treaty. Based on the professional advice we have received, we believe that, based on laws in effect as of the date hereof, interest payments on the Loan made to the Issuer should not be subject to withholding tax under the terms of an applicable double tax treaty between the Russian Federation and Luxembourg (the “**the Russian Federation—Luxembourg Double Tax Treaty**”).

However, because of a recent change in the approach of the Russian tax authorities towards application of benefits envisaged by double tax treaties and due to planned changes to the Russian Tax Code, there can be no assurance that such double tax treaty relief will be obtained in practice or will continue to be available.

The new protocol to the the Russian Federation—Luxembourg Double Tax Treaty was signed in 2011. The protocol introduces certain changes to the provisions of the Russian Federation—Luxembourg Double Tax Treaty. Such changes include inter alia a limitation of benefits of a resident of one contracting state if the main purpose or one of the main purposes of the establishment and existence of such resident was receipt of treaty benefits; further exchange of information procedures are extended. The protocol also provides that income falling under the “other income” category may be subject to Russian withholding tax. Once the protocol is ratified and becomes effective, it may have an impact on future payments under the Loan Agreement inter alia on payments other than interest income and principal.

The President of the Russian Federation in his budget message of 25 May 2009 expressed a goal of introducing legal mechanisms to restrict the use of international double tax treaties for the purpose of minimising taxes where the ultimate beneficiaries are not residents of the country being a party to the relevant double tax treaty.

The Government in the Main Tax Policy Guidelines for years 2012—2014 has undertaken to introduce changes to the Tax Code that would prevent application of treaty benefits to situations where ultimate beneficiaries of income are not residents of relevant treaty protected countries.

In a recent letter of the Ministry of Finance of the Russian Federation No. 03-08-13/1, dated 30 December 2011, it expresses a view that they are the noteholders who are the beneficial owners of interest payable by a Russian bank on the proceeds of a Eurobond offering that were placed as a deposit with the Russian bank by the issuer of the notes (being a special purpose vehicle established by the Russian bank). Although that letter refers to a deal

structure which is different from the structure of the transaction described in this Prospectus, and to an issuer domiciled in a jurisdiction which is different from the jurisdiction of the Issuer, we cannot exclude the risk that conclusions made in the letter may potentially be applied by the Russian tax authorities to the payments of interest in respect of the Notes.

Application of tax benefits under the double tax treaty could also be influenced by recently proposed amendments to the Russian Tax Code, which could enter into force in the near future. The Main Tax Policy Guidelines for years 2012—2014 proposes amendments to the Russian legislation aimed at provision for withholding tax relief for interest payments of Russian borrowers under eurobonds. To the best of our knowledge the amendments at the current stage state that for interest income paid on Eurobonds issued before 1 January 2013, Russian borrowers will be fully released from their duty as the tax agent (including for interest/coupon payments on Eurobonds that have already been made), provided that (i) the double tax treaty between the Russian Federation and the jurisdiction of tax residence of the issuer provides for relief of interest payments from withholding tax, (ii) the issuer duly confirms its tax residence. Release from the tax agent duty means that, in practice, withholding tax on Eurobond payments should not arise in the Russian Federation, because currently there is no mechanism or requirement for non-residents to self-assess and pay tax. For Eurobonds to be issued after 1 January 2013, Russian borrowers will be held responsible as the tax agent for profits tax only insofar as the income reported by the depository and clearing system is paid to a beneficiary who is a resident of a state with which the Russian Federation has not concluded a double tax treaty. However, different interpretations of some of the proposed changes are possible.

According to official communication on the website of the Ministry of Finance of the Russian Federation, based on its consultations with the Federal Tax Service there are no plans to challenge borrowers in connection with payments on Eurobonds issued during 2012 in respect of which borrowers are expected to be released from obligations of a tax agent under the proposed legislative amendments. However, this communication represents merely intention of the tax authorities and cannot be viewed as a binding document.

The draft of amendments to the Russian Tax Code is subject to further changes and is not under consideration in the State Duma at the time of preparing this Prospectus. At this time it is not clear to what extent such amendments could impact the application of the double tax relief to the interest payments paid under the Loan.

We believe that under tax laws of the Russian Federation as in effect on the date of this opinion payments of interest by the Borrower on the Loan to the Issuer should not be subject to the Russian withholding tax under the Russian Federation-Luxembourg double tax treaty. However, it is not currently possible to determine the extent to which aforementioned amendments or any change in the position of the Russian tax authorities (as set out above, pursuant to the letter of the Ministry of Finance of the Russian Federation and potential changes in the tax legislation) could impact the application of the double tax treaty benefits to the interest payments under the Loan made by Sistema. Accordingly, in absence of clarity on the potential amendments to the tax legislation there can be no assurance that such double tax treaty relief will be available in practice or will continue to be available throughout the term of the Loan.

In addition, if, as a result of the enforcement by the Trustee of the security granted to it by the Issuer by way of the security interests in the Trust Deed, interest under the Loan becomes payable to the Trustee, the benefit of the the Russian Federation—Luxembourg Double Tax Treaty may cease and payments of interest may be subject to Russian withholding tax.

If the payments under the Loan are subject to any withholding taxes (as a result of which the Issuer would reduce payments under the Notes in the amount of such withholding taxes), Sistema is obliged (subject to certain conditions) to increase payments as may be necessary so that the net payments received by the Noteholders will be equal to the amounts they would have received in the absence of such withholding. It should be noted, however, that tax gross-up provisions in contracts may not be enforceable under Russian law. In the event that Sistema fails to pay such additional amounts where it is obliged to do so, such failure would constitute an Event of Default under the Loan Agreement. If Sistema is obliged to increase payments, it may, subject to certain conditions, prepay the Loan in full. In such case, all outstanding Notes would be redeemable at par with accrued interest.

Russian VAT is not applied to the rendering of financial services involving the provision of a loan in monetary form. Therefore, no VAT will be payable in the Russian Federation on any payment of interest or principal in respect of the Loan.

EU Directive on the Taxation of Savings Income

Under Council Directive 2003/48/EC on the taxation of savings income (the “**Directive**”), each member state of the European Union (each, a “**Member State**”) is required to provide to the tax authorities of another Member State details of payments of interest or other similar income paid by a person within its jurisdiction to, or secured by such a person for, an individual beneficial owner resident in, or certain limited types of entity established in, that other Member State. However, for a transitional period, Austria and Luxembourg will (unless during such period they elect otherwise) instead operate a withholding system in relation to such payments. Under such a withholding system, the beneficial owner of the interest payment must be allowed to elect that certain provision of information procedures should be applied instead of withholding. The rate of withholding is 35%. The transitional period is to terminate at the end of the first full fiscal year following agreement by certain non-EU countries to exchange of information procedures relating to interest and other similar income.

A number of non-EU countries and certain dependent or associated territories of certain Member States have adopted similar measures (either provision of information or transitional withholding) in relation to payments made by a person within their respective jurisdictions to, or secured by such a person for, an individual beneficial owner resident in, or certain limited types of entity established in, a Member State. In addition, the Member States have entered into provision of information or transitional withholding arrangements with certain of those countries and territories in relation to payments made by a person in a Member State to, or secured by such a person for, an individual beneficial owner resident in, or certain limited types of entity established in, one of those countries or territories.

A proposal for amendments to the Directive has been published, including a number of suggested changes which, if implemented, would broaden the scope of the rules described above. Investors who are in any doubt as to their position should consult their professional advisers.

If a payment under a Note were to be made by a person in a Member State or another country or territory which has opted for a withholding system and an amount of, or in respect of, tax were to be withheld from that payment pursuant to the Directive or any law implementing or complying with, or introduced in order to conform to the Directive, neither the Issuer nor any Paying Agent nor any other person would be obliged to pay additional amounts under the terms of such Note as a result of the imposition of such withholding tax. The Issuer is, however, required to maintain a Paying Agent in a Member State that will not be obliged to withhold or deduct tax pursuant to the Directive or any such law.

Luxembourg

The statements herein regarding taxation in Luxembourg are based on the laws in force in Luxembourg as at the date of this Prospectus and are subject to any changes in law. The following summary does not purport to be a comprehensive description of all the tax considerations which may be relevant to a decision to purchase, own or dispose of the Notes. Each prospective holder or beneficial owner of Notes should consult its tax advisor as to the Luxembourg tax consequences of the ownership and disposition of the Notes.

When used in the subsequent paragraphs, their terms “interest,” “paying agent” and “residual entity” have the meaning given thereto in the Luxembourg laws of 21 June 2005 (the “**Laws**”).

Luxembourg tax residency of the Noteholders

A Noteholder will not become resident, or be deemed to be resident, in Luxembourg by reason only of the holding of the Notes, or the execution, performance, delivery and/or enforcement of the Notes.

Withholding tax

Luxembourg non-residents

Under Luxembourg tax law currently in effect and subject to the application of the Laws implementing the Directive and several agreements concluded between Luxembourg and certain dependant or associated territories of the European Union (“**EU**”), there is no withholding tax on payments of interest (including accrued but unpaid interest). There is also no Luxembourg withholding tax, subject to the application of the Laws, upon repayment of the principal or upon redemption or exchange of the Notes.

Under the Laws, a Luxembourg based paying agent is required since 1 July 2005 to withhold tax on interest and other similar income paid by it to (or under certain circumstances, to the benefit of) an individual resident in

another Member State or in certain EU dependent or associated territories, unless the beneficiary of the interest payments elects for the exchange of information or for the tax certificate procedure. The same treatment will apply to payments of interest and other similar income made to certain “residual entities” as defined in Article 4.2 of the Directive (i.e., an entity without legal personality (the Finnish and Swedish companies listed in Article 4.5 of the Directive are not considered as legal persons for this purpose) and whose profits are not taxed under the general arrangements for the business taxation and that is not, or has not opted to be considered as, a UCITS recognised in accordance with Council Directive 85/611/EEC) established in a Member State or in certain EU dependent or associated territories.

The withholding tax rate is 35 per cent as from 1 July 2011. The withholding tax system will only apply during a transitional period, the ending of which depends on the conclusion of certain agreements relating to information exchange with certain other countries (the transitional period may therefore never end).

Luxembourg residents

As from 1 January 2006, interest payments made by Luxembourg paying agents to Luxembourg individual residents or to certain foreign residual entities to secure the interest payment for such individual are subject to a 10 per cent. withholding tax (the “**10 Per Cent. Luxembourg Withholding Tax**”). Income (other than interest) from investment funds and from current accounts provided that the interest rate is not higher than 0.75 per cent, are exempt from the withholding tax. Furthermore, interest which is accrued once a year on savings accounts (short and long term) and which does not exceed EUR 250 per person and per paying agent is exempted from the withholding tax.

Taxation of the Noteholders

Taxation of Luxembourg non-residents

Noteholders who are non-residents of Luxembourg and who have neither a permanent establishment nor a fixed base of business in Luxembourg with which the holding of the Notes is connected are not liable to any Luxembourg income tax, whether they receive repayments of principal, payments of interest (including accrued but unpaid interest), payments received upon the redemption of the Notes, or realise capital gains on the sale of any Notes.

Taxation of Luxembourg residents

Luxembourg resident Noteholders, or non-resident Noteholders who have a permanent establishment or a fixed base of business in Luxembourg with which the holding of the Notes is connected will not be liable to any Luxembourg income tax on repayment of principal.

Luxembourg resident individuals

Pursuant to the Luxembourg law of 23 December 2005 as amended by the law of 17 July 2008, Luxembourg resident individuals, acting in the course of their private wealth, can opt to self-declare and pay a 10 per cent. tax (the “**10 Per Cent. Tax**”) on interest payments made after 31 December 2007 by paying agents located in an EU Member State other than Luxembourg, a Member State of the European Economic Area or in a State or territory which has concluded an international agreement directly related to the Directive. The 10 Per Cent. Luxembourg Withholding Tax or the 10 Per Cent. Tax on interest received represents the final tax liability for the Luxembourg resident individuals receiving the payment in the course of their private wealth and can be reduced in consideration of foreign withholding tax, based on double tax treaties concluded by Luxembourg. Individual Luxembourg resident Noteholders receiving the interest as business income must include interest income in their taxable basis. The 10 Per Cent. Luxembourg Withholding Tax levied will be credited against their final income tax liability.

Luxembourg resident individual Noteholders are not subject to taxation on capital gains upon the disposal of the Notes, unless the disposal of the Notes precedes the acquisition of the Notes or the Notes are disposed of within six months of the date of acquisition of these Notes. Upon sale, redemption or exchange of the Notes, accrued but unpaid interest will, however, be subject to the 10 Per Cent. Luxembourg Withholding Tax or to the 10% Tax if the Luxembourg resident individuals opt for the 10 Per Cent. Tax. Individual Luxembourg resident Noteholders receiving the interest as business income must also include the portion of the redemption price corresponding to this interest in their taxable income. The 10 Per Cent. Luxembourg Withholding Tax levied will be credited against their final income tax liability.

Luxembourg resident companies

Unless exempt from Luxembourg taxation, Luxembourg resident corporate (sociétés de capitaux) Noteholders or foreign entities of the same type which have a permanent establishment in Luxembourg with which the holding of the Notes is connected, must include in their taxable income any interest (including accrued but unpaid interest) as well as the difference between the sale or redemption price (including accrued but unpaid interest) and the lower of the cost or book value of the Notes sold or redeemed.

Net Wealth Tax

Luxembourg net wealth tax will not be levied on a Noteholder, unless (i) such Noteholder is a Luxembourg fully taxable resident company or (ii) the Notes are attributable to an enterprise or part thereof which is carried on in Luxembourg by a non-resident company through a permanent establishment.

Other Taxes

There is no Luxembourg registration tax, capital tax, stamp duty or any other similar tax or duty payable in Luxembourg (other than nominal court fees payable in Luxembourg in respect of or in connection with the execution, delivery and enforcement by legal proceedings (including any foreign judgment in the courts of Luxembourg), by Noteholders as a consequence of the issuance of the Notes, the performance of the Issuer's obligations under the Notes, nor will any of these taxes be payable as a consequence of a subsequent transfer or redemption of the Notes. However, in the case of court proceedings in a Luxembourg court or the presentation of the documents relating to the Notes to an "autorité constituée," such court or "autorité constituée" may require registration thereof, and an ad valorem registration tax, the rate of which will depend on the underlying agreement reflected in any such document(s), will become payable. The tax rate for documents containing acknowledgement of debt, such as the Loan, is of 0.24% of the relevant amounts.

There is no Luxembourg value added tax payable in respect of payments in consideration for the issuance of the Notes or in respect of the payment of interest or principal under the Notes or the transfer of the Notes. Luxembourg value added tax may, however, be payable in respect of fees charged for certain services rendered to the Issuer, if for Luxembourg value added tax purposes such services are rendered or are deemed to be rendered in Luxembourg and an exemption from Luxembourg value added tax does not apply with respect to such services.

No Luxembourg estate or inheritance taxes are levied on the transfer of the Notes upon death of a Noteholder in cases where the deceased was not a resident of Luxembourg for inheritance tax purposes. No Luxembourg gift tax is levied on the transfer of the Notes by gift, unless the gift is registered in Luxembourg.

United States—Certain Material United States Federal Income Tax Considerations

TO COMPLY WITH UNITED STATES TREASURY DEPARTMENT CIRCULAR 230, PROSPECTIVE INVESTORS ARE HEREBY NOTIFIED THAT: (A) ANY DISCUSSION OF FEDERAL TAX ISSUES IN THIS PROSPECTUS IS NOT INTENDED OR WRITTEN TO BE USED, AND CANNOT BE USED BY ANY TAXPAYER, FOR THE PURPOSE OF AVOIDING PENALTIES THAT MAY BE IMPOSED ON THE TAXPAYER UNDER THE UNITED STATES INTERNAL REVENUE CODE; (B) ANY SUCH DISCUSSION IS INCLUDED HEREIN IN CONNECTION WITH THE PROMOTION OR MARKETING (WITHIN THE MEANING OF CIRCULAR 230) OF THE TRANSACTIONS OR MATTERS ADDRESSED HEREIN; AND (C) A TAXPAYER SHOULD SEEK ADVICE BASED ON THE TAXPAYER'S PARTICULAR CIRCUMSTANCES FROM AN INDEPENDENT TAX ADVISOR.

The following is a summary of certain material U.S. federal income tax consequences of the acquisition, ownership and disposition of the Notes by a U.S. Holder (as defined below). This summary deals only with U.S. Holders that purchase the Notes at their "issue price" (generally, the first price at which a substantial part of the Notes is sold to investors for cash, excluding sales to bond houses, brokers or similar persons or organisations acting in the capacity of underwriters, placement agents or wholesalers) and who, for U.S. federal income tax purposes, will hold the Notes as capital assets and whose functional currency is the U.S. dollar. The discussion does not cover all aspects of U.S. federal income taxation that may be relevant to particular investors in light of their specific situations, and does not address state, local, foreign or other tax laws. In particular, this summary does not discuss all of the tax considerations that may be relevant to certain types of investors subject to special treatment under the U.S. federal income tax laws (such as financial institutions, insurance companies, regulated investment companies, real estate investment trusts, investors liable for the alternative minimum tax, partnerships

that invest in the Notes and partners in such partnerships, tax-deferred accounts, tax-exempt organisations, dealers in securities or currencies, or investors that will hold the Notes as part of straddles, hedging transactions or conversion transactions for U.S. federal income tax purposes).

As used herein, the term “**U.S. Holder**” means a beneficial owner of the Notes that is, for U.S. federal income tax purposes, an individual who is a citizen or resident of the United States, a corporation or any entity taxable as a corporation created or organised in the United States or under the laws of the United States or of any political subdivision thereof, an estate the income of which is subject to U.S. federal income taxation regardless of its source or a trust if it is subject to primary supervision of a court within the United States and one or more U.S. persons have the authority to control all substantial decisions of the trust or if the trust has a valid election in effect under applicable U.S. Treasury Regulations to be treated as a U.S. person.

The summary is based on the tax laws of the United States, including the Code, its legislative history, existing and proposed regulations thereunder, published rulings and court decisions, all as currently in effect and all subject to change at any time, possibly with retroactive effect.

Payments of Interest

Interest on a Note will be taxable to a U.S. Holder as ordinary income at the time it is received or accrued, depending on the holder’s method of accounting for tax purposes. Interest paid by the Issuer on the Notes generally will constitute income from sources outside the United States.

Should any foreign tax be withheld, the amount withheld and the gross amount of any additional amounts paid to a U.S. Holder will be included in such holder’s income at the time interest income is received or accrued in accordance with such holder’s method of tax accounting for U.S. federal income tax purposes. Any foreign withholding tax paid at the rate applicable to a U.S. holder would, subject to limitations and conditions, be treated as foreign income tax eligible for credit against such holder’s U.S. federal income tax liability or, at such holder’s election, eligible for deductions in computing U.S. federal taxable income. U.S. Holders should consult their tax advisors regarding the creditability or deductibility of any withholding taxes.

Purchase, Sale, Retirement or Other Taxable Disposition of the Notes

A U.S. Holder will generally recognise gain or loss on the sale, retirement or other taxable disposition of a Note equal to the difference between the amount realised on the sale, retirement or other taxable disposition and the tax basis of the Note. The amount realised does not include amounts attributable to accrued but unpaid interest not previously included in income, which will be treated as a payment of interest. A U.S. Holder’s tax basis in a Note will generally be its U.S. dollar cost. Gain or loss recognised on the sale, retirement or other taxable disposition of a Note will be long-term capital gain or loss if the U.S. Holder’s holding period in the Notes exceeds one year. The deductibility of capital losses is subject to limitations. Gain or loss realised by a U.S. Holder on the sale, retirement or other taxable disposition of a Note generally will be U.S. source.

Backup Withholding and Information Reporting

In general, payments of interest on, and the proceeds of a sale, redemption or other disposition of, the Notes, payable to a U.S. Holder by a U.S. paying agent or other U.S. intermediary will be reported to the U.S. Internal Revenue Service and to the U.S. Holder as may be required under applicable regulations. Backup withholding will apply to these payments if the U.S. Holder fails to provide an accurate taxpayer identification number or certification of exempt status or fails to report all interest and dividends required to be shown on its U.S. federal income tax returns. Certain U.S. Holders (including, among others, corporations) are not subject to backup withholding. U.S. Holders should consult their tax advisers as to their qualification for exemption from backup withholding and the procedure for obtaining an exemption.

Foreign Financial Asset Reporting

Legislation enacted in March 2010 imposes new reporting requirements on the holding of certain foreign financial assets, including debt of foreign entities, if the aggregate value of all of these assets exceeds \$50,000 at the end of the taxable year or \$75,000 at any time during the taxable year. These thresholds are higher for married individuals filing jointly and individuals living outside of the United States. The Notes are expected to constitute foreign financial assets subject to these requirements unless the Notes are held in an account at a financial institution (in which case, the account may be reportable if maintained by a foreign financial institution). U.S. Holders should consult their tax advisers regarding the application of this legislation.

GENERAL INFORMATION

- (1) The Notes have been accepted for clearance through Euroclear, Clearstream, Luxembourg and DTC. The Common Code for the Regulation S Notes is 078324287. The ISIN for the Regulation S Notes is XS0783242877. The CUSIP number of the Rule 144A Notes is 82977TAA1 and the ISIN of the Rule 144A Notes is US82977TAA16. The Common Code for the Rule 144A Notes is 078370025. The address of Euroclear is 1 Boulevard du Roi Albert II, B-1210 Brussels, Belgium and the address of Clearstream, Luxembourg is 42 Avenue JF Kennedy L-1855, Luxembourg. The address of DTC is 55 Water Street, New York, New York 10041-0099, United States.
- (2) Application has been made to the Irish Stock Exchange for the Notes to be admitted to the Official List and to trading on the Regulated Market, through the Listing Agent, Arthur Cox Listing Services Limited (“ACLSL”). ACLSL is acting solely in its capacity as listing agent for the Issuer in relation to the Notes and is not itself seeking admission to the Official List of the Irish Stock Exchange or to trading on the Regulated Market for the purposes of the Prospectus Directive.
- (3) It is expected that the admission of the Notes to the Official List and to trading on the Regulated Market will take place on or about 18 May 2012, subject to the issuance of the Global Certificates.
- (4) For so long as any Notes are outstanding, copies in English of the following documents in physical form may be obtained free of charge at the offices of the Issuer, the Trustee and the Principal Paying Agent during normal business hours on any weekday (Saturdays, Sundays and public holidays excepted):
 - Sistema JSFC’s charter;
 - the annual reports and consolidated annual accounts of Sistema for the years ended 31 December 2009, 2010 and 2011 prepared in accordance with the U.S. GAAP;
 - the articles of association of the Issuer;
 - the Reserves Report prepared by Miller and Lents referred in this Prospectus;
 - this Prospectus, together with any amendment or supplement hereto; and
 - the Trust Deed in respect of the Notes (including the form of the Global Certificates and the Definitive Certificates), the Loan Agreement and the Agency Agreement.
- (5) Except as disclosed in “Management’s Discussion and Analysis of Financial Condition and Results of Operations—Recent Developments,” since 31 December 2011, there has been no significant change in Sistema JSFC’s or Sistema’s financial or trading position or prospects and no material adverse change in Sistema JSFC’s or Sistema’s prospects.
- (6) Since the date of the incorporation of the Issuer on 2 May 2012, there has been no significant change in the financial or trading position of the Issuer and no material adverse change in the financial position and prospects of the Issuer. The Issuer has no subsidiaries.
- (7) The Issuer and Sistema JSFC have obtained all necessary consents, approvals and authorisations in Luxembourg and the Russian Federation, respectively, in connection with the issue and performance of the Notes and the making of the Loan. The issue of the Notes and the making of the Loan was authorised by a resolution of the board of directors of the Issuer dated 11 May 2012.
- (8) No consents, approvals, authorisations or order of any regulatory authorities are required by the Issuer under the laws of Luxembourg for the issue of the Notes and the making of the Loan.
- (9) Since the date of the incorporation of the Issuer, the Issuer is not and has not been involved in any governmental, legal or arbitration proceedings that may have, or have had in the recent past, a significant effect on the Issuer’s financial position or profitability, nor is the Issuer aware that any such proceedings are pending or threatened.
- (10) Save as described in “*Business—Material Litigation*,” in the 12 months preceding the date of this Prospectus, neither Sistema JSFC nor any its subsidiaries is or has been involved in any governmental, legal or arbitration proceedings that may have, or have had in the recent past, a significant effect on Sistema’s financial position or profitability. Sistema JSFC is not aware of any such proceedings that are pending or threatened.
- (11) As at the date of this Prospectus, Sistema JSFC is in compliance with applicable Russian law corporate governance requirements in all material respects.
- (12) The Trust Deed provides, amongst other things, that the Trustee may act or rely upon the opinion or advice of, or upon a certificate or other information from, any lawyer, banker, valuer, surveyor, broker, auctioneer,

accountant, auditor or other expert (whether or not addressed to the Trustee), notwithstanding the fact that such opinion, advice, certificate or other information contains a monetary or other limit on the liability of any such persons in respect thereof.

- (13) Save for the fees payable to the Joint Lead Managers, the Trustee, the Principal Paying Agent and the Registrar, so far as the Issuer is aware, no person involved in the issue of the Notes has an interest that is material to the issue of the Notes.
- (14) Sistema JSFC was incorporated as an open joint stock company under the laws of the Russian Federation by the Moscow Registration Chamber under registration No. 025.866 on 16 July 1993 and was recorded in the Unified State Register of Legal Entities under Primary State Registration Number 1027700003891 on 11 November 2002.
- (15) The Issuer estimates the total expenses related to the admission of the Notes to trading on the Regulated Market to be U.S.\$2,200,000.
- (16) Interest and principal on the Loan will be paid into an account operated by the Principal Paying Agent for the benefit of the Issuer.
- (17) Each time the Issuer sends an annual report to the holders of the Rule 144A Notes, the Issuer will include a reminder that: (a) each holder of the Rule 144A Notes that is a U.S. person is required to be a QIB and a QP that can make the representations set forth in “*Transfer Restrictions—Rule 144A Notes*”; (b) the Rule 144A Notes can only be transferred to a person if such person is a QIB that is also a QP which is capable of making the same representations; and (c) the Issuer has the right to force any holder of the Rule 144A Notes that is not a QIB and a QP to sell or redeem its Rule 144A Notes.
- (18) The U.S. GAAP Financial Statements included in this Prospectus have been audited by ZAO Deloitte & Touche CIS, independent auditors, as stated in their report appearing herein. ZAO Deloitte & Touche CIS has given and not withdrawn its consent to the inclusion in this Prospectus of its audit report on page F-2 in the form and context in which it appears and has authorised the contents of those parts of this document which comprise the report. ZAO Deloitte & Touche CIS has stated that it is responsible for the auditors’ report referred to above as part of the Prospectus and has declared that it has taken all reasonable care to ensure that the information contained in that report is, to the best of its knowledge, in accordance with the facts and contains no omission likely to affect its import.

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INDEPENDENT AUDITORS' REPORT

To the Board of Directors and Shareholders of Sistema Joint Stock Financial Corporation:

We have audited the accompanying consolidated statements of financial position of Joint-Stock Financial Corporation Sistema and its subsidiaries (the "Group") as of December 31, 2011 and 2010, and the related consolidated statements of operations, cash flows, and changes in shareholders' equity for the years ended December 31, 2011, 2010 and 2009. These financial statements are the responsibility of the Group's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Group's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such consolidated financial statements present fairly, in all material respects, the financial position of the Group as of December 31, 2011 and 2010, and the results of its operations and its cash flows for the years ended December 31, 2011, 2010 and 2009 in conformity with accounting principles generally accepted in the United States of America.

/s/ ZAO Deloitte & Touche CIS

Moscow, Russia
April 20, 2012

SISTEMA JSFC AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF FINANCIAL POSITION
AS OF DECEMBER 31, 2011 AND 2010
(Amounts in thousands of U.S. dollars, except share and per share amounts)

	Notes	<u>2011</u>	<u>2010</u>
ASSETS			
CURRENT ASSETS:			
Cash and cash equivalents		\$ 2,923,957	\$ 2,245,884
Assets from banking activities, current portion (including cash and cash equivalents of \$1,315,075 and \$2,308,488)	6	4,204,961	5,502,729
Short-term investments	7	763,631	879,680
Accounts receivable, net	8	1,756,278	1,780,423
VAT receivable		709,099	531,127
Inventories and spare parts	10	1,659,653	1,455,897
Deferred tax assets, current portion	21	311,891	357,821
Disposal group held for sale	4	1,409,064	1,370,142
Other current assets	9	1,722,844	1,685,336
Total current assets		<u>15,461,378</u>	<u>15,809,039</u>
NON-CURRENT ASSETS:			
Property, plant and equipment, net	12	18,360,826	18,022,199
Advance payments for non-current assets		264,709	1,312,053
Goodwill	13	1,601,260	1,872,520
Other intangible assets, net	14	2,251,166	3,021,918
Investments in affiliates	15	1,382,651	1,147,694
Assets from banking activities, net of current portion	6	2,303,120	1,799,620
Debt issuance costs, net		171,951	159,803
Deferred tax assets, net of current portion	21	348,589	304,761
Long-term investments	16	1,294,687	469,742
Other non-current assets		461,684	246,699
Total non-current assets		<u>28,440,643</u>	<u>28,357,009</u>
TOTAL ASSETS		<u><u>\$43,902,021</u></u>	<u><u>\$44,166,048</u></u>

See notes to consolidated financial statements.

SISTEMA JSFC AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF FINANCIAL POSITION (CONTINUED)
AS OF DECEMBER 31, 2011 AND 2010
(Amounts in thousands of U.S. dollars, except share and per share amounts)

	Notes	2011	2010
LIABILITIES AND SHAREHOLDERS' EQUITY			
CURRENT LIABILITIES:			
Accounts payable		\$ 2,189,019	\$ 1,741,712
Liabilities from banking activities, current portion	17	3,152,989	4,191,836
Taxes payable		794,117	649,194
Deferred tax liabilities, current portion	21	168,545	168,982
Subscriber prepayments, current portion		605,545	579,952
Accrued expenses and other current liabilities	18	2,362,768	3,277,693
Short-term loans payable	19	299,610	1,074,081
Current portion of long-term debt	20	4,097,076	2,103,405
Disposal group held for sale	4	248,317	295,805
Total current liabilities		13,917,986	14,082,660
LONG-TERM LIABILITIES:			
Long-term debt, net of current portion	20	12,013,197	12,206,515
Subscriber prepayments, net of current portion		106,586	129,515
Liabilities from banking activities, net of current portion	17	1,644,478	1,444,783
Deferred tax liabilities, net of current portion	21	1,412,199	1,580,518
Asset retirement obligation	2	214,121	258,382
Postretirement benefits obligation		77,591	58,732
Property, plant and equipment contributions		86,081	89,067
Total long-term liabilities		15,554,253	15,767,512
TOTAL LIABILITIES		29,472,239	29,850,172
Commitments and contingencies	27		
Redeemable noncontrolling interests	2	723,819	107,343
SHAREHOLDERS' EQUITY:			
Share capital (9,650,000,000 shares issued; 9,267,985,025 and 9,281,827,594 shares outstanding with par value of 0.09 Russian Rubles, respectively)	23	30,057	30,057
Treasury stock (382,014,975 and 368,172,406 shares with par value of 0.09 Russian Rubles, respectively)		(467,198)	(463,733)
Additional paid-in capital		2,575,601	2,553,563
Retained earnings		6,418,649	6,471,327
Accumulated other comprehensive loss		(518,354)	(171,149)
Total Sistema JSFC shareholders' equity		8,038,755	8,420,065
Non-redeemable noncontrolling interests in equity of subsidiaries		5,667,208	5,788,468
TOTAL EQUITY		13,705,963	14,208,533
TOTAL LIABILITIES AND EQUITY		\$43,902,021	\$44,166,048

See notes to consolidated financial statements.

SISTEMA JSFC AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS
FOR THE YEARS ENDED DECEMBER 31, 2011, 2010 AND 2009
(Amounts in thousands of U.S. dollars, except share and per share amounts)

	Notes	<u>2011</u>	<u>2010</u>	<u>2009</u>
Sales		\$ 32,452,236	\$ 26,222,373	\$ 17,425,502
Revenue from banking activities		529,012	588,946	697,227
TOTAL REVENUES		<u>32,981,248</u>	<u>26,811,319</u>	<u>18,122,729</u>
Cost of sales, exclusive of depreciation, depletion and amortization shown separately below		(13,021,173)	(10,716,816)	(7,084,969)
Cost related to banking activities, exclusive of depreciation and amortization shown separately below		(310,332)	(374,036)	(540,263)
Selling, general and administrative expenses		(3,936,588)	(3,747,805)	(3,028,891)
Depreciation, depletion and amortization		(3,281,629)	(2,862,754)	(2,434,733)
Transportation costs		(789,785)	(535,391)	(159,001)
Provision for doubtful accounts		(135,967)	(161,519)	(246,981)
Loss from impairment and provisions of other assets	11	(1,031,262)	(313,381)	(717,516)
Taxes other than income tax		(6,257,642)	(4,106,338)	(1,607,243)
Other operating expenses, net		(458,852)	(260,271)	(436,371)
Equity in results of affiliates		120,929	92,235	(12,758)
Gain on acquisition	3	—	—	2,782,835
Gain upon adoption of equity method	15	—	477,400	—
Gain/(loss) on disposal of interests in subsidiaries and affiliates	4	62,514	—	(383,978)
OPERATING INCOME		<u>3,941,461</u>	<u>4,302,643</u>	<u>4,252,860</u>
Interest income		176,584	131,534	191,203
Change in fair value of derivative instruments		(2,268)	(2,062)	(35,200)
Interest expense		(1,742,690)	(1,597,244)	(1,246,356)
Foreign currency transactions (losses)/ gains		(326,415)	26,151	(94,053)
Income from continuing operations before income tax		2,046,672	2,861,022	3,068,454
Income tax expense	21	(1,088,546)	(1,065,480)	(743,895)
Equity in net income of energy companies in the Republic of Bashkortostan		—	—	4,400
Income from continuing operations		<u>\$ 958,126</u>	<u>\$ 1,795,542</u>	<u>\$ 2,328,959</u>
Income/(loss) from discontinued operations, net of income tax effect of \$26,184, \$23,483 and \$2,773, respectively		71,233	(2,999)	(16,679)
Gain/(loss) on disposal of discontinued operations, net of income tax effect of \$39,547, \$nil and \$nil	4	161,817	324,656	(26,194)
NET INCOME		<u>\$ 1,191,176</u>	<u>\$ 2,117,199</u>	<u>\$ 2,286,086</u>
Noncontrolling interest		(973,174)	(1,198,502)	(642,645)
NET INCOME ATTRIBUTABLE TO SISTEMA JSFC		<u>\$ 218,002</u>	<u>\$ 918,697</u>	<u>\$ 1,643,441</u>
Amounts attributable to Sistema JSFC				
Income from continuing operations		\$ 118,087	\$ 621,663	\$ 1,676,476
Income/(loss) from discontinued operations ..		99,915	297,034	(33,035)
Weighted average number of common shares outstanding—basic and diluted		9,276,977,916	9,280,322,906	9,278,981,940
Income per share, basic and diluted, U.S. cent				
Income from continuing operations		1.27	6.7	18.07
Income/(loss) from discontinued operations ..		1.08	3.2	(0.36)
Net income attributable to Sistema JSFC shareholders		2.35	9.90	17.71

See notes to consolidated financial statements.

SISTEMA JSFC AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED DECEMBER 31, 2011, 2010 AND 2009
(Amounts in thousands of U.S. dollars)

	<u>2011</u>	<u>2010</u>	<u>2009</u>
CASH FLOWS FROM OPERATING ACTIVITIES:			
Net income	\$1,191,176	\$2,117,199	\$ 2,286,086
(Gain)/loss on disposal of discontinued operations	(161,817)	(324,656)	26,194
(Income)/loss from discontinued operations	(71,233)	2,999	16,679
Income from continuing operations	958,126	1,795,542	2,328,959
Adjustments to reconcile net income to net cash provided by operations:			
Depreciation, depletion and amortization	3,281,629	2,862,754	2,434,733
Equity in results of affiliates	(120,929)	(92,235)	12,758
Deferred income tax benefit	(14,934)	(24,097)	(29,954)
Change in fair value of derivative financial instruments	2,268	2,062	35,200
Foreign currency transactions loss/(gain)	326,415	(26,151)	94,053
Debt issuance cost amortization	49,179	89,244	51,707
Non-cash compensation to employees of subsidiaries	51,037	70,978	10,946
Accretion expense associated with the asset retirement obligation	29,475	8,925	5,916
Loss from impairment and provisions of other assets	1,031,262	313,381	717,516
Loss on disposal of property, plant and equipment	24,160	32,124	8,624
(Gain)/loss on disposal of interests in subsidiaries and affiliates . .	(62,514)	—	383,978
(Gain) on acquisition	—	—	(2,782,835)
(Gain) upon adoption of equity method	—	(477,400)	—
Amortization of connection fees	(96,676)	(95,706)	(36,449)
Provision for doubtful accounts	135,967	161,519	246,981
Allowance for loan losses	10,563	29,052	34,606
Dividends received from affiliates	42,328	34,937	107,735
Other	—	—	18,961
Changes in operating assets and liabilities, net of effects from purchase of businesses:			
Trading securities	(121,253)	120,236	(99,224)
Accounts receivable	(186,070)	(417,639)	(234,463)
VAT receivable	(167,414)	(464,537)	(133,088)
Other current assets	(144,852)	(298,271)	256,753
Inventories and spare parts	(190,841)	(395,067)	(120,194)
Accounts payable	574,602	226,193	(484,882)
Subscriber prepayments	99,340	132,105	77,871
Taxes payable	97,105	(54,119)	297,738
Accrued expenses and other liabilities	(198,047)	406,003	442,544
Postretirement benefits obligation	(5,650)	55,331	(3,661)
Net cash provided by operating activities of continuing operations	<u>5,404,276</u>	<u>3,995,164</u>	<u>3,642,829</u>
Net cash provided by operating activities of discontinued operations . .	<u>167,132</u>	<u>61,588</u>	<u>41,740</u>
Net cash provided by operating activities	<u>\$5,571,408</u>	<u>\$4,056,752</u>	<u>\$ 3,684,569</u>

SISTEMA JSFC AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS (CONTINUED)
FOR THE YEARS ENDED DECEMBER 31, 2011, 2010 AND 2009
(Amounts in thousands of U.S. dollars)

	<u>2011</u>	<u>2010</u>	<u>2009</u>
CASH FLOWS FROM INVESTING ACTIVITIES:			
Payments for purchases of property, plant and equipment	(3,680,939)	(3,486,468)	(3,000,930)
Payments for purchases of intangible assets	(451,151)	(693,106)	(433,486)
Payments for purchases of businesses, net of cash acquired	(375,245)	(364,532)	(1,729,063)
Payments for purchases of long-term investments	(929,097)	(478,530)	(758,591)
Payments for purchases of short-term investments	(893,682)	(851,325)	(936,122)
Payments for purchases of other non-current assets	(173,816)	(78,286)	(145,914)
(Increase)/decrease in restricted cash	(45,299)	(16,445)	11,778
Proceeds from sale of subsidiaries, net of cash disposed	184,596	307,358	123,165
Proceeds from sale of property, plant and equipment	170,178	18,782	5,196
Proceeds from sale of long-term investments	165,629	140,979	111,105
Proceeds from sale of other non-current assets	—	92,430	35,649
Proceeds from sale of short-term investments	1,184,068	461,882	336,127
Net (decrease)/ increase in loans to customers and banks	(341,126)	107,917	82,813
Net cash used in investing activities	<u>\$(5,185,884)</u>	<u>\$(4,839,344)</u>	<u>\$(6,298,273)</u>
CASH FLOWS FROM FINANCING ACTIVITIES:			
(Principal payments on)/proceeds from short-term borrowings, net	(276,885)	460,617	(864,416)
Net (decrease)/increase in deposits from customers of the banking division	(651,101)	597,888	(1,201,192)
Net (decrease)/increase in debt securities issued and other liabilities	(457,867)	(225,504)	1,008,365
Advance received for shares of SSTL	—	602,276	—
Proceeds from long-term borrowings, net of debt issuance costs	6,421,015	5,459,359	11,638,990
Debt issuance costs	(69,860)	(86,522)	(174,844)
Principal payments on long-term borrowings	(4,331,488)	(5,302,634)	(4,390,547)
Principal payments on capital lease obligations	(19,122)	(10,420)	(8,755)
Acquisition of noncontrolling interests in existing subsidiaries	(261,295)	(787,434)	(194,233)
Dividends paid	(960,486)	(823,616)	(605,477)
Proceeds from capital transactions of subsidiaries	153,710	109,112	—
Purchases of treasury shares	(28,559)	—	—
Net cash (used in)/provided by financing activities	<u>\$ (481,938)</u>	<u>\$ (6,878)</u>	<u>\$ 5,207,891</u>
Effect of foreign currency translation on cash and cash equivalents	<u>\$ (154,384)</u>	<u>\$ (10,110)</u>	<u>\$ 56,436</u>
Net decrease in cash and cash equivalents	<u>\$ (250,798)</u>	<u>\$ (799,580)</u>	<u>\$ 2,650,623</u>
Cash and cash equivalents at the beginning of the period (including cash of discontinued operations)	4,573,556	5,373,136	2,722,513
Cash and cash equivalents at the end of the period (including cash of discontinued operations)	4,322,758	4,573,556	5,373,136
Cash and cash equivalents of discontinued operations at the end of the period	<u>(83,726)</u>	<u>(19,184)</u>	<u>(21,375)</u>
Cash and cash equivalents of continuing operations at the end of the period *	<u>\$ 4,239,032</u>	<u>\$ 4,554,372</u>	<u>\$ 5,351,761</u>
CASH PAID DURING THE PERIOD FOR:			
Interest paid, net of amounts capitalized	\$(1,802,826)	\$(1,643,973)	\$(1,246,503)
Income taxes paid	(1,069,790)	(987,696)	(599,907)
NON-CASH INVESTING AND FINANCING ACTIVITIES:			
Property, plant and equipment contributed free of charge	\$ 6,110	\$ 2,814	\$ 3,213
Equipment acquired through vendor financing	152,489	36,064	27,983
Equipment acquired under capital leases	2,708	2,567	179,086
Amounts owed for capital expenditures	322,867	220,790	285,975
Payable related to business acquisitions	6,857	23,281	37,985
Advances for purchase of long-lived assets	118,192	675,548	142,874
* Cash and cash equivalents at the end of the period comprised of the following:			
<i>Non-banking activities</i>	<u>\$ 2,923,957</u>	<u>\$ 2,245,884</u>	<u>\$ 3,415,305</u>
<i>Banking activity</i>	<u>1,315,075</u>	<u>2,308,488</u>	<u>1,936,456</u>
	<u>\$ 4,239,032</u>	<u>\$ 4,554,372</u>	<u>\$ 5,351,761</u>

See notes to consolidated financial statements.

SISTEMA JSFC AND SUBSIDIARIES

**CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY
FOR THE YEARS ENDED DECEMBER 31, 2011, 2010 AND 2009**

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

	Share capital	Treasury Stock	Additional paid-in capital	Retained earnings	Accumulated other comprehensive income	Sistema JSFC shareholders' equity	Non-redeemable non-controlling interests	Total equity	Redeemable non-controlling interests		
	Shares	Shares	Amount	Amount	Amount	Amount	Amount	Amount	Amount		
Balances at January 1, 2009	9,650,000,000	30,057	(371,018,060)	(466,345)	2,450,496	3,930,143	(453,107)	5,491,244	3,836,573	9,327,817	237,948
Accrued compensation costs	—	—	6,287	—	—	—	—	6,287	2,934	9,221	—
Change in fair value of noncontrolling interests	—	—	—	—	—	4,175	—	4,175	3,320	7,495	(2,395)
Dividends declared by subsidiaries	—	—	—	—	—	—	—	—	(587,746)	(587,746)	(12,503)
Acquisition of noncontrolling interests	—	—	—	—	—	—	—	—	(46,985)	(46,985)	(140,749)
Disposals and capital transactions of subsidiaries	—	—	—	—	—	—	—	—	233,191	(71,517)	—
Acquisition of subsidiaries	—	—	—	—	—	—	86,267	(304,708)	2,552,102	2,552,102	—
Comprehensive income:											
Change in fair value of interest rate swaps, net of income tax effect of \$3,527	—	—	—	—	—	—	(13,136)	(13,136)	(10,442)	(23,578)	—
Unrealized losses on available-for-sale securities, net of income tax effect of \$nil	—	—	—	—	—	—	(2,596)	(2,596)	—	(2,596)	—
Unrecognized actuarial gains, net of income tax effect of \$nil	—	—	—	—	—	—	668	668	2,446	3,114	—
Translation adjustment, net of income tax effect of \$nil	—	—	—	—	—	—	288,257	288,257	250,173	538,430	(4,399)
Net income	—	—	—	—	—	1,643,441	—	1,643,441	638,286	2,281,727	4,359
Total comprehensive income									880,463	2,797,097	(40)
Balances at December 31, 2009	9,650,000,000	30,057	(371,018,060)	(466,345)	2,088,319	5,577,759	(93,647)	7,136,143	6,873,852	14,009,995	82,261
Issue of shares to employees	—	—	2,845,654	2,612	—	—	—	2,612	—	2,612	—
Accrued compensation costs	—	—	—	—	—	336	—	60,965	757	61,722	—
Change in fair value of noncontrolling interests	—	—	—	—	—	(6,639)	—	(6,639)	(5,479)	(12,118)	12,118
Dividends declared by subsidiaries	—	—	—	—	—	—	—	—	(838,158)	(838,158)	(14,973)
Dividends declared by Sistema JSFC	—	—	—	—	—	—	—	—	—	(17,455)	—
Acquisition of noncontrolling interests	—	—	—	—	—	—	—	(17,455)	(695,950)	(713,649)	—
Disposals and capital transactions of subsidiaries	—	—	—	—	—	—	—	—	(687,050)	(206,107)	—
Acquisition of subsidiaries	—	—	—	—	—	—	—	480,943	—	—	19,216
Comprehensive income:											
Change in fair value of interest rate swaps, net of income tax effect of \$(6,357)	—	—	—	—	—	—	13,932	13,932	11,496	25,428	—
Unrealized losses on available-for-sale securities, net of income tax effect of \$nil	—	—	—	—	—	—	3,628	3,628	—	3,628	—
Unrecognized actuarial loss, net of income tax effect of \$nil	—	—	—	—	—	—	(2,291)	(2,291)	(5,232)	(7,523)	—
Translation adjustment, net of income tax effect of \$7,528	—	—	—	—	—	—	(92,771)	(92,771)	(56,487)	(149,258)	938
Net income	—	—	—	—	—	918,697	—	918,697	1,190,719	2,109,416	7,783
Total comprehensive income									1,140,496	1,981,691	8,721
Balances at December 31, 2010	9,650,000,000	30,057	(368,172,406)	(463,733)	2,553,563	6,471,327	(171,149)	8,420,065	5,788,468	14,208,533	107,343

SISTEMA JSFC AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY (CONTINUED)
FOR THE YEARS ENDED DECEMBER 31, 2011, 2010 AND 2009

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

	Share capital		Treasury Stock		Additional paid-in capital	Retained earnings	Accumulated other comprehensive income	Sistema JSFC shareholders' equity	Non-redeemable non-controlling interests	Total equity	Redeemable non-controlling interests
	Shares	Amount	Shares	Amount							
Balances at December 31, 2010	9,650,000,000	30,057	(368,172,406)	(463,7331)	2,553,563	6,471,327	(171,149)	8,420,065	5,788,468	14,208,533	107,343
Purchase of treasury shares	—	—	(34,078,140)	(28,585)	—	—	—	(28,585)	—	(28,585)	—
Disposal of treasury shares	—	—	20,235,571	25,120	—	—	—	25,120	—	25,120	—
Accrued compensation cost	—	—	—	—	24,334	—	—	24,334	—	24,334	—
Change in fair and redemption value of noncontrolling interests	—	—	—	—	—	(183,532)	—	(183,532)	—	(183,532)	177,477
Dividends declared by subsidiaries	—	—	—	—	—	—	—	—	(838,089)	(838,089)	(5,741)
Dividends declared by Sistema JSFC	—	—	—	—	—	(87,148)	—	(87,148)	—	(87,148)	—
Disposals and capital transactions of subsidiaries	—	—	—	—	(2,296)	—	—	(2,296)	(140,945)	(143,241)	600,000
Comprehensive income:											
Change in fair value of interest rate swaps, net of income tax effect of \$(1,841)	—	—	—	—	—	—	3,903	3,903	3,461	7,364	—
Unrecognized actuarial gains, net of income tax effect of \$nil	—	—	—	—	—	—	3,148	3,148	3,256	6,404	—
Translation adjustment, net of income tax effect of \$nil	—	—	—	—	—	—	(354,256)	(354,256)	(274,405)	(628,661)	(2,972)
Net income	—	—	—	—	—	218,002	—	218,002	1,125,462	1,343,464	(152,288)
Total comprehensive income								(129,203)	857,774	728,571	(155,260)
Balances at December 31, 2011	9,650,000,000	30,057	(382,014,975)	(467,198)	2,575,601	6,418,649	(518,354)	8,038,755	5,667,208	13,705,963	723,819

See notes to consolidated financial statements.

SISTEMA JSFC AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
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1. DESCRIPTION OF THE BUSINESS AND OPERATING ENVIRONMENT

Description of the business—Sistema Joint Stock Financial Corporation (the “Company”, together with its subsidiaries, the “Group”) invests in, and manages a range of companies which operate in the telecommunications, oil and energy, high technology, banking and other sectors. The main focus of the Group’s activities is service-based industries. The Company and the majority of the Company’s consolidated subsidiaries are incorporated in the Russian Federation (“RF”).

The controlling shareholder of the Company is Vladimir P. Evtushenkov. Minority holdings are held by certain top executives and directors of the Company. The rest of the shares are listed on the London Stock Exchange in the form of Global Depositary Receipts (“GDRs”) and Russian stock exchanges.

Below are the Group’s significant entities and their principal activities:

<u>Significant entities</u>	<u>Short name</u>	<u>Principal activity</u>	<u>Beneficial ownership as of December 31,</u>	
			<u>2011</u>	<u>2010</u>
Sistema Joint Stock Financial Corporation . . .	Sistema	Investing and financing		
Core Assets:				
Mobile TeleSystems and subsidiaries	MTS	Telecommunications	53%	55%
Bashneft and subsidiaries	Bashneft	Oil and gas production	69% ⁽¹⁾	73% ⁽¹⁾
Bashkirenergo (Note 4)	Bashkirenergo	Energy production	39% ⁽²⁾	31% ⁽²⁾
Developing Assets:				
RTI and subsidiaries (Note 5)	RTI	Technology	85%	—
MTS Bank and subsidiaries ⁽³⁾	MTS Bank	Banking	99%	99%
Sistema Shyam TeleServices Limited	SSTL	Telecommunications	57%	74%
Sistema Mass-media and subsidiaries	SMM	Mass media	75%	75%
Detsky Mir-Center and subsidiaries	Detsky Mir	Retail trading	75%	75%
Intourist and subsidiaries	Intourist	Travel services	66%	66%
Medsi and subsidiaries	Medsi	Healthcare services	100%	100%
Binnopharm and subsidiaries	Binnopharm	Pharmaceuticals	100%	100%
NIS	NIS	Technology	51%	51%

⁽¹⁾ Voting interests as of December 31, 2011 and 2010—86%.

⁽²⁾ Voting interests as of December 31, 2011 and 2010—50%.

⁽³⁾ Former title of MTS Bank is Moscow Bank for Reconstruction and Development (“MBRD”).

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of presentation—The accompanying consolidated financial statements have been prepared in conformity with the accounting principles generally accepted in the United States of America (“U.S. GAAP”). The Group’s entities maintain accounting records in the local currencies of the countries of their domicile in accordance with the requirements of respective accounting and tax legislation. The accompanying financial statements differ from the financial statements prepared for statutory purposes in that they reflect certain adjustments, appropriate to present the financial position, results of operations and cash flows in accordance with U.S. GAAP, which are not recorded in the accounting books of the Group’s entities.

Principles of consolidation—The consolidated financial statements include the accounts of the Company, as well as entities where the Company has operating and financial control, most often through the direct or indirect ownership of a majority voting interest. Those ventures where the Group exercises significant influence but does not have operating and financial control are accounted for using the equity method. Investments in which the Group does not have the ability to exercise significant influence over operating and financial policies are accounted for under the cost method and included in other investments in the consolidated statements of financial position. The consolidated financial statements also include accounts of

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variable interest entities (“VIEs”) in which the Group is deemed to be the primary beneficiary. An entity is generally a VIE if it meets any of the following criteria: (i) the entity has insufficient equity to finance its activities without additional subordinated financial support from other parties, (ii) the equity investors cannot make significant decisions about the entity’s operations or (iii) the voting rights of some investors are not proportional to their obligations to absorb the expected losses of the entity or receive the expected returns of the entity and substantially all of the entity’s activities involve or are conducted on behalf of the investor with disproportionately few voting rights.

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

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

Significant estimates for the Group include the allowances for doubtful accounts, customer loans and deferred tax assets, the valuation of goodwill and other long-lived assets, asset retirement obligations, income tax benefits, redeemable noncontrolling interests, derivative instruments, share-based compensation and assets acquired and liabilities assumed in business combinations, the recoverability of investments and the estimates of oil and gas reserves.

Concentration of business risk—The Group’s principal business activities are within the Commonwealth of Independent States (“CIS”), primarily in the RF and Ukraine. Laws and regulations affecting businesses operating in the RF and Ukraine are subject to rapid changes, which could impact the Group’s assets and operations.

Foreign currency—Management has determined that the functional currencies of most of the Group’s subsidiaries are the currencies of the countries of their domicile, with the exception of certain subsidiaries whose functional currency is the U.S. dollar (“USD”) due to the pervasive use of the USD in their operations or whose functional currency is the currency of its parent company if the entity is a device or shell company for holding investments or obligations.

In preparing the financial statements of the entities within the Group, transactions in currencies other than the entity’s functional currency are recognized at the rates of exchange prevailing on the dates of the transactions. At each balance sheet date, monetary assets and liabilities that are denominated in foreign currencies are retranslated at the rates prevailing at that date. Non-monetary items carried at fair value that are denominated in foreign currencies are translated at the rates prevailing at the date when the fair value was determined. Non-monetary items that are measured in terms of historical cost in a foreign currency, are not restated.

The Group has selected the USD as its reporting currency. The Group’s assets and liabilities are translated into USD at exchange rates prevailing on the balance sheet date. Revenues, expenses, gains and losses are translated into USD at average exchange rates prevailing during the reporting period. Equity is translated at the applicable historical rates. The resulting translation gain or loss is recorded as a separate component of other comprehensive income.

On the disposal of a foreign operation, all of the accumulated exchange differences in respect of that operation attributable to the Group are reclassified to profit or loss.

The official rate of exchange, as determined by the Central Bank of the RF, between the Russian ruble (“RUB”) and USD as of December 31, 2011 was 32.20 RUB to 1 USD (30.48 RUB to 1 USD as of December 31, 2010).

Revenue recognition—Generally, revenues are recognized when all of the following conditions have been met: (i) there is persuasive evidence of an arrangement; (ii) delivery has occurred; (iii) the fee is fixed and determinable; and (iv) collectability of the fee is reasonably assured. Revenue amounts are presented net of value added taxes.

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

MTS

Revenues derived from wireless, local telephone, long distance, data and video services are recognized when services are provided. This is based upon either usage (minutes of traffic processed, volume of data transmitted) or period of time (monthly subscription fees).

The content revenue is presented net of related costs when MTS acts as an agent of the content providers while the gross revenue and related costs are recorded when MTS is a primary obligor in the arrangement.

Upfront fees received for connection of new subscribers, installation and activation of wireless, wireline and data transmission services ("connection fees") are deferred and recognized over the estimated average subscriber life, as follows:

Mobile subscribers	1-5 years
Residential wireline voice phone subscribers	15 years
Residential subscribers of broadband internet service	1 year
Other fixed line subscribers	3-5 years

MTS calculates an average life of mobile subscribers for each region in which it operates and amortizes regional connection fees.

Incentives provided to customers are usually offered on signing a new contract or as part of a promotional offering. Incentives, representing the reduction of the selling price of the service (free minutes and discounts) are recorded in the period to which they relate, when the respective revenue is recognized, as a reduction to both accounts receivable and revenue. However, if the sales incentive is a free product or service delivered at the time of sale, the cost of the free product or service is classified as an expense. In particular, the Group sells handsets at prices below cost to contract subscribers. Such subsidies are recognized in the cost of handsets and accessories when the sale is recorded.

Bashneft

Revenues from the production and sale of crude oil and petroleum products are recognised when title passes to customers at which point the risks and rewards of ownership are assumed by the customer and the price is fixed and determinable. Revenues include excise taxes on petroleum products sales and duties on export sales of crude oil and petroleum products. Excise taxes, which are re-charged to third parties under the terms of processing agreements, are excluded from revenues.

Revenue from a contract to provide services is recognised by reference to the stage of completion of the contract. Revenue from time and material contracts is recognised at the contractual rates as labour hours are delivered and direct expenses are incurred.

Construction contracts revenue includes the initial amount agreed in the contract plus any variations in contract work, claims and incentive payments, to the extent that it is probable that they will result in revenue and can be measured reliably. As soon as the outcome of a construction contract can be estimated reliably, contract revenue is recognised in profit or loss in proportion to the stage of completion of the contract. Contract expenses are recognised as incurred unless they create an asset related to future contract activity. The stage of completion is assessed by reference to surveys of work performed. When the outcome of a construction contract cannot be estimated reliably, contract revenue is recognised only to the extent of contract costs incurred that are likely to be recoverable. An expected loss on a contract is recognised immediately in profit or loss.

RTI

Revenues from the long-term contracts are recognized by reference to the stage of completion of the contract activity at the statement of financial position date when the outcome of a contract can be estimated reliably. This is normally measured by the proportion that contract costs incurred for work performed to

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date relate to the estimated total contract costs, except where this would not be representative of the stage of completion. Variations in contract work, claims and incentive payments are included to the extent that they have been agreed with the customer. Where the outcome of a contract cannot be estimated reliably, contract revenue is recognized to the extent of contract costs incurred where it is probable that such costs will be recoverable. When it is probable that total contract costs will exceed total contract revenue, the expected loss is recognized immediately.

The sales of software products and system integration services are generally multiple-element arrangements, involving the provision of related services, including customization, implementation and integration services, as well as ongoing support and maintenance provided to customers. A multiple-element arrangement is separated into more than one unit of accounting if all of the following criteria are met: (a) the delivered items have value to the customer on a standalone basis; (b) there is objective and reliable evidence of the fair value of the undelivered items; and (c) the arrangement includes a general right of return relative to the delivered items, delivery or performance of the undelivered items is considered probable and substantially in the control of the Group.

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

In cases where extended payment terms exist, license and related customization fees are recognized when payments are due, unless a history of collection, without providing concessions, has been established under comparable arrangements.

When sale agreements provide price protection to the dealer, the revenue is deferred until the dealer sells the merchandise to a third party due to the frequent sales price reductions and rapid technology obsolescence.

Certain products of this segment are generally sold with a limited warranty for product quality. The product return reserves and other post-contract support obligations are accrued at the time of sale. The segment accrues for estimated incurred but unidentified issues based on historical activity.

MTS Bank

Revenues from interest bearing assets are recognized on an accrual basis using the effective interest method. The effective interest method is a method of calculating the amortized cost of a financial asset or a financial liability (or group of financial assets or financial liabilities) and of allocating the interest income or interest expense over the relevant period.

The effective interest rate is the rate that exactly discounts estimated future cash receipts (including all fees on points paid or received that form an integral part of the effective interest rate, transaction costs and other premiums or discounts) through the expected life of the debt instrument, or (where appropriate) a shorter period, to the net carrying amount on initial recognition.

SSTL

Service revenues are recognized as services are rendered, net of discounts and waivers. Processing fees and activation revenues on recharge vouchers and start-up kits are recognized as revenues net of discounts, as and when they get activated.

Revenues from infrastructure services are recognized as services are rendered, in accordance with the terms of the related contracts. Indefeasible right of use contracts are accounted for as operating leases and revenues are recognized over the term of the lease.

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Other businesses

The Group's other businesses recognize revenue when products are shipped or when services are rendered to customers. In cases where the Group acts as an agent, only the net agency fee is recognized as revenue.

Regulated services—Regulated tariff services provided by the Group primarily consist of local telephone services and services rendered to other operators, such as traffic charges, connection fees and line rental services, provided by MTS, and energy provided by Bashkirenergo. Changes in the rate structure for such services are subject to the Federal Tariff Service approval. Revenue from regulated tariff services represented approximately 3.5%, 4.1% and 4% of the consolidated revenue for the years ended December 31, 2011, 2010 and 2009, respectively. This does not include revenue attributable to Bashkirenergo whose financial results are presented in discontinued operations (Note 4).

Cash and cash equivalents—Cash equivalents include cash on hand, demand deposits and other highly liquid investments with a maturity of three months or less when purchased. Within the cash and cash equivalents balance are cash equivalents of \$1,918.1 million and \$1,321.0 million as of December 31, 2011 and 2010, respectively, which primarily comprise term deposits with banks and bank promissory notes with original maturities of less than 90 days.

Restricted cash—Restricted cash includes cash and cash equivalents restricted by agreements with third parties for special purposes. Restricted cash included in other non-current assets in the consolidated statements of financial position as of December 31, 2011 and 2010 was \$86.3 million and \$48.3 million, respectively, including cash deposited by the Group to guarantee certain loans, and to be in compliance with government regulation of local currency conversion into foreign currencies in Uzbekistan.

Financial instruments—The Group's financial instruments include cash and cash equivalents, short-term investments, accounts receivable, derivative financial instruments, financial assets and liabilities from banking activities, accounts payable and short-term and long term debt.

Hedging activities—The Group uses derivative instruments, including swap, forward and option contracts to manage foreign currency and interest rate risk exposures. The Group reviews its fair value hierarchy classifications quarterly. Changes in significant observable valuation inputs identified during these reviews may trigger reclassification of fair value hierarchy levels of financial assets and liabilities. During the years ended December 31, 2011 and 2010 no reclassifications occurred. The fair value measurement of the Group's hedging agreements is based on the observable yield curves for similar instruments ("Level 2" of the hierarchy established by the U.S. GAAP guidance).

The Group designates derivatives as either fair value hedges or cash flow hedges in case the required criteria are met. Changes in the fair value of derivatives that are designated and qualify as fair value hedges are recorded in the consolidated statement of operations together with any changes in the fair value of the hedged asset or liability that is attributed to the hedged risk.

The effective portion of changes in the fair value of derivatives that are designated and qualify as cash flow hedges are recognized in accumulated other comprehensive income. The gain or loss relating to the ineffective portion is recognized immediately in the consolidated statement of operations. For derivatives that do not meet the conditions for hedge accounting, gains and losses from changes in the fair value are included in the consolidated statement of operations.

Assets and liabilities related to multiple derivative contracts with one counterparty are not offset by the Group.

The Group does not use financial instruments for trading or speculative purposes.

Fair value of financial instruments—The fair market value of certain financial instruments approximates their carrying value due to the short term nature of these amounts, namely cash and cash equivalents, short-term investments, accounts receivable and accounts payable, short-term debt and assets and liabilities from banking activities which are included in current assets and liabilities.

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Accounts receivable—Accounts receivable are stated at their net realizable value after deducting a provision for doubtful accounts. Such provision reflects either specific cases of delinquencies or defaults or estimates based on evidence of collectability.

Assets from banking activities—Assets from banking activities comprise assets (loans, notes and others) involved in operations of the banking division. Impairment losses on loans to customers and banks are included in the allowance for loan losses. Allowance represents management's best estimate of probable credit losses inherent in the lending portfolios as of the balance sheet date. Loans not individually reviewed are evaluated as a group using reserve factor percentages based on historic loss experience qualitative factors. Loans deemed to be uncollectible are charged against the allowance for loan losses. Correspondingly, recoveries of amounts previously charged as uncollectible are credited to the allowance for loan losses. A provision for loan losses is charged to the consolidated statement of operations based on management's evaluation of the estimated losses, after given consideration to the net chargeoffs, that have been incurred in the Group's loan portfolio.

The Group performs detailed reviews of its lending portfolios on a periodic and systematic basis to identify inherent risks and to assess the overall collectability of those portfolios. The allowance on certain homogeneous loan portfolios, which generally consist of consumer and mortgage loans, is based on an evaluation of aggregated portfolios of homogeneous loans, generally by loan type.

Loss forecast models are utilized for portfolios of homogeneous loans which consider a variety of factors including, but not limited to, historical loss experience, anticipated defaults or foreclosures based on portfolio trends, delinquencies and credit scores, and estimated loss factors by loan type. The remaining loan portfolios are reviewed on an individual loan basis.

Loans subject to individual reviews are analyzed and segregated by risk according to the Group's internal risk rating scale. These risk classifications, in conjunction with an analysis of historical loss experience, current economic conditions and performance trends within specific portfolio segments, and any other pertinent information result in the estimation allowances for loan losses. An allowance for loan losses is established for individually impaired loans. A loan is considered impaired when, based on current information and events, it is probable that the Group will be unable to collect all amounts due, including principal and interest, according to the contractual terms of the agreement. Individually impaired loans are measured based on the present value of payments expected to be received, or for loans that are solely dependent on the collateral for repayment, the estimated fair value of the collateral. If the recorded investment in impaired loans exceeds the measure of estimated fair value, an allowance is established as a component of the allowance for loan losses.

Non-accrual loans—In general, the accrual of interest on loans is discontinued at the time the loan is 90 days delinquent unless the credit is well secured and in process of collection. In all cases, loans are placed on non-accrual, or written-off at an earlier date, if collection of principal or interest is considered doubtful. All interest earned but not collected for loans that are placed on non-accrual or written-off is reversed against interest income. Loans are returned to accrual status when all the principal and interest amounts contractually due are reasonably assured of repayment within a reasonable time frame and when the borrower has demonstrated payment performance of cash or equivalents for a minimum of six months.

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

The Group's subsidiaries account for inventories using either first-in, first-out or weighted average cost methods.

The cost of raw materials includes the cost of purchase, customs duties, transportation and handling costs. Work in-progress and finished goods are stated at production cost which includes direct production expenses and manufacturing overheads. Costs and estimated earnings in excess of billings on uncompleted contracts include the accumulated costs of projects contracted with third parties, net of related progress billings. The Group periodically assesses its inventories and spare parts for obsolete or slow-moving stock.

Value-added taxes—Value-added taxes ("VAT") related to sales are payable to the tax authorities on an accrual basis based on invoices issued to the customer. VAT incurred for purchases may be reclaimed,

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subject to certain restrictions, against VAT related to sales. VAT related to purchase transactions that will be reclaimed against future sales are recorded as VAT receivable in the accompanying financial statements.

Held for sale—The Group classifies assets and liabilities as held for sale when all the following conditions have been met: (i) management having the authority to approve the action, commits to a plan to sell the asset (disposal group); (ii) the asset (disposal group) is available for immediate sale in its present condition; (iii) an active program to locate a buyer and other actions required to complete the plan to sell have been initiated; (iv) the sale is probable and transfer of the assets (disposal group) is expected to qualify for recognition as a completed sale, within one year; (v) the asset (the disposal group) is being marketed at a reasonable price; and (vi) it is unlikely that the plan will be changed significantly or withdrawn. Held for sale assets are measured at the lower of carrying amount or fair value less cost to sell.

Property, plant and equipment—Property, plant and equipment are stated at historical cost. Cost includes major expenditures for improvements and replacements, which extend useful lives of the assets or increase their revenue generating capacity. Repairs and maintenance, including preventative maintenance, are charged to the consolidated statement of operations as incurred.

The Group recognizes the costs of overhauls and preventive maintenance performed with respect to oil refining assets as expenses when incurred. Cost of major overhauls and replacements, which extend useful lives of the assets or increase their revenue generating capacity are capitalized to the cost of the assets.

Depreciation for property, plant and equipment other than depletion on oil and gas properties is computed under the straight-line method utilizing estimated useful lives of the assets as follows:

Buildings	20-50 years
Leasehold improvements	Lesser of the estimated useful life or the term of the lease
Switches and transmission devices	7-31 years
Network and base station equipment	4-12 years
Refining, marketing, distribution and chemicals	3-40 years
Exploration and production assets	3-19 years
Power and utilities	3-47 years
Other plant, machinery and equipment	3-25 years

Depletion of proved oil and gas properties is calculated using the unit-of-production method based on total proved reserves. Depletion expense of other capitalized costs related to oil and gas production is calculated using the unit-of production method based on proved developed reserves.

Assets held under capital leases are initially recognized as assets of the Group at their fair value at the inception of a lease or, if lower, at the present value of minimum lease payments. The discount rate used in determining the present value of the minimum lease payments is the Group's incremental borrowing rate, unless (1) it is practicable to determine the implicit rate computed by the lessor; and (2) the implicit rate is less than the Group's incremental borrowing rate. If both of those conditions are met, the interest rate implicit in the lease is used.

Items of property, plant and equipment that are retired or otherwise disposed of are eliminated from the consolidated statement of financial position along with the corresponding accumulated depreciation and depletion. Any gain or loss resulting from such retirement or disposal is included in the determination of consolidated net income.

Construction in-progress and telecommunications equipment for installation are not depreciated until an asset is placed into service.

Transportation expenses—Transportation expenses represent all expenses incurred in the transportation of crude oil and petroleum products via the Transneft pipeline network, as well as by railway and other transportation means. Transportation expenses also include all other shipping and handling costs.

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Asset retirement obligation—The Group calculates an asset retirement obligation and an associated asset retirement cost when the Group has a legal or constructive obligation in connection with the retirement of tangible long-lived assets.

As of December 31, 2011 and 2010, the estimated present value of the Group's asset retirement obligations and change in liabilities were as follows:

	<u>2011</u>	<u>2010</u>	<u>2009</u>
Balance, beginning of the year	\$273,916	\$189,490	\$ 62,053
Liabilities incurred in the current period	10,105	5,811	5,847
Business combinations	—	—	92,044
Property dispositions	(15,827)	—	—
Accretion expense	29,475	21,745	16,129
Revisions in estimated cash flows	(66,140)	58,734	17,693
Currency translation adjustment	(16,805)	(1,864)	(4,276)
Balance, end of the year	<u>\$214,724</u>	<u>\$273,916</u>	<u>\$189,490</u>
Current portion	603	15,534	—
Long-term portion	214,121	258,382	189,490
Balance, end of the year	<u>\$214,724</u>	<u>\$273,916</u>	<u>\$189,490</u>

The Group's asset retirement obligation relates primarily to the cost of removing MTS' equipment from sites and decommissioning of Bashneft's wells, dismantling equipment, restoring the sites and performing other related activities. Revisions in estimated cash flows are attributable to changes in economic assumptions, such as inflation rates

The Group recorded the long-term portion of asset retirement obligation as a separate line item in the consolidated statements of financial position, the current portion—as a component of accrued expenses and other current liabilities.

Business combinations—Acquisition of businesses from third parties is accounted for using the purchase method. On acquisition, the assets and liabilities of an acquired entity are measured at their fair values as at the date of acquisition. The noncontrolling interest is stated at the noncontrolling interests' proportion of the fair values of the assets and liabilities recognized.

Acquisitions of the noncontrolling interests which occurred on or after January 1, 2009 are accounted for as equity transactions.

Acquisitions of entities under common control are accounted for on a carryover basis, which results in the historical book value of assets and liabilities of the acquired entity being combined with that of the Group. Any difference between the purchase price and the net assets acquired is reflected in equity.

Goodwill—Goodwill is determined as the excess of the consideration transferred plus the fair value of any noncontrolling interest in the acquiree at the acquisition date over the fair values of the identifiable net assets acquired. The excess of the fair values of the identifiable net assets acquired over the cost of the business combination plus the fair value of any noncontrolling interest in the acquiree at the acquisition date is credited to income.

Goodwill is not amortized to operations, but instead is reviewed for impairment at least annually Goodwill is reviewed for impairment by comparing the carrying value of each reporting unit's net assets (including allocated goodwill) to the fair value of the reporting unit. If the reporting unit's carrying amount is greater than its fair value, a second step is performed whereby implied fair value that relates to the reporting unit's goodwill is compared to the carrying value of the reporting unit's goodwill. The Group recognizes a goodwill impairment charge for the amount by which the carrying value of goodwill exceeds the fair value.

Intangible assets other than goodwill—Other intangible assets include billing, telecommunication and other software, operating licenses, acquired customer bases, radio frequencies, trademarks and telephone numbering capacity. License costs are capitalized as a result of (a) the purchase price allocated to licenses

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acquired in business combinations; and (b) licenses purchased directly from government organizations which require license payments.

All finite-life intangible assets are being amortized using the straight-line method utilizing estimated useful lives of the assets as follows:

Billing and telecommunication software	1 -20 years
Operating licenses	3-15 years
Acquired customer base	1 -8 years
Numbering capacity with finite contractual life . . .	2-10 years
Acquired radio frequencies	2-15 years

Trademarks and telephone numbering capacity with unlimited contractual life are not amortized, but are reviewed, at least annually, for impairment. If the fair value of the intangible asset is less than its carrying value, an impairment loss is recognized in an amount equal to the difference. The Group also evaluates the remaining useful life of its intangible assets that are not subject to amortization on an annual basis to determine whether events and circumstances continue to support an indefinite useful life. If an intangible asset that is not being amortized is subsequently determined to have a finite useful life, that asset is tested for impairment.

Investments—The Group’s share in the net assets and net income of certain entities, where the Group holds 20% to 50% of voting shares and has the ability to exercise significant influence over their operating and financial policies (“affiliates”) is included in the consolidated net assets and operating results using the equity method of accounting. The Group’s share in the net income of affiliates where the Group has day-to-day involvement in business activities and which are integral to the Group’s business is recorded within operating income. In other cases, the Group’s share in net income is shown after the income tax provision. Other-than-temporary decreases in the value of the investment in affiliates are recognized in net income.

All other equity investments, which consist of investments for which the Company does not have the ability to exercise significant influence, are accounted for under the cost method or at fair value. Investments in private companies are carried at cost, less provisions for other-than-temporary impairment in value. For public companies that have readily determinable fair values, the Company classifies its equity investments as available-for-sale or trading. For available for sale securities, the Group records these investments at their fair values with unrealized holding gains and losses included in the consolidated statement of comprehensive income/(loss), net of any related tax effect. For trading securities, the Group records the investment at fair value. Unrealized holding gains and losses for trading securities are included in earnings.

The Group purchases promissory notes for investing purposes. These notes are carried at cost and the discount against the nominal value is accrued over the period to maturity. A provision is made, based on management assessment, for notes that are considered uncollectible. The notes are classified as held-to-maturity.

Investments which are expected to be realized within twelve months after the statement of financial position date are classified as short-term investments. Other investments are classified as long-term investments.

Debt issuance costs—Debt issuance costs are recorded as an asset and amortized using the effective interest method over the terms of the related loans.

Impairment of long-lived assets other than goodwill and indefinite lived intangible assets—The Group periodically evaluates the recoverability of the carrying amount of its long-lived assets. Whenever events or changes in circumstances indicate that the carrying amounts of those assets may not be recoverable, the Group compares the undiscounted net cash flows estimated to be generated by those assets to the carrying amount of those assets. When these undiscounted cash flows are less than the carrying amounts of the assets, the Group records impairment losses to write the asset down to fair value, measured by the estimated discounted net future cash flows expected to be generated from the use of the assets.

Liabilities from banking activities—Liabilities from banking activities include deposits from banks and customers, promissory notes issued and other liabilities that arise out of operations of the MTS Bank.

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Property, plant and equipment contributions—Telecommunication equipment and transmission devices, installed at newly constructed properties in Moscow, have been historically transferred to MGTS, a fixed line operator and subsidiary of the Group, by the Moscow City Government free of charge. These assets are capitalized by the Group at their market value at the date of transfer. Simultaneously, deferred revenue is recorded in the same amount and is amortized as a reduction of the depreciation charge in the consolidated statement of operations over the contributed assets' life.

Income taxes—Income taxes of the Group's Russian entities have been computed in accordance with RF laws. The corporate income tax rate in the RF is 20%. The income tax rate on dividends paid within Russia is 9%. The foreign subsidiaries of the Group are paying income taxes in their respective jurisdictions.

Deferred tax assets and liabilities are recognized for differences between the carrying amounts of assets and liabilities in the consolidated financial statements and the tax bases of assets and liabilities that will result in future taxable or deductible amounts. The deferred tax assets and liabilities are measured using the enacted tax laws and rates applicable to the periods in which the differences are expected to affect taxable income. Deferred tax assets are reduced by a valuation allowance when, in the opinion of management, it is more likely than not that some portion or all of the deferred tax assets will not be realized. In making such determination, we consider all available positive and negative evidence, including future reversals of existing taxable temporary differences, projected future taxable income, tax planning strategies and recent financial operations.

Uncertain tax positions are recognized in the consolidated financial statements for positions which are considered more likely than not of being sustained based on the technical merits of the position on audit by the tax authorities. The measurement of the tax benefit recognized in the consolidated financial statements is based upon the largest amount of tax benefit that, in management's judgment, is greater than 50% likely of being realized based on a cumulative probability assessment of the possible outcomes.

The Group recognizes interest and penalties relating to unrecognized tax benefits and penalties within income taxes.

Treasury stock—if the Group reacquires its own equity instruments, those instruments ("treasury shares") are recognized as a deduction of equity at cost, being the consideration paid to reacquire the shares. No gain or loss is recognized in profit or loss on the purchase, sale, issue or cancellation of the Group's own equity instruments. Such treasury shares may be acquired and held by the Company or by other subsidiaries of the Group.

Share-based compensation—The Group calculates and records the fair value of equity instruments, such as stock options or restricted stock, awarded to employees for services received and recognizes such amounts in the consolidated statement of operations. The fair value of the equity instruments is measured on the date they are granted and is recognized over the period during which the employees are required to provide services in exchange for the equity instruments (Note 26). Share-based compensation expense includes the estimated effects of forfeitures. Such estimates are adjusted over the requisite service period to the extent actual forfeitures differ, or are expected to differ from such estimates. Changes in estimated forfeitures are recognized in the period of change and also impact the amount of expense to be recognized in future periods.

For phantom stock awards that include a component that will be settled in cash, and a component that is settled in equity, the Group accounts for the awards separately, based on their substance. For the component that is settled in cash, the awards generally are accounted for as liabilities with compensation cost recognized over the service (vesting) period of the award based on the fair value of the award remeasured at each reporting period. For the component that is settled in equity, compensation cost is measured based on the fair value of the award on the date of grant and the compensation cost is recognized over the service (vesting) period of the award.

Retirement and post-retirement benefits—Subsidiaries of the Group contribute to local state pension funds and social funds, on behalf of their employees.

In Russia, starting from January 1, 2010, social contributions are calculated by the application of following rates: 26%—for accumulated personal income up to RUB 415,000, 0%—for the personal earnings above the

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aforementioned amount. Social contributions are allocated to three social funds, including a pension fund, and the rate of contributions to the pension fund is 20%. The contributions are expensed as incurred.

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

In addition to the above, Intracom Telecom and MGTS have defined benefit plans to provide their employees certain benefits upon and after retirement. The net period cost of the Group's defined benefit plans is measured on an actuarial basis using the projected unit credit method and several actuarial assumptions. The recognition of expense for defined benefit plans is significantly impacted by estimates made by management such as discount rates used to value certain liabilities, expected return on assets, mortality rates, future rates of compensation increase and other related assumptions. Gains and losses occur when actual experience differs from actuarial assumptions. If such gains or losses exceed ten percent of the greater of plan assets or plan liabilities the Company amortizes those gains or losses over the average remaining service period of the employees.

The Group records in the statement of financial position the funded status of its pension plans based on the projected benefit obligation.

Borrowing costs—Borrowing costs are recognized as an expense in the period in which they are incurred. Borrowing costs for assets that require a period of time to get them ready for their intended use are capitalized and amortized over the related assets' estimated useful lives. The capitalized borrowing costs for the years ended December 31, 2011, 2010 and 2009 amounted to \$59.6 million, \$46.4 million and \$87.5 million, respectively.

Advertising costs—Advertising costs are expensed as incurred. Advertising costs for the year ended December 31, 2011, 2010 and 2009 were \$427.5 million, \$417.3 million and \$440.7 million, respectively, and were reflected as a component of selling, general and administrative expenses in the accompanying consolidated statements of operations.

Taxes other than income tax—Taxes other than income tax comprise excises, extraction tax and customs, which relate to the Bashneft, and property tax.

Redeemable noncontrolling interests—From time to time, in order to optimize the structure of business acquisitions and to defer payment of the purchase price the Group enters into put and call option agreements to acquire noncontrolling interests in the existing subsidiaries. These put and call option agreements qualify as redeemable securities and are accounted for at either redemption value or the fair value of redeemable noncontrolling interests as of the reporting date. The fair value of redeemable noncontrolling interests is assessed based on discounted future cash flows of the acquired entity ("Level 3" significant unobservable Inputs of the hierarchy established by the US GAAP guidance). Any changes in redemption value of redeemable noncontrolling interests are accounted for in the Group's retained earnings. Redeemable noncontrolling interests are presented as temporary equity in the consolidated statement of financial position.

Earnings per share—Basic earnings per share ("EPS") is based on net income attributable to the Company divided by the weighted average number of shares outstanding during the year.

Diluted EPS is based on net income attributable to the Company adjusted in certain circumstances, divided by the weighted average number of shares outstanding during the year, adjusted for the dilutive effect of all potential shares that were outstanding during the year. Such potentially dilutive shares are excluded when the effect would be to increase diluted earnings per share or reduce the diluted loss per share.

Diluted EPS reflect the potential dilution related stock options granted to employees. The diluted EPS is not different from basic for the years ended December 31, 2011, 2010 and 2009.

Distributions to shareholders—Distributable retained earnings of the Group are based on amounts extracted from the statutory accounts of the Company (based on the Russian accounting standards) and may significantly differ from amounts calculated on the basis of U.S. GAAP.

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Reclassifications and revisions—Certain comparative information presented in the consolidated financial statements for the years ended December 31, 2010 and 2009 has been revised in order to achieve comparability with the presentation used in the consolidated financial statements for the year ended December 31, 2011. Such reclassifications and revisions were not significant to the Group financial statements, except for presentation of discontinued operations of Bashkirenergo (Note 4).

Recent accounting pronouncements

Adopted during the period

In October 2009, the Financial Accounting Standards Board (“FASB”) amended the revenue recognition for multiple deliverable arrangements guidance to remove the non-software components of tangible products and certain software components of tangible products from the scope of existing software revenue guidance, resulting in the recognition of revenue similar to that for other tangible products. The FASB amended the revenue recognition for multiple deliverable arrangements guidance to require the use of the relative selling price method when allocating revenue in these types of arrangements. This method allows a vendor to use its best estimate of selling price if neither vendor specific objective evidence nor third party evidence of selling price exists when evaluating multiple deliverable arrangements. This updated guidance is effective prospectively for revenue arrangements entered into or materially modified in fiscal years beginning on or after June 15, 2010. The adoption of this guidance, effective January 1, 2011, did not have a significant impact on the Group’s consolidated financial statements.

To be adopted in future periods

In June 2011, the FASB amended its guidance on the presentation of comprehensive income. Under the amended guidance, an entity has the option to present comprehensive income in either one continuous statement or two consecutive financial statements. A single statement must present the components of net income and total net income, the components of other comprehensive income and total other comprehensive income, and a total for comprehensive income. In a two-statement approach, an entity must present the components of net income and total net income in the first statement. That statement must be immediately followed by a financial statement that presents the components of other comprehensive income, a total for other comprehensive income, and a total for comprehensive income. The option under the current guidance that permits the presentation of components of other comprehensive income as part of the statement of changes in shareholders’ equity has been eliminated. The amendment becomes effective for fiscal years, and interim periods within those years, beginning after December 15, 2011. Early adoption is permitted. This guidance will not have an impact on the amounts reported in the Group’s consolidated financial statements as it is disclosure-only in nature.

In September 2011, the FASB updated the authoritative guidance on testing goodwill for impairment. The update gives entities carrying out goodwill impairment test an option of performing qualitative assessment before calculating the fair value of a reporting unit. If an entity determines, on the basis of qualitative factors, that the fair value of a reporting unit is more likely than not less than the carrying amount, the two-step impairment test would be required. The guidance is effective for all entities for annual and interim goodwill impairment tests performed for fiscal years beginning after December 15, 2011. The adoption of this guidance is not expected to have a significant impact on the Group’s consolidated financial statements.

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3. ACQUISITIONS

Business combinations in the year ended December 31, 2011

During the year ended December 31, 2011, the Group had no acquisitions which are considered to be individually material. The following table summarizes the information for business combinations which occurred during the year ended December 31, 2011:

Acquiree	Principal activity	Date of acquisition	Interest acquired	Acquiring segment	Purchase price (in millions)
Inteleca Group	Fixed line operator	April	100%	MTS	\$ 19.2
Infocentr	Fixed line operator	April	100%	MTS	15.4
Orenburgnefteproduct	Wholesale and retail of oil products	April	94%	Bashneft	119.3
Bashneft-Nefteproduct	Wholesale and retail of oil products	July	100%	Bashneft	101.7
Altair	Fixed line and Internet services	August	100%	MTS	25.6
Moskovia	Broadcasting company	September	56%	Other	22.7
TVT	Fixed line operator	October	100%	MTS	162.5
Scon and other	Retail of oil products	December	100%	Bashneft	17.8
Donskoe	Agriculture	December	100%	Other	15.7
Total					<u>\$499.9</u>

In July 2010, Bashneft acquired a 49.99% interest in ASPEC, a company engaged in the wholesale and retail of oil products, real estate development and automotive retail business, for a cash consideration of \$123 million. In July 2011, ASPEC was reorganized into two legal entities: ASPEC and Bashneft-Nefteproduct. As a result of the reorganization, Bashneft received 100% of Bashneft-Nefteproduct which accumulated ASPEC's petroleum products trading business, and simultaneously withdrew as shareholder from ASPEC which retained the other remaining businesses. The consideration transferred in this business combination was measured at the acquisition-date fair value of the Group's share in the part of ASPEC's businesses that was disposed of (i.e. the other remaining businesses). No resulting gain or loss has been recognized as a result of this transaction.

The following table summarizes the amounts of the assets acquired and liabilities assumed recognized at the acquisition date, as well as the fair value at the acquisition date of the noncontrolling interest in the acquirees:

	(in millions)
Current assets	\$ 180.5
Property, plant and equipment	273.4
Goodwill	241.7
Customer base	20.1
Other non-current assets	3.5
Current liabilities	(146.3)
Non-current liabilities	(46.7)
Noncontrolling interest	(26.3)
Purchase price	<u>\$ 499.9</u>

The purchase price allocation for TVT is provisional as the Group has not completed the valuation of the company's individual assets as of the date of these consolidated financial statements.

The goodwill arising from the acquisitions consists largely of the synergies which are expected to arise from combining the operations of the Group and acquired companies as well as to the economic potential of the markets in which the acquired companies operate. The goodwill arising on each particular acquisition was assigned to the acquiring segment. None of the goodwill recognized is expected to be deductible for income tax purposes. The customer base assets recognized as a result of the acquisitions are amortized over a period ranging from 8 to 14 years.

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Pro forma results of operations have not been presented because the effects of these business combinations, both individually and in aggregate, were not material to the Group's consolidated results of operations.

Business combinations in the year ended December 31, 2010

Sky Link—In November 2009, the Group and Svyazinvest (“the Parties”) signed a non-binding memorandum of understanding, under which the Parties agreed to enter in a series of transactions which would ultimately result in (i) the disposal of the Group's investment in Svyazinvest to a state-controlled enterprise; (ii) non-cash extinguishment of the Group's indebtedness to Sberbank; (iii) an increase in the Group's ownership in Sky Link from 50% to 100% and disposal of this 100% investment to Svyazinvest; and (iv) the disposal of 28% of MGTS' common stock previously owned by Svyazinvest to the Group.

In April 2010 the Group raised its effective equity interest in Sky Link by 50% to 100%. This 100% interest had previously been agreed to be disposed of as a part of the transaction with Svyazinvest (see above), and was therefore classified as an asset held for sale upon the date of the Group acquiring 100% ownership. The purchase price allocation for the acquisition was as follows:

	<u>(in millions)</u>
Current assets	\$ 47.6
Non-current assets	541.3
Current liabilities	(135.2)
Non-current liabilities	(136.9)
Fair value of the Group's investments as of the date of acquisition	<u>(148.3)</u>
Purchase price	<u>\$ 168.5</u>

In July 2010, the Group and Svyazinvest signed an exchange agreement where the parties agreed to exchange their interests in MGTS and Sky Link under certain conditions.

According to the share exchange agreement, Svyazinvest agreed to transfer to the Group 28% of ordinary shares in MGTS (23.3% of the share capital of MGTS), in exchange for Group's 100% interest in Sky Link. Furthermore, the Group was to make an additional cash payment of RUB 450 million to Svyazinvest to cover the difference in value of MGTS and Sky Link shares, and the new shareholders of Sky Link agreed to settle its obligations to the Group in the total amount of approximately \$307.4 million. As a result of the transaction the Group recognized a gain on disposal of discontinued operations amounting to \$324.7 million.

Upon completion of the foregoing deal, the Group's interest in MGTS increased to 93.3% and the noncontrolling interests attributable to MGTS decreased by \$410.3 million, with corresponding increase in additional paid-in capital of \$86.0 million.

Other—The following table summarizes the information for other business combinations which occurred during the year ended December 31, 2010:

<u>Acquiree</u>	<u>Principal activity</u>	<u>Date of acquisition</u>	<u>Interest acquired</u>	<u>Acquiring segment</u>	<u>Purchase price (in millions)</u>
Tenzor Telecom	Fixed line operator	February	100%	MTS	6.2
Penza Telecom	Fixed line operator	May	100%	MTS	19.3
M2M Telematics	Navigation and telematics	July	51%	Other	20.0
Multiregion	Fixed line operator	July	100%	MTS	123.6
Serebryany Bor	Lease of a building	October	100%	Other	5.9
Lank Telecom	Fixed line operator	December	100%	MTS	17.8
NMSK	Fixed line operator	December	100%	MTS	<u>23.2</u>
Total					<u>\$216.0</u>

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The following table summarizes the amounts of the assets acquired and liabilities assumed recognized at the acquisition date, as well as the fair value at the acquisition date of the noncontrolling interest in the acquirees:

	<u>(in millions)</u>
Current assets	\$ 53.5
Property, plant and equipment	75.3
Goodwill	181.3
Customer base	115.7
Other non-current assets	38.3
Current liabilities	(153.3)
Non-current liabilities	(51.3)
Noncontrolling interest	<u>(43.5)</u>
Purchase price	<u>\$ 216.0</u>

The goodwill arising from the acquisitions consists largely of the synergies expected from combining the operations of the Group and acquired companies as well as to the economic potential of the markets in which the acquired companies operate. The goodwill arising on each particular acquisition was assigned to the acquiring segment. None of the goodwill recognized is expected to be deductible for income tax purposes. The customer base assets recognized as a result of the acquisitions are amortized over a period ranging from 8 to 12 years.

Business combinations in the year ended December 31, 2009

Oil and energy companies in the Republic of Bashkortostan—In April 2009, the Group increased its share in oil and energy companies in the Republic of Bashkortostan to controlling interests for a total cash consideration of \$2.0 billion. As a result of this transaction, the Group increased its interest to a 76.5% in Bashneft, a 65.8% in Ufaneftekhim, a 87.2% in Novoil, a 73.0% in Ufaorgsintez, a 78.5% in UNPZ and a 73.3% in BNP and acquired control over Bashkirenergo since Bashneft, Ufaneftekhim, Novoil and UNPZ's aggregated interest in the ordinary shares of Bashkirenergo was 50.2%.

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

	<u>(in millions)</u>
Current assets	\$ 1,416.3
Property, plant and equipment	8,754.7
Other non-current assets	367.9
Current liabilities	(1,030.3)
Non-current liabilities	(205.1)
Deferred taxes	(985.0)
Noncontrolling interest	<u>(2,552.1)</u>
Net assets acquired	<u>5,766.4</u>
Carrying value of the Group's investments in energy companies in the Republic of Bashkortostan as of the date of acquisition	(983.6)
Gain on acquisition	<u>(2,782.8)</u>
Cash consideration paid	<u>\$ 2,000.0</u>

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Other—The following table summarizes the information for other business combinations which occurred during the year ended December 31, 2009:

Acquiree	Principal activity	Date of acquisition	Interest acquired	Acquiring segment	Purchase price (in millions)
Telefon.ru	Mobile retailer	February	100%	MTS	\$ 60.0
Eldorado	Mobile retailer	March	100%	MTS	17.8
Kolorit Dizayn	Outdoor advertising services	September	100%	MTS	39.7
Teleforum	Mobile retailer	October	100%	MTS	2.2
Evrotel	Fixed line operator	December	100%	MTS	90.0
Total					<u>\$209.7</u>

The following table summarizes the amounts of the assets acquired and liabilities assumed recognized for these business combinations at the acquisition date:

Current assets	\$ 69.7
Property, plant and equipment	83.7
Goodwill	287.9
Customer base	4.7
Other non-current assets	2.5
Current liabilities	(202.2)
Non-current liabilities	(6.3)
Contingent consideration	(30.3)
Purchase price	<u>\$ 209.7</u>

The goodwill arising from the acquisitions of these entities consists largely of the synergies expected from combining the operations of MTS and acquired companies. The goodwill arising on all acquisition was assigned to MTS. None of the goodwill recognized is expected to be deductible for income tax purposes.

In connection with the business combinations which occurred during the years ended December 31, 2011, 2010 and 2009 the Group incurred \$7.1 mln, \$12.7 mln and \$24.7 mln of third-party acquisition related costs included in selling, general and administrative expenses in the consolidated statements of operations.

Acquisitions of noncontrolling interests in existing subsidiaries

From time to time the Group makes the acquisitions of noncontrolling interests in respects of its subsidiaries where it retains control. The Group accounted for these changes in its ownership interest as equity transactions.

In April 2011, a termination record was entered into the Unified State Register thereby legally completing the merger of OJSC Comstar-UTS (“Comstar”), MTS’ fixed line subsidiary, into MTS. In accordance with the terms of the merger, qualifying holders of Comstar ordinary shares received ordinary shares of MTS at an exchange ratio of 0.825 MTS ordinary shares for each one Comstar ordinary share. A total of 98,853,996 Comstar shares were converted into existing MTS treasury shares as well as newly issued MTS shares. As a result, MTS’ charter capital increased by 73,087,006 ordinary shares to a total of 2,066,413,144 ordinary shares. The transaction was accounted for directly in equity and resulted in the decrease of noncontrolling interest by \$244.2 million and corresponding increase in additional paid-in capital by \$102.4 million.

In September 2010, through voluntary tender offer, MTS acquired 37,614,087 ordinary Comstar shares, or approximately 9.0% of Comstar’s issued share capital, for a total cost of RUB 8.28 billion (approximately \$271.89 million as of October 6, 2010). This brings MTS’ total ownership interest in Comstar to 70.97% of Comstar’s issued share capital (or 73.33% excluding treasury shares). The transaction was accounted for directly in equity.

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In April 2010, Bashneft acquired 25% of shares of Sistema-Invest, a subsidiary of the Group, for a cash consideration of \$205 million. As a result of acquisition the Group's interest in Sistema-Invest increased to 90%. In December 2010 the Group's interest in Sistema-Invest increased to 100% for a cash consideration of \$120 million. The transactions in April and December 2010 were accounted for directly in equity and resulted in the decrease in noncontrolling interest by \$245.7 million and by \$35 million, respectively.

In February-April 2010, Bashneft made mandatory offers to acquire noncontrolling interests in Ufimsky Refinery, Ufaorgsintez, Ufaneftekhim, Novoil and Bashkirnefteproduct. As a result of subsequent purchases of noncontrolling interests the Group's ownership in these entities increased by 0.51%, 3.67%, 5.64%, 0.51% and 0.59% respectively for a total cash consideration of \$128.1 million. These transactions were accounted for directly in equity and resulted in the decrease in noncontrolling interest by \$119.1 million.

In December 2009, through a series of transactions, a group of investment funds have exchanged their joint 14.2% interest in Moscow City Telephone Network ("MGTS"), the incumbent fixed line operator in Moscow, for 1.6% of the outstanding MTS shares, which were previously held in treasury and \$7.3 million in cash. Simultaneously, MTS received 11.06% of the total shares outstanding of Comstar from MGTS Finance S.A., a wholly owned subsidiary of MGTS. The transaction was accounted for directly in equity and resulted in an increase of noncontrolling interests by \$135.1 million.

In October 2009, SMM issued additional share capital in exchange for the remaining 49% interest in its subsidiary Russian World Studios ("RWS"), a motion picture company. As a result of this transaction, SMM increased its interest in RWS up to 100%, and the Group's share in SMM decreased from 100% to 75%. The transaction was accounted for directly in equity and resulted in an increase of noncontrolling interest by \$38.0 million.

4. DISPOSALS AND DISCONTINUED OPERATIONS

Discontinued operations

Bashkirenergo—In December 2011, Sistema and INTER RAO UES, a Russian energy holding, signed a non-binding memorandum of understanding summarizing the intention of INTER RAO UES to acquire, and Sistema to sell, energy producing business of Bashkirenergo which now controls both energy producing and distribution power capacities. The results of operations of the generation business of Bashkirenergo are reported in discontinued operations in the consolidated statements of operations for all periods presented, and the assets and related liabilities are included in the consolidated statement of financial position as disposal group held for sale as of December 31, 2011 and 2010. Such assets and liabilities consisted of the following:

	<u>2011</u>	<u>2010</u>
Current assets	\$ 299,807	\$ 170,746
Non-current assets	1,109,257	1,153,606
Total assets of disposal group held for sale	1,409,064	1,324,352
Current liabilities	117,122	177,445
Non-current liabilities	131,195	86,904
Total liabilities of disposal group held for sale	\$ 248,317	\$ 264,349

The results of discontinued operations of Bashkirenergo for the years ended December 31, 2011, 2010 and 2009 were as follows:

	<u>2011</u>	<u>2010</u>	<u>2009</u>
Total revenue	\$ 1,535,314	\$ 1,676,021	\$ 880,381
Total expense	(1,444,205)	(1,617,642)	(894,563)
Income/(loss) from discontinued operations before income tax	91,109	58,379	(14,182)
Income tax expense	(24,047)	(22,642)	(2,773)
Income/(loss) from discontinued operations, net of income tax effect	\$ 67,062	\$ 35,737	\$ (16,955)

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ESKB—In September 2011, the Group completed the sale of 100% interest in electricity retail company ESKB, a subsidiary of Bashkirenergo, to RusHydro for a total cash consideration of RUB 5.7 billion. As a result of this transaction, the Group recognized gain on disposal of discontinued operations of \$149.5 million.

The results of discontinued operations of ESKB for the years ended December 31, 2011, 2010 and 2009 were as follows:

	<u>2011</u>	<u>2010</u>	<u>2009</u>
Total revenue	\$ 973,113	\$ 22,627	\$ 19,646
Total expense	(962,605)	(19,264)	(16,243)
Income from discontinued operations before income tax	<u>10,508</u>	<u>3,363</u>	<u>3,403</u>
Income tax expense	(2,137)	(841)	(727)
Income from discontinued operations, net of income tax effect	<u>\$ 8,371</u>	<u>\$ 2,522</u>	<u>\$ 2,676</u>

WattDrive—In November 2011, the Group completed the sale of its 74.9% interest in WattDrive, a subsidiary of RTI. As a result of this transaction, the Group recognized gain on disposal of discontinued operations of \$12.3 million. Losses from discontinued operations of WattDrive amounted to \$4.2 million, \$1.0 million and \$2.4 million for the years ended December 31, 2011, 2010 and 2009, respectively.

Sky Link—As discussed in Note 3, during the year ended December 31, 2010, the Group recognized gain on disposal of discontinued operations of Sky Link of \$324.7 million. Loss from discontinued operations of Sky Link amounted to \$39.3 million for the year ended December 31, 2010.

SITRONICS—In April 2009, SITRONICS, a subsidiary of RTI, disposed of distribution business of its wholly-owned subsidiary SITRONICS IT B.V. for a total consideration of \$49.8 million. As a result of the sale and subsequent settlement transactions, the Group recognized a loss on disposal of discontinued operations of \$26.2 million.

Disposal of interests in subsidiaries and affiliates

Intourist—In July 2011, Intourist sold 50.1% interest in ITC, its wholly-owned subsidiary which managed Intourist’s tour operating and retail business to Thomas Cook Group plc for a consideration of \$45 million satisfied by the cash payment of \$10 million and by the issue of \$35 million of the acquirer’s shares. As a result of this transaction the Group recognized a gain in the amount of \$47.8 million. Upon disposal of the controlling interest, the Group accounted for its remaining equity interest in ITC in accordance with the equity method (Note 15).

Sistema-Hals—In April-October 2009, in a series of transactions the Group sold its controlling interest in Sistema-Hals, a real estate development company, for a nominal price of RUB 60. As a result of this transaction, the Group’s share in Sistema-Hals decreased from 80% to 28.2%. The Group recognized a loss in the amount of \$364.9 million on this disposal in the year ended December 31, 2009. Later, in December 2010, the Group disposed of its remaining interest in Sistema-Hals for a total cash consideration of \$70 million.

MTT—In March 2009, the Group sold its 50% interest in MTT, a long-distance fixed line operator, for a total consideration of \$54.0 million recognizing a loss of \$19.4 million.

5. CAPITAL TRANSACTIONS OF SUBSIDIARIES

MTS—In December 2011, MTS acquired 29% of the ordinary shares of MGTS from Sistema for RUB 10.56 billion (\$336.3 million as of December 1, 2011). Upon completion of this transaction, MTS’ ownership interest in MGTS increased to 99.01% of the ordinary shares and 69.7% of the preferred shares, which overall totals 94.1% of MGTS charter capital. The transaction was accounted for directly in equity and resulted in decrease in noncontrolling interest for \$178.7 million and increase in additional paid-in capital for \$118.6 million.

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In December 2010, MTS acquired 100% of Sistema Telecom from Sistema for RUB 11.59 billion (\$379.0 million as of December 27, 2010). Sistema Telecom's key assets consist of property rights in respect of the group of trademarks, including the distinctive "egg" trademarks of MTS, Comstar and MGTS, certain promissory notes previously issued by MTS in the amount of RUB 2.00 billion (\$65.5 million) and a 45% interest in TS-Retail, a 100% subsidiary of Sistema through direct and indirect ownership. The transaction was accounted for directly in equity and resulted in the decrease in noncontrolling interests by \$198.7 million.

In October 2009, Sistema sold its interest in Comstar, held directly and through its wholly-owned subsidiaries, to MTS. As a result of this transaction, the Group's effective ownership in Comstar decreased. The transaction was accounted for directly in equity and resulted in the increase in noncontrolling interests by \$154.6 million.

SSTL—In March 2011, the Russian Federal Agency for State Property Management acquired a 17.14% interest in SSTL, through the acquisition of shares issued by SSTL for the rupee equivalent of \$600 million. As a result of this transaction the Group's share in SSTL decreased to 57%. In connection with the transaction the Group entered into a put option agreement to acquire this interest in SSTL during a one year period beginning five years after the purchase of shares in SSTL at the higher of \$777 million or their market value at that date determined by an independent appraiser. The Group accounted for the redeemable noncontrolling interest in SSTL at the redemption value and presented this as temporary equity in its consolidated statements of financial position.

RTI—In February 2011, the Group and the Bank of Moscow established RTI. The Group contributed its 97% interest in Concern RTI, a manufacturer of radiotechnical equipment, and RUB 2.88 billion (approximately \$97 million) in cash receiving 84.6% of the share capital of the newly established company. The Bank of Moscow invested RUB 3 billion (approximately \$100 million) of cash in exchange for 15.4% of the company's share capital. Upon completion of the deal, the effective ownership of the Group in Concern RTI decreased to 82.1% which resulted in the increase of noncontrolling interest by \$49.2 million.

In July 2011, Sistema sold its controlling interest in SITRONICS, a provider of telecommunication, IT and microelectronic solutions, to RTI, a fellow subsidiary (see discussion above). Upon completion of the deal, the effective ownership of the Group in SITRONICS decreased to 59.2% and resulted in the increase of noncontrolling interest by \$29.3 million.

Sistema-Invest—In May 2011, the Group completed the reorganization of Sistema-Invest, its subsidiary holding the Group's investments in the oil and energy companies in the Republic of Bashkortostan, by merging into it Bashkir Integrated Energy Systems, UNKH-EnergolInvest, UNPZ-EnergolInvest and Novoil-EnergolInvest (the "Merged Entities") which were previously owned by a number of other Group subsidiaries including Bashneft, UNPZ, Novoil and Ufaneftekhim. During the merger, shares of the Merged Entities were converted into Sistema-Invest treasury shares and additionally issued ordinary shares. As a result of the reorganization, Sistema-Invest holds 50.17% of the ordinary shares of Bashkirenergo (47.87% of its charter capital) previously held by the Merged Entities. This transaction was accounted for directly in equity and resulted in the increase of noncontrolling interest by \$225.1 million.

Detsky Mir—In December 2010, Detsky Mir, a subsidiary of the Company, increased its share capital through an additional share issue offered to Sberbank in a private placement. Detsky Mir-Center issued 743 shares with a par value of RUB 100 representing 25%+1 share of the company's share capital after the additional issue. Sberbank acquired the interest in Detsky Mir for a total consideration of approximately RUB 3.4 billion (approximately \$111.6 million as of December 31, 2010). The strategic objective of the shareholders was to use the proceeds of the investment to grow the value of the business with the ultimate aim of attracting a strategic investor or achieving a similar event in the next several years. If this is not achieved within three years, and under certain other conditions, Sberbank will have the right to sell its interest in Detsky Mir to Sistema. The parties also agreed to certain pre-emptive and tag-along and drag-along rights in relation to their respective interests in Detsky Mir. The transaction was accounted for directly in equity and resulted in the increase in noncontrolling interests by \$12.7 million and corresponding increase in additional paid-in capital by \$96.5 million.

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MTS Bank—In October 2010, MTS Bank issued additional shares, which were all purchased by the Group. As a result of transaction, the Group's share in MTS Bank increased to 99.3%. The transaction was accounted for directly in equity and resulted in a decrease in the noncontrolling interest of \$12.5 million.

Bashneft—In January 2010, as part of its plans to build a vertically integrated oil group, Sistema transferred its interest in Bashkirnefteproduct to Bashneft. Earlier, in December 2009, Sistema transferred its interests in Ufaneftekhim, Novoil, Ufaorgsintez and UNPZ to Bashneft. These transactions were accounted for directly in equity and resulted in the increase in noncontrolling interests by \$53 million and \$328 million, respectively. In October 2009, the Group reduced its equity stake in Bashneft from 77.8% to 72.9% in exchange for cash consideration of \$122.3 million. The transaction was accounted for directly in equity and resulted in the increase in noncontrolling interests by \$127.0 million.

6. ASSETS FROM BANKING ACTIVITIES, NET

Assets from banking activities, net of an allowance for loan losses, as of December 31, 2011 and 2010 consisted of the following:

	<u>2011</u>	<u>2010</u>
Cash and cash equivalents	\$ 1,315,075	\$ 2,308,488
Loans to customers	4,146,685	3,326,827
Investments in securities (trading)	650,579	694,753
Loans to banks	243,167	477,108
Investments in securities (available-for-sale)	209,089	554,874
Other investments	197,375	197,351
Less: allowance for loan losses	(253,889)	(257,052)
Assets from banking activities, net	6,508,081	7,302,349
Less: amounts maturing after one year	(2,303,120)	(1,799,620)
Assets from banking activities, current portion	<u>\$ 4,204,961</u>	<u>\$ 5,502,729</u>

Major categories of loans to customers as of December 31, 2011 and 2010 comprise the following:

	<u>2011</u>	<u>2010</u>
Corporate customers	\$3,245,105	\$2,553,242
Individuals	901,580	773,585
Total	<u>\$4,146,685</u>	<u>\$3,326,827</u>

As of December 31, 2011, approximately 73% and 1% of loans to corporate customers and individuals, respectively, were evaluated individually for impairment.

The following table presents the effective average interest rates by categories of loans as of December 31, 2011 and 2010:

	<u>2011</u>			<u>2010</u>		
	<u>RUB</u>	<u>USD</u>	<u>Other</u>	<u>RUB</u>	<u>USD</u>	<u>Other</u>
Loans to customers						
—corporate customers	11.1%	7.6%	11.2%	13.4%	11.6%	10.0%
—individuals	17.5%	10.5%	12.6%	16.5%	10.4%	12.6%
Loans to banks	3.9%	0.2%	0.7%	4.7%	0.4%	0.5%

As of December 31, 2011 and 2010, MTS Bank did not hold any investments classified as held-to-maturity. In May 2010, MTS Bank sold the part of its bank bonds in the amount of \$90.9 million, which were previously classified as held- to-maturity. The remaining portion of these bonds in the amount of \$232.3 million was reclassified to available-for-sale and accounted for at fair value.

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The movement in the allowance for loan losses for the years ended December 31, 2011, 2010 and 2009 was as follows:

	<u>2011</u>	<u>2010</u>	<u>2009</u>
Allowance for loan losses, beginning of the year	\$257,052	\$228,000	\$193,394
Additions charged to the results of operations	48,057	38,797	87,433
Write-off of allowance for loans	(37,494)	(9,126)	(51,182)
Currency translation adjustment	(13,726)	(619)	(1,645)
Allowance for loan losses, end of the year	<u>\$253,889</u>	<u>\$257,052</u>	<u>\$228,000</u>

7. SHORT-TERM INVESTMENTS

Short-term investments as of December 31, 2011 and 2010 consisted of the following:

	<u>2011</u>	<u>2010</u>
Bank deposits with original maturities exceeding 90 days	447,134	773,540
Promissory notes and loans	192,236	75,901
Investments in securities (trading)	124,080	2,827
Funds in trust management	—	26,986
Other	181	426
Total	<u>\$763,631</u>	<u>\$879,680</u>

Promissory notes and loans from third parties, which are primarily denominated in RUB, bear interest rates varying from 5.5% to 14.0% as of December 31, 2011.

The effective interest rates on bank deposits with original maturities exceeding 90 days as of December 31, 2011 are between 2.0% to 9.0% for RUB and USD denominated deposits.

As of December 31, 2010, the effective interest rates on bank deposits with original maturities exceeding 90 days were between 6.5% to 9.0% for RUB and USD denominated deposits.

8. ACCOUNTS RECEIVABLE, NET

Accounts receivable, net of provision for doubtful accounts, as of December 31, 2011 and 2010 consisted of the following:

	<u>2011</u>	<u>2010</u>
Trade receivables	\$1,954,585	\$2,008,595
Less: provision for doubtful accounts	(198,307)	(228,172)
Total	<u>\$1,756,278</u>	<u>\$1,780,423</u>

Management anticipates no losses in respect of receivables from related parties and accordingly no provision has been created in respect thereof.

9. OTHER CURRENT ASSETS

Other current assets as of December 31, 2011 and 2010 consisted of the following:

	<u>2011</u>	<u>2010</u>
Prepaid expenses and other receivables	\$ 955,542	\$1,100,730
Tax advances and overpayments	592,605	460,941
Advances paid to third parties	324,791	312,228
	1,872,938	1,873,899
Less: provision for doubtful accounts	(150,094)	(188,563)
Total	<u>\$1,722,844</u>	<u>\$1,685,336</u>

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10. INVENTORIES AND SPARE PARTS

Inventories and spare parts as of December 31, 2011 and 2010 consisted of the following:

	<u>2011</u>	<u>2010</u>
Work-in-progress	\$ 290,837	\$ 212,863
Finished goods and goods for resale	877,864	744,564
Raw materials and spare parts	552,079	505,500
Costs and estimated earnings in excess of billings on uncompleted contracts	15,143	6,686
	<u>1,735,923</u>	<u>1,469,613</u>
Less: long-term portion	(76,270)	(13,716)
Total	<u>\$1,659,653</u>	<u>\$1,455,897</u>

11. LOSS FROM IMPAIRMENT AND PROVISIONS OF OTHER ASSETS

Impairment losses recognized by the Group for the years ended December 31, 2011, 2010 and 2009 comprised of the following:

	<u>2011</u>	<u>2010</u>	<u>2009</u>
Goodwill and licenses in SSTL	\$ 694,651	\$ —	\$ —
Long-lived assets in MTS Turkmenistan	—	119,580	—
Investments in Svyazinvest	—	—	349,410
Other	336,611	193,801	368,106
Total	<u>\$1,031,262</u>	<u>\$313,381</u>	<u>\$717,516</u>

Suspension of operating licenses in SSTL—On February 2, 2012 the Indian Supreme Court delivered its judgment on a public interest petition seeking cancellation of 122 cellular phone licences granted by the Government of India in 2008, including licenses granted to SSTL in 21 telecom circles (out of 22 existing 2G licenses). In its judgment the Court quashed all 122 licences issued on and after January 10, 2008, including those granted to SSTL. The Court’s directions shall come into force after four months from February 2, 2012. Further, the Court directed the Telecom Regulatory Authority of India to make fresh recommendations for the grant of licences and the allocation of spectrum in the 2G band by auction, as was done for the allocation of spectrum in the 3G band.

As a consequence of the above cancellation, the Group reassessed the carrying amount of assets in SSTL as of December 31, 2011. Due to the withdrawal of licences, the total impairment loss of \$694.7 million was recognized, whereof the loss from impairment of operating licenses is \$346.0 million and the loss from impairment of goodwill is \$348.7 million.

Management of the Group has the intent and the ability to continue its operations in India, and has performed an analysis of the recoverability of the carrying amounts of other long-lived assets as of December 31, 2011. This analysis supported the carrying value of the assets as of December 31, 2011 of \$654.0 million and indicated that no impairment is required, based on the assumption of continuous use. Management also considered recent market transactions and current prices of the long-lived assets, and concluded that no impairment of other long-lived assets of SSTL has occurred.

In addition, SSTL’s loan agreements contain clauses which allow lenders, under certain circumstances including the termination or alteration of telecom licenses, to declare all or part of the loans to be payable on demand. As a consequence of such clauses, the Group has classified all debt payable by SSTL in the amount of \$1,573.5 million as short-term in the Group’s consolidated statement of financial position as of December 31, 2011.

Suspension of operating licenses in MTS Turkmenistan—In December 2010, MTS suspended its operations in Turkmenistan following a notice received from the Ministry of Communications of

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Turkmenistan informing of a decision to suspend licenses held by BCTI, its wholly-owned subsidiary in Turkmenistan, for a period of one month starting from December 21, 2010. On January 21, 2011, the period of license suspension expired, however, permission to resume operations was not granted. Following the decision to suspend the licenses, the Turkmenistan government authorities took further steps, including unilateral termination of interconnect agreements between BCTI and state-owned telecom operators, to prevent MTS from providing services to its customers. The Group initiated a number of proceedings against the Turkmenistan government authorities and the state-owned telecom operators to defend its legal rights.

On December 21, 2010, BCTI filed three requests for arbitration with the International Court of Arbitration of the International Chamber of Commerce (“ICC”) against the Ministry of Communications of Turkmenistan and several state-owned telecom operators requesting specific performance on the respective agreements and compensation of damages. Subsequently, the sovereign state of Turkmenistan was joined as a respondent in the proceedings against the Ministry of Communications of Turkmenistan. An independent appraisal has shown that MTS and BCTI have suffered damages amounting to \$855 million as a result of breaches committed by the respondents. MTS have made a claim for this amount in the ICC proceedings. In March 2012 MTS and BCTI withdrew the demand for specific performance of the 2005 Agreement from its’ claim against Ministry of Communications of Turkmenistan and Turkmenistan after negotiations with Turkmen government stopped at the end of 2011 and not resumed to date.

On January 21, 2011, MTS sent a formal notice to the Government of Turkmenistan requesting to resolve the dispute through negotiations and notifying it of its intention to file a claim pursuant to the provisions of the Bilateral Investment Treaty between the Russian Federation and Turkmenistan. The dispute was not resolved by negotiations and, accordingly, on September 1, 2011, MTS filed a claim against Turkmenistan in the International Centre for the Settlement of Investment Disputes (“ICSID”). On October 5, 2011, the claim was registered by the ICSID Secretariat.

Considering the adverse impact of such circumstances on the Group’s ability to conduct operations in Turkmenistan, the Group determined that all of its long-lived assets attributable to Turkmenistan were impaired and recorded an impairment charge of \$119.6 million, whereby the loss from the impairment of intangible assets was \$12.1 million and for property, plant and equipment was \$107.5 million. These impairments were recognized in the consolidated statement of operations for the year ended December 31, 2010. The Group also assessed the recoverability of the subsidiary’s current assets and provided for or wrote down those which were considered to be impaired in the total amount of \$18.2 million.

Investments in shares of Svyazinvest—In December 2006, the Group acquired a 25% interest plus one share in Telecommunication Investment Joint Stock Company (“Svyazinvest”), a holding company that holds controlling interests in seven publicly traded incumbent fixed-line operators based in all seven Federal districts of Russia, Rostelecom, a publicly traded long-distance fixed-line operator operating a Russia-wide network, and several other non-public entities, for a total consideration of approximately \$1,390.0 million.

As discussed in Note 3, In November 2009, the Group and Svyazinvest signed a non-binding memorandum of understanding (“MOU”), whereby the Group agreed to dispose of its share in Svyazinvest in exchange for certain consideration.

Svyazinvest is a non-public entity and the Group had no access to consolidated financial information of Svyazinvest at a level of detail necessary to perform a complete fair value assessment of the Svyazinvest business directly, based on estimated future cash flows or otherwise. As a result, management had determined that the best estimate of the fair value of the Group’s investment in Svyazinvest as of December 31, 2009 was the amount determined based on the MOU. Based on the MOU, the estimated fair value of the investment, which included significant unobservable inputs, was approximately RUB 26.0 billion (\$859.7 million as of December 31, 2009) compared to a carrying value of RUB 36.5 billion (\$1,205.5 million as of December 31, 2009). As a result, during the year ended December 31, 2009 the Group had recorded an impairment loss of RUB 10.5 billion (\$349.4 million).

In September 2010, the Group completed the sale of its Svyazinvest interest under the terms stipulated in the MOU. Accordingly, no gain or loss was recognized on disposal in the year ended December 31, 2010.

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12. PROPERTY, PLANT AND EQUIPMENT, NET

Property, plant and equipment, net of accumulated depreciation, as of December 31, 2011 and 2010 consisted of the following:

	<u>2011</u>	<u>2010</u>
Switches, transmission devices, network and base station equipment	\$12,161,261	\$11,295,627
Refining, marketing, distribution and chemicals	4,900,081	4,886,962
Exploration and production assets	3,767,298	3,758,454
Other plant, machinery and equipment	2,160,619	2,063,254
Buildings and leasehold improvements	1,658,871	1,782,206
Power and utilities	664,100	610,782
Construction in-progress and equipment for installation	2,415,512	1,678,000
Land	42,014	33,650
	<u>27,769,756</u>	<u>26,108,935</u>
Less: accumulated depreciation and depletion	(9,408,930)	(8,086,736)
Total	<u>\$18,360,826</u>	<u>\$18,022,199</u>

Depreciation and depletion expenses for the years ended December 31, 2011, 2010 and 2009 amounted to \$2,668.2 million, \$2,332.8 million and \$1,961.5 million, respectively.

13. GOODWILL

The carrying amounts of goodwill attributable to each reportable segment are as follows:

	<u>MTS</u>	<u>SSTL</u>	<u>RTI</u>	<u>MTS Bank</u>	<u>Other</u>	<u>Total</u>
Balance as of January 1, 2010						
Gross amount of goodwill	\$1,176,889	\$ 441,393	\$124,157	\$ 64,072	\$ 2,508	\$1,809,019
Accumulated impairment loss	(48,466)	—	—	(63,560)	—	(112,026)
	<u>1,128,423</u>	<u>441,393</u>	<u>124,157</u>	<u>512</u>	<u>2,508</u>	<u>1,696,993</u>
Adjustments to preliminary allocations	(6,004)	—	—	—	—	(6,004)
Purchase price allocations	181,311	—	—	—	—	181,311
Currency translation adjustment	2,255	—	(2,404)	—	369	220
Balance as of December 31, 2010						
Gross amount of goodwill	1,354,081	441,393	121,753	64,072	2,877	1,984,176
Accumulated impairment loss	(48,096)	—	—	(63,560)	—	(111,656)
	<u>1,305,985</u>	<u>441,393</u>	<u>121,753</u>	<u>512</u>	<u>2,877</u>	<u>1,872,520</u>
Adjustments to preliminary allocations	6,945	—	—	—	—	6,945
Purchase price allocations	185,690	—	—	—	56,051	241,741
Impairment (Note 11)	—	(348,679)	—	—	—	(348,679)
Currency translation adjustment	(74,835)	(92,714)	176	—	(3,894)	(171,267)
Balance as of December 31, 2011						
Gross amount of goodwill	1,469,313	348,679	121,929	64,072	55,034	2,059,027
Accumulated impairment loss	(45,528)	(348,679)	—	(63,560)	—	(457,767)
	<u>\$1,423,785</u>	<u>\$ —</u>	<u>\$121,929</u>	<u>\$ 512</u>	<u>\$55,034</u>	<u>\$1,601,260</u>

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14. OTHER INTANGIBLE ASSETS, NET

Intangible assets other than goodwill as of December 31, 2011 and 2010 consisted of the following:

	2011			2010		
	Gross carrying value	Accumulated amortization	Net carrying value	Gross carrying value	Accumulated amortization	Net carrying value
Amortized intangible assets:						
Billing and telecommunication software	\$1,668,715	(1,042,773)	625,942	\$1,682,959	(1,056,324)	626,635
Acquired customer base	544,911	(215,267)	329,644	649,231	(236,326)	412,905
Radio frequencies	353,776	(138,546)	215,230	314,722	(100,496)	214,226
Operating licenses	702,311	(285,955)	416,356	1,410,192	(448,960)	961,232
Numbering capacity with finite contractual life, software and other	408,659	(31,541)	377,118	659,559	(137,739)	521,820
	3,678,372	(1,714,082)	1,964,290	4,716,663	(1,979,845)	2,736,818
Unamortized intangible assets:						
Trademarks	203,952	—	203,952	216,504	—	216,504
Numbering capacity with indefinite contractual life	82,924	—	82,924	68,596	—	68,596
Total intangible assets	\$3,965,248	(1,714,082)	2,251,166	\$5,001,763	(1,979,845)	3,021,918

Amortization expense recorded on other intangible assets for the years ended December 31, 2011, 2010 and 2009 amounted to \$613.4 million, \$530.0 million and \$473.2 million, respectively.

The estimated amortization expense for each of the five following years and thereafter is as follows:

Year ended December 31 ,	
2012	\$ 602,700
2013	443,375
2014	282,408
2015	180,474
2016	116,992
Thereafter	338,341
	\$1,964,290

Actual amortization expense to be reported in future periods could differ from these estimates as a result of new intangible assets acquisitions, changes in useful lives and other relevant factors.

15. INVESTMENTS IN AFFILIATES

Investments in and loans to affiliates as of December 31, 2011 and 2010 consisted of the following:

	2011		2010	
	Voting power, %	Carrying value	Voting power, %	Carrying value
Belkamneft	38.5%	\$ 597,060	38.5%	\$ 559,784
Bashneft-Polus	74.9%	341,000	—	—
SITRONICS Nano	49.8%	235,674	49.8%	243,366
MTS Belarus	49.0%	176,659	49.0%	227,130
ITC (Note 4)	49.9%	10,873	—	—
ASPEC (Note 3)	—	—	49.99%	107,185
RussNeft	49.0%	—	49.0%	—
Other	Various	21,385	Various	10,229
Total		\$ 1,382,651		\$ 1,147,694

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Belkamneft—In April 2009, upon obtaining control over Bashneft in business combination (Note 3), the Group received a 38.5% interest in Belkamneft, a company engaged in the production of crude oil. Since the Group was unable to exert any influence over the operations of Belkamneft, it accounted for this investment using the cost method. This changed in April 2010 with the acquisition of a 49% interest in Russneft, the controlling shareholder of Belkamneft; thereafter, while the Group’s equity interest was unchanged, the Group was in a position to exert significant influence and consequently, the equity method of accounting was adopted. The excess of the fair value of the investment over its carrying value in the amount of \$477.4 million was recognized as gain in the consolidated statement of operations for the year ended December 31, 2010.

The financial position and results of operations of Belkamneft as of and for the years ended December 31, 2011 and 2010 were as follows:

	(unaudited)	
	2011	2010
Total assets	\$2,553,094	\$2,589,636
Total liabilities	448,498	462,671
Net income	195,852	87,949

Bashneft-Polus—In December 2011, in connection with the development of two oil fields named after R.Trebs and A.Titov located in the Nenets Autonomous District of Russia, Bashneft entered into an agreement with LUKOIL, to sell a 25.1% interest in Bashneft-Polus, its wholly-owned subsidiary holding the mineral rights for the development of the fields, for \$152.9 million accompanied by a shareholders’ agreement.

The Group concluded that, although the Group retained a 74.9% interest in Bashneft-Polus, the shareholders agreement provides LUKOIL with substantive participating rights in the entity. The Group, therefore, deconsolidated Bashneft-Polus and began accounting for the entity under the equity method of accounting prospectively from the date control over the subsidiary was relinquished. The Group recognized a gain of \$34.6 million on this disposal, which was recognized in the Group’s consolidated statement of operations for the year ended December 31, 2011. The Group recognized income tax expense in the amount of \$31.0 million associated with this transaction.

The financial position and results of operations of Bashneft-Polus as of and for the year ended December 31, 2011 were as follows:

	(unaudited)
Total assets	\$755,545
Total liabilities	300,436
Net income	—

SITRONICS-Nano—In October 2009, SITRONICS, a subsidiary of the Group, entered into an agreement to form SITRONICS-Nano, which is owned 49.75% by SITRONICS, 49.75%—by Russian Corporation of Nanotechnologies (“RUSNANO”) and 0.5%—by another party. The primary purpose of SITRONICS-Nano is to acquire equipment and licenses necessary to launch 90 nanometer microchip production and to lease them to SITRONICS, and to provide project financing to SITRONICS. The equipment and licenses purchases are financed through the equity of SITRONICS-Nano and external borrowings.

SITRONICS-Nano is determined to be a variable interest entity where SITRONICS has a variable interest through a lease agreement and is not the primary beneficiary. SITRONICS accounts for the investment under the equity method.

RUSNANO has a put option to sell its shares to Sistema at market price plus 25% not earlier than in nine years and not later than in 10.5 years from the date of financing (December 2009). Sistema has a call option to acquire at any time RUSNANO’s shares at RUB 6,480.0 million (\$201.3 million as of December 31, 2011) plus 18% p.a. In addition, during the first nine years of operations of SITRONICS-Nano on non-fulfillment of certain criteria, RUSNANO can put its share in SITRONICS-Nano to Sistema at RUB 6,480.0 million (\$201.3 million as of December 31, 2011) plus 18% p.a., less any net profit attributed and paid to RUSNANO during the period from the date of the put option application.

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The maximum exposure to a loss is determined as the Group's contribution to SITRONICS-Nano adjusted by the Group's share of distributed results of the investee and is equal to \$211.2 million.

The financial position and results of operations of SITRONICS-Nano as of and for the years ended December 31, 2011 and 2010 were as follows:

	(unaudited)	
	2011	2010
Total assets	\$500,661	\$449,488
Total liabilities	94,918	20,142
Net income/(loss)	919	(2,783)

MTS Belarus—The financial position and results of operations of MTS Belarus as of and for the year ended December 31, 2011 and 2010 were as follows:

	(unaudited)	
	2011	2010
Total assets	\$417,555	\$527,609
Total liabilities	92,884	72,533
Net income	107,533	145,707

RussNeft—In April 2010, the Group acquired a noncontrolling 49% interest in RussNeft, an oil and gas company, for a total cash consideration of \$20 million. The investment is accounted for using the equity method. As a result of the final measurement of the equity interest in RussNeft and the ongoing operational losses, the Group recognized a loss in the amount of \$20 million in the year ended December 31, 2010 bringing the carrying value of the Group's investment to nil in its consolidated statements of financial position. Nothing has been recognized in 2011 for this investment as the entity's net assets were still negative. As of December 31, 2011 the RussNeft's shares were pledged as a guarantee of payment of certain RussNeft debts.

The financial position and results of operations of RussNeft as of and for the year ended December 31, 2011 and 2010 were as follows:

	(unaudited)	
	2011	2010
Total assets	\$5,307,259	\$6,219,259
Total liabilities	6,513,095	7,206,314
Net income	546,193	588,934

16. LONG-TERM INVESTMENTS

Long-term investments as of December 31, 2011 and 2010 consisted of the following:

	2011	2010
Bank deposits	\$ 772,867	\$108,025
Loans and notes	450,814	281,712
Other	71,006	80,005
Total	\$1,294,687	\$469,742

The effective interest rates on bank deposits as of December 31, 2011 are between 4.9% to 10.7% for RUB and USD denominated deposits.

Long-term investments as of December 31, 2011 include loan given to Bashneft-Polus, an affiliate of the Group, in amount of \$166 million.

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17. LIABILITIES FROM BANKING ACTIVITIES

Liabilities from banking activities as of December 31, 2011 and 2010 consisted of the following:

	<u>2011</u>	<u>2010</u>
Term deposits	\$ 2,473,950	\$ 3,026,225
Deposits repayable on demand	2,089,509	2,026,740
Promissory notes issued and other liabilities	234,008	583,654
	<u>4,797,467</u>	<u>5,636,619</u>
Less: amounts maturing within one year	(3,152,989)	(4,191,836)
Total liabilities from banking activities, net of current portion	<u>\$ 1,644,478</u>	<u>\$ 1,444,783</u>

Liabilities from banking activities as of December 31, 2011 and 2010 include liabilities with affiliates and other related parties for \$240.1 million and \$153.8 million, respectively. The fair value of liabilities from banking activities approximates their carrying value.

The following table presents the effective average interest rates by categories of bank deposits and notes issued as of December 31, 2011 and 2010:

	<u>2011</u>			<u>2010</u>		
	<u>RUB</u>	<u>USD</u>	<u>Other</u>	<u>RUB</u>	<u>USD</u>	<u>Other</u>
Term deposits:						
—corporate customers	8.1%	4.2%	2.8%	6.9%	4.8%	3.8%
—individuals	7.8%	4.8%	4.4%	11.0%	7.8%	7.5%
Promissory notes issued	8.6%	1.1%	—	8.3%	5.0%	—
Deposits repayable on demand:						
—corporate customers	2.2%	—	—	1.6%	—	—
—individuals	0.4%	0.1%	0.1%	0.4%	0.2%	0.3%

18. ACCRUED EXPENSES AND OTHER CURRENT LIABILITIES

Accrued expenses and other current liabilities as of December 31, 2011 and 2010 consisted of the following:

	<u>2011</u>	<u>2010</u>
Customers' advances	\$ 777,162	\$ 724,518
Payroll and other accrued expenses	389,537	468,187
Accruals for services	308,457	365,447
Bitel liability (Note 27)	213,152	210,760
Accrued interest on loans	163,771	180,878
Tax and legal provisions	101,481	88,605
Financial instruments at fair value	40,917	57,473
Dividends payable	13,069	53,474
Advance for shares of SSTL (Note 5)	—	602,276
Other	355,222	526,075
Total	<u>\$2,362,768</u>	<u>\$3,277,693</u>

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19. SHORT-TERM LOANS PAYABLE

Short-term loans payable as of December 31, 2011 and 2010 consisted of the following:

	Interest rate (Actual at December 31, 2011)	2011	2010
<i>USD-denominated:</i>			
VTB	—	\$ —	\$ 200,000
Other	Various	18,274	14,890
		<u>18,274</u>	<u>214,890</u>
<i>RUB-denominated:</i>			
Zenit	10.25%-10.50%	28,912	8,844
Bank of Moscow	MOSPRIME+5.0% (12.22%)	26,394	—
Sberbank	—	—	581,069
Other	Various	60,794	58,717
		<u>116,100</u>	<u>648,630</u>
<i>Other currencies</i>			
ING Bank	13%	128,225	154,171
Other	Various	37,011	41,296
Loans from related parties	Various	—	15,094
Total		<u>\$299,610</u>	<u>\$1,074,081</u>

20. LONG-TERM DEBT

Long-term debt as of December 31, 2011 and 2010 consisted of the following:

	2011	2010
Loans from banks and financial Institutions	\$10,326,198	\$ 7,229,309
Notes and corporate bonds	5,356,583	6,674,890
Capital leases	227,647	250,876
Loans from related parties	54,931	50,339
Vendor financing	133,705	95,590
Other borrowings	11,209	8,916
	<u>16,110,273</u>	<u>14,309,920</u>
Less amounts maturing within one year	(4,097,076)	(2,103,405)
Total	<u>\$12,013,197</u>	<u>\$12,206,515</u>

The schedule of repayments of long-term debt over the five-year period and thereafter beginning on December 31, 2011 is as follows:

Year ended December 31,	
2012	\$ 4,097,076
2013	2,354,096
2014	1,467,499
2015	2,363,042
2016	2,189,133
Thereafter	3,639,427
Total	<u>\$16,110,273</u>

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Loans from banks and financial institutions—Loans from banks and financial institutions as of December 31, 2011 and 2010 consisted of the following:

	<u>Maturity</u>	<u>Interest rate (Actual at December 31, 2011)</u>	<u>2011</u>	<u>2010</u>
<i>USD-denominated:</i>				
Calyon, ING Bank N.V, Nordea Bank AB, Raiffeisen Zentralbank Osterreich AG	2012-2020	LIBOR + 1.15% (1.96%)	\$ 580,742	\$ —
Deutsche Bank	2012-2014	LIBOR + 1.55% (1.85%)	300,000	—
China Development Bank	2012-2017	LIBOR + 1.5% (2.31%)	249,616	157,406
Gazprombank	2012-2014	LIBOR + 4.9% (5.48%)	229,309	—
Skandinaviska Enskilda Banken AB	2012-2017	LIBOR + 0.23%-1.8% (1.03%-2.61%)	204,507	242,013
Bank of China	2012-2017	LIBOR+1.5%-1.95% (2.31%-2.76%)	139,805	139,960
Bank of Moscow	2014-2018	LIBOR+ 6.75%-9.5% (7.33-9.8%)	117,450	—
EBRD	2012-2014	LIBOR + 1.51%-3.1% (2.32%-3.91%)	83,333	116,667
HSBC Bank plc and ING BHF Bank AG	2012-2014	LIBOR+0.3% (1.11%)	51,503	71,244
HSBC Bank plc, ING Bank AG and Bayerische Landesbank	2012-2015	LIBOR+0.3% (1.11%)	42,961	59,570
Citibank International plc and ING Bank N.V.	2012-2013	LIBOR+0.43% (1.23%)	40,688	62,486
Commerzbank AG, ING Bank AG and HSBC Bank plc	2012-2014	LIBOR+0.3% (1.11%)	36,495	51,285
Golden Gates (Bank of Moscow)	2012	9.75%	20,000	306,000
Societe Generale	2012-2016	LIBOR+1.25% (2.06%)	18,860	20,768
The Royal Bank of Scotland	2012-2013	LIBOR+0.35% (1.16%)	12,574	61,361
Barclays Bank plc	—	—	—	46,047
Troika Dialog Bank	—	—	—	30,000
Other	Various	Various	6,324	14,128
			2,134,167	1,378,935
<i>EUR-denominated:</i>				
Bank of China	2012-2016	EURIBOR+1.95% (3.57%)	116,812	35,123
Syndicated Loan to Intracom Telecom	2012	EURIBOR+4.5% (5.61%)	116,487	158,808
EBRD	2012	EURIBOR+5.2% (6.49%)	77,658	158,808
BNP Paribas	2012-2018	EURIBOR+1.65% (3.27%)	64,033	52,159
LBWW	2012-2017	EURIBOR+0.75% (2.37%)	36,215	43,201
The Royal Bank of Scotland	2012-2013	EURIBOR+0.35% (1.97%)	8,958	13,740
Other	Various	Various	16,282	18,346
			436,445	480,185
<i>RUB-denominated:</i>				
Sberbank	2013-2017	7.75%-8.90%	4,388,106	2,053,182
Gazprombank	2013-2018	8.75%-9.00%	1,830,699	990,914
Bank of Moscow	2013-2018	MosPrime+7.25% (14.47%) 7.8%-10.25%	590,309	459,364
Raiffeisenbank	2014	MosPrime+3% (9.37%-10.22%)	83,861	63,172
Unicredit	2014-2016	MosPrime+4.5%-7.5% (10.87%-13.87%)	69,271	66,927
ING Bank	2014	10.74%	32,613	—
VTB	—	—	—	492,176
VTB-Capital	—	—	—	492,176
Other	Various	Various	6,875	15,118
			7,001,734	4,633,029
<i>Other currencies:</i>				
State Bank of India	2012	13.5%	396,095	535,595
Other	Various	Various	357,757	201,565
			753,852	737,160
Total			\$10,326,198	\$7,229,309

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Certain loans from banks and financial institutions are subject to restrictive covenants, including, but not limited to compliance with certain financial ratios, limitations on dispositions of assets and transactions within the Group, retention of telecom licenses. As described in Note 11, SSTL's loan agreements contain clauses which allow lenders, under certain circumstances including the termination or alteration of telecom licenses, to declare all or part of the loans to be payable on demand. As a consequence of such clauses, the Group has reclassified all debt payable by SSTL in the amount of \$1,573.5 million as short-term in the Group's consolidated statement of financial position as of December 31, 2011.

Equipment with carrying value of \$241.9 million has been pledged to collateralize some of the other loan facilities provided to the Group.

Notes and corporate bonds—Notes and corporate bonds as of December 31, 2011 and 2010 consisted of the following:

	Currency	Interest rate (December 31, 2011)	Fair value as of December 31, 2011	Carrying value as of December 31,	
				2011	2010
MTS International Notes due					
2020	USD	8.6%	\$ 804,975	\$ 750,000	\$ 750,000
MTS Notes due 2016	RUB	14.3%	482,667	465,895	492,176
MTS Notes due 2020	RUB	8.2%	443,732	457,928	492,176
MTS Notes due 2014	RUB	7.6%	412,625	422,988	492,176
MTS Finance Notes due 2012	USD	8.0%	402,000	400,000	400,000
Bashneft Bonds due 2016	RUB	12.5%	371,950	357,301	1,640,587
Sistema JSFC Bonds due 2014	RUB	14.8%	366,747	352,641	648,155
Sistema JSFC Bonds due 2016	RUB	7.7%	344,691	349,940	—
Bashneft Bonds due 2014	RUB	9.4%	310,752	310,597	—
MTS Notes due 2018	RUB	8.0%	302,976	298,499	315,337
MTS Notes due 2017	RUB	8.7%	298,639	310,597	328,117
Sistema JSFC Bonds due 2016	RUB	12.5%	256,484	247,333	623,423
MTS Notes due 2015	RUB	7.8%	228,838	234,706	39,823
Sistema JSFC Bonds due 2013	RUB	9.8%	159,520	154,829	196,870
SITRONICS Bonds due 2013	RUB	10.8%	90,384	93,179	98,435
Intourist Bonds due 2013	RUB	14.0%	61,498	62,119	65,623
SITRONICS Bonds due 2013	RUB	11.8%	39,070	39,011	41,212
DM-Center Bonds due 2015	RUB	8.5%	33,576	35,719	37,733
MTS Notes due 2013	RUB	7.0%	12,652	13,318	13,250
			5,423,776	5,356,600	6,675,093
Less: unamortized discount			—	(17)	(203)
Total			\$5,423,776	\$5,356,583	\$6,674,890

All Group's RUB-denominated notes and corporate bonds are traded on MICEX-RTS, a Russian exchange. MTS International Notes due 2020 are traded on Irish stock exchange. MTS Finance Notes due 2012 redeemed in January 2012 were traded on Luxembourg stock exchange. The fair values of notes and corporate bonds are based on the market quotes as of December 31, 2011 at the exchanges where they are traded.

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In certain instances the Group has an unconditional obligation to repurchase notes at par value if claimed by the noteholders, where a subsequent sequential coupon is announced. The notes therefore can be defined as callable obligations under the FASB authoritative guidance on debt, as the holders have the unilateral right to demand repurchase of the notes at par value upon announcement of new coupons. The FASB authoritative guidance on debt requires callable obligations to be disclosed as maturing in the reporting period, when the demand for repurchase could be submitted disregarding the expectations of the Group about the intentions of the noteholders. The Group discloses such notes in the aggregated maturities schedule as these are the reporting periods when the noteholders will have the unilateral right to demand repurchase.

Notes and corporate bonds are subject to certain financial and non-financial restrictive covenants, including, but not limited to, limitations on dispositions of assets, limitations on transactions with affiliates, compliance with certain financial ratios. Management believes that the Group is in compliance with all restrictive financial covenants relating to notes and corporate bonds as of December 31, 2011.

21. INCOME TAX

The Group's income tax expense for the years ended December 31, 2011, 2010 and 2009 was as follows:

	<u>2011</u>	<u>2010</u>	<u>2009</u>
Current provision	\$1,103,480	\$1,089,577	\$773,849
Deferred income tax benefit	(14,934)	(24,097)	(29,954)
Total	<u>\$1,088,546</u>	<u>\$1,065,480</u>	<u>\$743,895</u>

Income tax expenses is different from that which would be obtained by applying the statutory income tax rate to income from continuing operations before income tax expense and equity in net income of Energy companies in the Republic of Bashkortostan. The items causing this difference are as follows:

	<u>2011</u>	<u>2010</u>	<u>2009</u>
Income tax provision computed on income from continuing operations before taxes at the statutory rate of 20%	\$ 409,334	\$ 572,204	\$ 613,691
Adjustments due to:			
Change in valuation allowance	281,221	105,129	191,253
Non-deductible expenses	279,166	240,116	144,392
Earnings distribution from subsidiaries	103,806	80,530	101,642
Effect of Group restructuring	3,543	75,400	232,900
Impairment of goodwill	69,740	—	—
Impairment of long-lived assets in Turkmenistan	—	27,565	—
(Reductions)/additions to unrecognized tax benefits	(4,034)	766	(10,451)
Dispositions of subsidiaries	—	—	68,209
Non-taxable gain on bargain purchase	—	—	(556,567)
Settlements with tax authorities on prior period income tax . . .	(10,497)	(27,252)	(43,347)
Foreign rates differential	(41,002)	(6,587)	(698)
Currency exchange and translation differences	(2,731)	(2,391)	2,871
Income tax expense	<u>\$1,088,546</u>	<u>\$1,065,480</u>	<u>\$ 743,895</u>

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The tax effects of temporary differences that give rise to the deferred tax assets and liabilities are presented below:

	<u>2011</u>	<u>2010</u>
Deferred tax assets		
Property, plant and equipment	\$ 330,904	\$ 392,279
Tax losses carried forward	669,271	475,523
Accrued expenses	146,672	172,593
Inventory obsolescence	52,399	61,762
Allowance for doubtful accounts and loans receivable	26,994	38,904
Intangible assets	165,092	37,517
Deferred connection fees	42,818	31,522
Deferred revenues	16,755	20,832
Other	57,970	77,570
	<u>1,508,875</u>	<u>1,308,502</u>
Less: valuation allowance	(743,160)	(460,660)
Total deferred tax assets	<u>\$ 765,715</u>	<u>\$ 847,842</u>
Deferred tax liabilities		
Property, plant and equipment	(1,181,266)	(1,362,833)
Intangible assets	(235,117)	(257,604)
Undistributed earnings of subsidiaries and affiliates	(229,840)	(242,367)
Debt issuance costs	(20,975)	(34,966)
Other	(18,781)	(36,990)
Total deferred tax liabilities	<u>\$(1,685,979)</u>	<u>\$(1,934,760)</u>
Net deferred tax assets, current portion	\$ 311,891	\$ 357,821
Net deferred tax assets, net of current portion	348,589	304,761
Net deferred tax liabilities, current portion	(168,545)	(168,982)
Net deferred tax liabilities, net of current portion	(1,412,199)	(1,580,518)

The Group has the following significant balances for income tax losses carried forward as of December 31, 2011 and 2010:

Jurisdiction	Period for carry-forward	<u>2011</u>	<u>2010</u>
India	2012-2019	\$381,320	\$241,330
Luxembourg	Unlimited	125,124	124,464
Russia	2012-2021	160,189	94,164
Other	2012-2013	2,638	15,565
Total		<u>\$669,271</u>	<u>\$475,523</u>

Management has established the valuation allowances against certain deferred tax assets (see the table below), that are not more likely than not to be realized in future periods. In evaluating the Group's ability to realize its deferred tax assets, the Company considers all available positive and negative evidence, including operating results, ongoing tax planning, and forecasts of future taxable income on a jurisdiction by jurisdiction basis. The valuation allowance as of December 31, 2011 and 2010 relates to the following deferred tax assets:

	<u>2011</u>	<u>2010</u>
Tax losses carried forward	\$478,482	\$335,362
Impairment of licenses in SSTL	87,743	—
Sale of investment in Svyazinvest	66,596	66,887
Other	110,339	58,411
Total	<u>\$743,160</u>	<u>\$460,660</u>

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22. FAIR VALUE MEASUREMENTS AND DERIVATIVE FINANCIAL INSTRUMENTS

The following fair value hierarchy table presents information regarding Group's assets and liabilities measured at fair value on a recurring basis as of December 31, 2011 and 2010:

	Fair value measurements using			Total fair value
	Quoted prices in active markets for identical assets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)	
<i>December 31, 2011</i>				
Assets at fair value:				
Trading securities	\$ 774,659	\$ —	\$ —	\$ 774,659
Available-for-sale securities	97,625	111,464	—	209,089
Interest rate swaps	—	2,341	—	2,341
Currency option agreements	—	894	—	894
Total assets	<u>872,284</u>	<u>114,699</u>	<u>—</u>	<u>986,983</u>
Liabilities at fair value:				
Interest rate swaps	—	(15,959)	—	(15,959)
Put options	—	—	(24,958)	(24,958)
Redeemable noncontrolling interests	—	—	(99,819)	(99,819)
Total liabilities	<u>—</u>	<u>(15,959)</u>	<u>(124,777)</u>	<u>(140,736)</u>
<i>December 31, 2010</i>				
Assets at fair value:				
Trading securities	697,580	—	—	697,580
Available-for-sale securities	328,502	226,372	—	554,874
Interest rate swaps	—	3,322	—	3,322
Currency option agreements	—	247	—	247
Total assets	<u>1,026,082</u>	<u>229,941</u>	<u>—</u>	<u>1,256,023</u>
Liabilities at fair value:				
Interest rate swaps	—	(31,315)	—	(31,315)
Put options	—	(11,636)	(22,689)	(34,325)
Cross-currency interest rate swaps	—	(3,469)	—	(3,469)
Currency option agreements	—	(2,612)	—	(2,612)
Redeemable noncontrolling interests	—	—	(107,343)	(107,343)
Total liabilities	<u>\$ —</u>	<u>\$(49,032)</u>	<u>\$(130,032)</u>	<u>\$(179,064)</u>

23. SHARE CAPITAL

As of December 31, 2011 and 2010, the Company had 9,650,000,000 voting common shares with a par value of RUB 0.09 issued, of which 9,267,985,025 and 9,281,827,594 shares were outstanding, respectively.

Dividends declared by the Company in the years ended December 31, 2011, 2010 and 2009 are as follows:

	<u>2011</u>	<u>2010</u>	<u>2009</u>
Dividends declared, million Rubles	2,509	530.8	—
Dividends declared, equivalent in million USD	87.1	17.5	—

24. SEGMENT INFORMATION

The Group defines operating segments as components of an enterprise engaging in business activities about which separate financial information is available that is evaluated regularly by the chief operating decision maker or group in deciding how to allocate resources and in assessing performance. The Group's management evaluates the performance of the segments based on operating income.

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In April 2011, the Group's Board of Directors approved a new organizational and management structure which established two business units based on the level of maturity of the various assets under management, namely "Core Assets" and "Developing Assets". This change of the structure caused the composition of the Group's reportable segments to change. The Group identified six reportable segments namely MTS and Bashneft, which form part of the Core Assets, and SSTL, MTS Bank and RTI, which form part of the Developing Assets, and Corporate division (Note 1). Information about operating segments that are not reportable due to their materiality have been combined and disclosed in the "Other" category. Prior period segment data has been restated to reflect these changes.

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

Financial information by reportable segment is presented below:

For the year ended December 31, 2011	Core Assets		Developing Assets			Other	Corporate	Total
	MTS	Bashneft	SSTL	MTS Bank	RTI			
Net sales to external customers ^(a) . . .	12,312,501	16,537,117	262,264	529,012	1,355,363	1,947,440	37,551	32,981,248
Intersegment sales	6,187	11,969	—	31,894	737,676	27,537	26,998	842,261
Equity in results of affiliates . . .	49,443	75,245	—	—	—	(3,759)	—	120,929
Net interest expense ^(b)	—	—	—	(1,912)	—	—	—	(1,912)
Depreciation, depletion and amortization . .	2,293,021	611,876	99,424	17,339	104,010	146,560	9,399	3,281,629
Operating income/(loss) .	2,893,938	2,778,789	(1,196,084)	(23,510)	50,382	(129,373)	(228,712)	4,145,430
Interest income	62,559	74,021	34,152	—	13,028	74,310	102,685	360,755
Interest expense	656,898	559,806	162,442	—	83,403	110,684	274,569	1,847,802
Income tax expense/(benefit)	613,681	527,117	(6,747)	(5,118)	28,854	12,984	(82,225)	1,088,546
Capital expenditures ^(c) .	2,584,467	877,442	178,156	34,360	127,166	321,702	8,797	4,132,090
For the year ended December 31, 2010	Core Assets		Developing Assets			Other	Corporate	Total
	MTS	Bashneft	SSTL	MTS Bank	RTI			
Net sales to external customers ^(a)	11,295,251	11,705,968	114,615	588,946	1,169,343	1,898,620	38,576	26,811,319
Intersegment sales	3,805	772	—	24,799	462,473	3,926	24,736	520,511
Equity in results of affiliates	70,649	36,074	—	—	1,389	(15,877)	17,883	110,118
Net interest revenue ^(b)	—	—	—	24,444	—	—	—	24,444
Depreciation, depletion and amortization	2,000,495	591,477	81,822	18,571	97,950	64,895	7,544	2,862,754
Operating income/(loss)	2,744,107	2,301,342	(410,789)	21,329	82,604	84,251	(288,791)	4,534,053
Interest income	84,396	74,511	4,971	—	7,774	4,145	90,494	266,291
Interest expense	777,288	327,852	91,982	—	87,923	120,654	335,484	1,741,183
Income tax expense/(benefit)	566,339	417,154	—	11,727	29,327	42,218	(1,285)	1,065,480
Capital expenditures ^(c) . .	2,647,117	1,088,772	169,000	19,151	91,236	105,344	58,954	4,179,574

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For the year ended December 31, 2009	Core Assets		Developing Assets			Other	Corporate	Total
	MTS	Bashneft	SSTL	MTS Bank	RTI			
Net sales to external customers ^(a)	9,860,924	4,848,231	36,374	697,227	,086,585	1,574,649	18,739	18,122,729
Intersegment sales	6,329	1,298	—	16,617	316,591	51,871	14,131	406,837
Equity in results of affiliates	60,313	4,400	—	—	—	(73,071)	—	(8,358)
Net interest expense ^(b)	—	—	—	51,980	—	—	—	51,980
Depreciation, depletion and amortization . . .	1,776,461	415,970	28,065	13,554	69,699	123,278	7,706	2,434,733
Operating income/(loss)	2,282,523	3,349,839	(250,791)	(83,514)	(10,997)	(508,974)	670,911	5,448,997
Interest income	108,543	32,372	8,625	—	18,012	3,002	142,500	313,054
Interest expense	577,139	218,745	44,498	—	80,847	148,313	343,170	1,412,712
Income tax expense/(benefit)	556,030	103,812	—	12,138	(6,237)	(2,075)	80,227	743,895
Capital expenditures ^(c)	2,207,987	289,658	210,100	25,900	125,706	574,265	800	3,434,416

- (a) Interest income and expenses of the MTS Bank are presented as revenues from financial services and cost of financial services, correspondingly, in the Group's consolidated financial statements.
- (b) Represents the net interest result of banking activities. In reviewing the performance of MTS Bank, the chief operating decision maker reviews the net interest result, rather than the gross interest amounts.
- (c) Represents purchases of property, plant and equipment and intangible assets.

	Investments in affiliates		Segment assets		Indebtedness ^(a)	
	2011	2010	2011	2010	2011	2010
Core assets:						
MTS	176,659	230,130	15,919,243	14,388,217	8,700,407	7,160,611
Bashneft	937,601	666,969	13,530,524	12,354,042	3,393,314	3,927,161
Developing assets:						
SSTL	—	—	1,113,191	1,788,876	1,573,523	1,245,856
MTS Bank	—	—	6,978,934	7,849,704	—	—
RTI	214,625	220,755	2,629,665	2,378,495	1,126,471	917,435
Other	16,527	—	4,079,014	5,773,667	369,382	383,411
Corporate	37,239	29,840	3,135,691	3,466,480	1,246,786	1,749,527
Total	1,382,651	1,147,694	47,386,262	47,999,481	16,409,883	15,384,001

- (a) Represents the sum of short-term and long-term debt.

The following table summarizes dividends declared to Corporate division during the years ended December 31, 2011, 2010 and 2009:

	2011	2010	2009
Bashneft, including			
JSOC Bashneft	\$495,938	\$738,525	\$ 55,195
OJSC Sistema-Invest	145,634	197,410	—
MTS, including			
MTS OJSC	543,863	535,439	679,457
OJSC MGTS	157,216	—	—

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The reconciliation of the segment operating income to the consolidated income from continuing operations before income tax expense and a reconciliation of segment assets to the consolidated segment assets are as follows:

	<u>2011</u>	<u>2010</u>	<u>2009</u>
Total segment operating income	\$ 4,145,430	\$ 4,534,053	\$ 5,448,997
Intersegment eliminations	(203,969)	(231,410)	(1,196,137)
Operating income	<u>3,941,461</u>	<u>4,302,643</u>	<u>4,252,860</u>
Interest income	176,584	131,534	191,203
Change in fair value of derivative financial instruments	(2,268)	(2,062)	(35,200)
Interest expense	(1,742,690)	(1,597,244)	(1,246,356)
Foreign currency exchange and translation (loss)/gain	(326,415)	26,151	(94,053)
Income from continuing operations before income tax	<u><u>\$ 2,046,672</u></u>	<u><u>\$ 2,861,022</u></u>	<u><u>\$ 3,068,454</u></u>

	<u>December 31</u>	
	<u>2011</u>	<u>2010</u>
Total segment assets	\$47,386,262	\$47,999,481
Intersegment eliminations	(3,484,241)	(3,833,433)
Total assets	<u><u>\$43,902,021</u></u>	<u><u>\$44,166,048</u></u>

For the years ended December 31, 2011 and 2010, the Group did not have revenues from transactions with a single external customer amounting to 10% or more of the Group's consolidated revenues.

For the years ended December 31, 2011, 2010 and 2009 the Group's revenues outside of the RF were as follows:

	<u>2011</u>	<u>2010</u>	<u>2009</u>
Ukraine	\$1,212,826	\$1,148,663	\$1,074,127
Uzbekistan	440,988	447,971	404,940
India	262,264	114,615	36,374
Armenia	200,450	207,281	221,341
Central and Eastern Europe	147,325	150,755	44,038
Greece	77,264	231,461	390,199
Turkmenistan	—	207,586	160,763
Other	170,585	433,802	324,043
Total	<u><u>\$2,511,702</u></u>	<u><u>\$2,942,134</u></u>	<u><u>\$2,655,825</u></u>

As of December 31, 2011 and 2010, the Group's long-lived assets located outside of the RF were as follows:

	<u>2011</u>	<u>2010</u>
Ukraine	\$1,045,663	\$1,281,135
Uzbekistan	950,200	966,668
India	702,651	1,085,337
Armenia	430,653	485,007
Greece	98,938	110,045
Central and Eastern Europe	72,251	81,272
Other	73,086	88,043
Total	<u><u>\$3,373,442</u></u>	<u><u>\$4,097,507</u></u>

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25. RELATED PARTY TRANSACTIONS

The Group provides services to and purchases services from affiliates. During the years ended December 31, 2011, 2010 and 2009, the Group entered into transactions with related parties as follows:

	<u>2011</u>	<u>2010</u>	<u>2009</u>
Sales of goods and services	\$(750,027)	\$(864,187)	\$(144,707)
Revenue from banking activities	(13,926)	(11,554)	(21,782)
Cost of sales	249,197	8,097	2,086
Cost related to banking activities	550	14,043	2,342
Selling, general and administrative expenses	12,850	72,164	44,252

The Group enters into transactions to purchase and sell goods and services from and to its related parties in the normal course of business.

As of December 31, 2011 and 2010, the related party balances were as follows:

	<u>2011</u>	<u>2010</u>
Assets:	\$	
Cash and cash equivalents	1,038	1,457
Short-term investments	3,323	29,475
Accounts receivable, net	136,201	94,688
Other current assets	7,166	6,261
Long-term investments	188,043	144,144
Liabilities:		
Accounts payable	(46,225)	(63,781)
Accrued expenses and other current liabilities	(53,898)	(81,535)

Other related party balances as of December 31, 2011 and 2010 are disclosed in the corresponding notes to the financial statements.

26. SHARE-BASED COMPENSATION

The Company, and several of its subsidiaries, operate share-based compensation plans in order to compensate their employees. This is done through either “equity” plans, in which employees may exercise their options for shares, or “phantom” plans, which generally allow employees to receive cash compensation which varies depending on the share price that the options are linked to.

Sistema JSFC Share-based Long-Term Motivation Program—In 2010, the Company’s Board of Directors amended a three-year motivational program for senior management (“Sistema JSFC Share-based Long-Term Motivation Program”). According to the program, participants were granted phantom shares of the Company upon their continued employment with the Group. Participants had right to convert up to two-thirds of phantom shares granted before December 31, 2010 into cash and the rest, including shares granted during 2011, were converted into ordinary shares of the Company in January 2012.

The grant-date fair value of an equity portion of the award was measured at the fair value of the Company’s ordinary shares at grant-date and equated to \$83.8 million and \$54.3 million as of December 31, 2011 and 2010, respectively. The Group recognized \$31.7 million, \$75.5 million and \$41 million of compensation expense for the Company’s Share-based Long-Term Motivation Program for the years ended December 31, 2011, 2010, and 2009, respectively.

In addition to the plans disclosed above, the Group has a number of share-based compensation plans in its subsidiaries, including MTS and Bashneft, not disclosed here on the basis of their lack of significance to the Group.

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27. COMMITMENTS AND CONTINGENCIES

Operating leases—The Group leases land, buildings and office space mainly from municipal organizations through contracts which expire in various years through 2060.

Rental expenses under operating leases amounting to \$527.2 million, \$495.7 million and \$396.4 million for the years ended December 31, 2011, 2010 and 2009, respectively, and are included in selling, general and administrative expenses and operating expenses. Rental expenses under the operating leases amounting to \$232.0 million, \$182.4 million and \$168.7 million for the years ended December 31, 2011, 2010 and 2009, respectively, are included in cost of sales.

Future minimum rental payments under operating leases in effect as of December 31, 2011, are as follows:

Year ended December 31,	
2012	\$ 387,384
2013	186,023
2014	172,452
2015	171,873
2016	172,020
Thereafter	<u>568,870</u>
Total	<u><u>\$1,658,622</u></u>

Agreement with Apple—In August 2008, MTS entered into an unconditional purchase agreement with Apple Sales International to buy 1.5 million iPhone handsets at the list price on the purchase date over a three year period. Pursuant to the agreement MTS is also required to incur certain iPhone promotion costs. As of December 31, 2011 MTS made 28.6% of its total purchase installment contemplated by the agreement. The total amount paid for handsets purchased under the agreement for the years ended December 31, 2011, 2010 and 2009 amounted to \$140.8 million, \$79.4 million and \$3.4 million, respectively.

Capital commitments—As of December 31, 2011, the Group had executed purchase agreements of approximately \$764.1 million to acquire property, plant and equipment, intangible assets and costs related thereto.

Guarantees—As of December 31, 2011, MTS Bank and its subsidiaries guaranteed loans for several companies, including related parties, which totaled \$304.3 million. These guarantees would require payment by the Group only in the event of default on payment by the respective debtor. As of December 31, 2011, no event of default has occurred under any of the guarantees issued by the Group.

Commitments on loans and unused credit lines—As of December 31, 2011, MTS Bank and its subsidiaries had \$528.6 million of commitments on loans and unused credit lines available to its customers.

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

Generally, according to Russian tax legislation, tax declarations remain open and subject to inspection for a period of three years following the tax year. As of December 31, 2011, tax declarations of the Company and its subsidiaries in Russia for the preceding one-three fiscal years are open for further review.

During 2011, 2010 and 2009 the Russian tax authorities completed the tax audits of the number of Group’s subsidiaries. Based on the results of this audits, the Russian tax authorities assessed that \$61.8 million and

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\$17.4 million in additional taxes, penalties and fines were payable by the Group as of December 31, 2011 and 2010, respectively. The Group partially appealed in courts of original jurisdictions.

Management believes that it has adequately provided for tax and customs liabilities in the accompanying consolidated financial statements. As of December 31, 2011 and 2010, the provision accrued amounted to \$7.1 million and \$10.0 million, respectively. In addition, the accrual for unrecognized income tax benefits, potential penalties and interest recorded in accordance with the authoritative guidance on income taxes totaled \$22.4 million and \$17.8 million as of December 31, 2011 and 2010, respectively. However, the risk remains that the relevant authorities could take differing positions with regard to interpretive issues and the effect could be significant.

With regard to matters where practice concerning payment of taxes is unclear, management estimated possible tax exposure to be approximately \$550 million and \$184 million as of December 31, 2011 and 2010, respectively.

Pricing of revenue and expenses between each of the Group's subsidiaries in the course of its activities might be subject to transfer pricing rules. The Group's management believes that taxes payable are calculated in compliance with the applicable tax regulations relating to transfer pricing. However there is a risk that the tax authorities may take a different view and impose additional tax liabilities. As of December 31, 2011, 2010 and 2009, no provision was recorded in the consolidated financial statements in respect of such additional claims.

Bitel—In December 2005, MTS Finance, a subsidiary of MTS, acquired a 51.0% interest in Tarino Limited (“Tarino”), from Nomihold Securities Inc. (“Nomihold”), for \$150.0 million in cash based on the belief that Tarino was at that time the indirect owner, through its wholly owned subsidiaries, of Bitel LLC (“Bitel”), a Kyrgyz company holding a GSM 900/1800 license for the entire territory of Kyrgyzstan.

Following the purchase of the 51.0% interest, MTS Finance entered into a put and call option agreement with Nomihold for “Option Shares”, representing the remaining 49.0% interest in Tarino shares and a proportional interest in Bitel shares. The call option was exercisable by MTS Finance from November 22, 2005 to November 17, 2006, and the put option was exercisable by Nomihold from November 18, 2006 to December 8, 2006. The call and put option price was \$170.0 million.

Following a decision of the Kyrgyz Supreme Court on December 15, 2005, Bitel's corporate offices were seized by a third party. As the Group did not regain operational control over Bitel's operations in 2005, it accounted for its 51.0% investment in Bitel at cost as at December 31, 2005. The Group appealed the decision of the Kyrgyz Supreme Court in 2006, but the court did not act within the time period permitted for appeal. The Group subsequently sought the review of this dispute over the ownership of Bitel by the Prosecutor General of Kyrgyzstan to determine whether further investigation could be undertaken by the Kyrgyz authorities.

In January 2007, the Prosecutor General of Kyrgyzstan informed the Group that there were no grounds for involvement by the Prosecutor General's office in the dispute and that no legal basis existed for the Group to appeal the decision of the Kyrgyz Supreme Court. Consequently, the Group decided to write off the costs relating to the purchase of the 51.0% interest in Bitel, which was reflected in its consolidated financial statements for the year ended December 31, 2006. Furthermore, with the impairment of the underlying asset, a liability of \$170.0 million was recorded with an associated charge to earnings.

In November 2006, MTS Finance received a letter from Nomihold purporting to exercise the put option and sell the Option Shares for \$170.0 million to MTS Finance. In January 2007, Nomihold commenced an arbitration proceeding against MTS Finance in the London Court of International Arbitration in order to compel MTS Finance to purchase the Option Shares. Nomihold sought specific performance of the put option, unspecified monetary damages, interest, and costs. In January 2011 the London Court of International Arbitration made an award in favor of Nomihold satisfying Nomihold's specific performance request and ordered MTS Finance to pay to Nomihold \$170.0 million for the Option Shares, \$5.9 million in damages and \$34.9 million in interest and other costs—all representing in total approximately \$210.8 million (“Award”). An amount of the Award is bearing an interest until Award is satisfied. In addition to the \$170.0 million liability related to this case and accrued in the year ended December 31, 2006, the Group

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recorded an additional loss in amount of \$40.8 million and \$3.2 million in the consolidated financial statements for the year ended December 31, 2010 and 2011, respectively, representing interest accrued on the awarded sums.

On January 26, 2011, Nomihold obtained a freezing order in respect of the Award from the English High Court of Justice which, in part, restricts MTS Finance from dissipating its assets. Additionally, MTS Finance has been granted permission to appeal the Award, but the Court has imposed conditions upon the appeal. MTS Finance is currently seeking to have the conditions lifted.

Further on February 1, 2011, Nomihold obtained an order of the Luxemburg District Court enforcing the Award in Luxembourg. This order is in the process of being appealed.

As an issuer of US \$400,000,000 2012 Notes pursuant to an Indenture dated January 28, 2005 (as amended) (“the Notes”), MTS Finance was due to redeem the principal of the Notes and pay the final coupon payment on January 30, 2012. However as a result of the freezing order, MTS applied to and obtained from the English Court an order authorizing both payments to be made by MTS on behalf of MTS Finance (“the Direct Payments”). The Direct Payments to noteholders by the trustee under the Indenture were made on or around January 28, 2012.

The Direct Payments were made despite an obligation under an intercompany loan agreement dated January 28, 2005 between MTS and MTS Finance (“the Intercompany Loan Agreement”) to process the payments through MTS Finance. However because MTS Finance was subject to a freezing order and not capable of transferring out the money to the trustee for distribution, and because MTS owed obligations to the noteholders as guarantor under the Indenture, MTS decided to make the Direct Payments to the noteholders pursuant to an order of the English Court.

In relation to the obligations under the Intercompany Loan Agreement, MTS and MTS Finance have agreed to refer to arbitration the question of whether under the Intercompany Loan Agreement itself there remains an obligation to make any further payments to MTS Finance in light of the Direct Payment. On February 9, 2012, MTS received a request for arbitration from MTS Finance. The process is underway and will clarify the rights between the parties under the Intercompany Loan Agreement. MTS denies that any further payments are due under the Intercompany Loan Agreement. The arbitration will be conducted under the Rules of the London Court of International Arbitration and it is expected to last between 6 and 12 months.

In addition, three Isle of Man companies affiliated with the Group (the “KFG Companies”), have been named defendants in lawsuits filed by Bitel in the Isle of Man seeking the return of dividends received by these three companies in the first quarter of 2005 from Bitel in the amount of approximately \$25.2 million plus compensatory damages, and to recover approximately \$3.7 million in losses and accrued interest. In the event that the defendants do not prevail in these lawsuits, the Group may be liable to Bitel for such claims. Bitel’s Isle of Man advocates have recently withdrawn from their representation of Bitel, and Bitel does not appear to be pursuing these claims.

In January 2007, the KFG Companies asserted counterclaims against Bitel, and claims against other defendants, including Altimo LLC (“Altimo”), Altimo Holdings & Investments Limited (“Altimo Holdings”), CP-Crédit Privé SA and Fellowes International Holdings Limited, for the wrongful misappropriation and seizure of Bitel. The defendants sought to challenge the jurisdiction of the Isle of Man courts to try the counterclaims asserted by the KFG Companies.

On March 10, 2011, the Judicial Committee of the UK Privy Council ruled in favor of the KFG Companies and confirmed the jurisdiction of the Isle of Man courts to try the counterclaims asserted by the KFG Companies against various defendants, including Sky Mobile, Altimo and Altimo Holdings, for the wrongful misappropriation and seizure of Kyrgyz telecom operator Bitel and its assets.

On June 30, 2011, the KFG Companies obtained from the Isle of Man court a general asset freezing injunction over the assets of Altimo and Altimo Holdings. The general freezing injunction against Altimo Holdings was replaced on November 30, 2011 by a specific freezing injunction over (i) Altimo Holding’s interest in its Dutch subsidiary, Altimo Coöperatief U.A., and (ii) VimpelCom common shares worth \$500 million that Altimo Coöperatief U.A. has lodged with the Isle of Man court. The KFG Companies are proceeding with their counterclaims in the Isle of Man. A trial has been set to commence in May 2013.

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In a separate arbitration proceeding initiated against the KFG Companies by Kyrgyzstan Mobitel Investment Company Limited (“KMIC”), under the rules of the London Court of International Arbitration, the arbitration tribunal in its award found that the KFG Companies breached a transfer agreement dated May 31, 2003 (the “Transfer Agreement”), concerning the shares of Bitel. The Transfer Agreement was made between the KFG Companies and IPOC International Growth Fund Limited (“IPOC”), although IPOC subsequently assigned its interest to KMIC, and KMIC was the claimant in the arbitration. The tribunal ruled that the KFG Companies breached the Transfer Agreement when they failed to establish a date on which the equity interests in Bitel were to be transferred to KMIC and by failing to take other steps to transfer the Bitel interests. This breach occurred prior to MTS Finance’s acquisition of the KFG Companies. The arbitration tribunal ruled that KMIC is entitled only to damages in an amount to be determined in future proceedings. The tribunal is currently deciding whether to stay the damages phase of the LCIA proceedings pending conclusion of the Isle of Man proceedings. The Group is not able to predict the outcome of these proceedings or the amount of damages to be paid, if any.

3G license—In May 2007, the Federal Service for Supervision in the Area of Communications and Mass Media awarded MTS a license to provide 3G services in the RF. The 3G license was granted subject to certain capital and other commitments. The major conditions are that the Group will have to build a certain number of base stations that support 3G standards and will have to start providing services in the RF by a certain date, and will have to build a certain number of base stations by the end of the third, fourth and fifth years from the date of granting the license. Management believes that as of December 31, 2011 the Group is in compliance with these conditions.

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

28. SUBSEQUENT EVENTS

For the purpose of the accompanying consolidated financial statements, subsequent events have been evaluated through April 20, 2012.

Acquisition of noncontrolling interest in NIS—In February 2012, the Group increased its interest in NIS, a federal GPS network operator, from 51% to 70% through an acquisition of an additional issue of NIS’ shares paid by contributing its 51% interest in M2M Telematics, acquired in 2010 (Note 3), to the charter capital of NIS.

Voluntary tender offer for noncontrolling interest in SITRONICS—In March 2012, RTI, a subsidiary of the Group, made a voluntary tender offer to acquire up to 36.9% of SITRONICS’ common shares, representing all noncontrolling interest in the company including the shares underlying SITRONICS GDRs. The offer period remains open until May 22, 2012.

Motivation program—In January 2012, Sistema JSFC granted approximately 1% of the Company’s charter capital to certain members of management and Board of Directors within the framework of Sistema JSFC Share-based Long-Term Motivation Program (Note 26).

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29. SUPPLEMENTARY INFORMATION ON OIL AND GAS EXPLORATION AND PRODUCTION ACTIVITIES (UNAUDITED)

This section provides unaudited supplemental information on oil and gas exploration and production activities in accordance with ASC No. 932 Extractive Activities—Oil and Gas, subtopic 235, Notes to Financial Statements (ASC No. 932) in six separate tables:

- I. Capitalized costs relating to oil and gas producing activities;
- II. Costs incurred in oil and gas property acquisition, exploration, and development activities;
- III. Results of operations for oil and gas producing activities;
- IV. Reserve quantity information;
- V. Standardized measure of discounted future net cash flows;
- VI. Principal sources of changes in the standardized measure of discounted future net cash flows.

Amounts shown for equity companies represent the Group's share in its exploration and production affiliates, which are accounted for using the equity method of accounting.

I. Capitalized costs relating to oil and gas producing and exploration activities

As of December 31, 2011	Consolidated subsidiaries	Group's share in equity investees
Unproved oil and gas properties	\$ —	\$ 358,659
Proved oil and gas properties	3,699,741	2,111,775
Accumulated depreciation, depletion and amortization	(475,813)	(554,230)
Net capitalized costs	<u>\$3,223,928</u>	<u>\$1,916,204</u>
As of December 31, 2010	Consolidated subsidiaries	Group's share in equity investees
Unproved oil and gas properties	\$ 48,799	\$ —
Proved oil and gas properties	3,693,491	2,020,998
Accumulated depreciation, depletion and amortization	(315,900)	(414,135)
Net capitalized costs	<u>\$3,426,390</u>	<u>\$1,606,863</u>

II. Costs incurred in oil and gas property acquisition, exploration, and development activities

Year ended December 31, 2011	Consolidated subsidiaries	Group's share in equity investees
Acquisition of proved properties	\$ —	\$ —
Acquisition of unproved properties	—	358,659
Exploration costs	15,948	11,029
Development costs	471,955	174,516
Total costs incurred	<u>\$487,903</u>	<u>\$544,204</u>
Year ended December 31, 2010	Consolidated subsidiaries	Group's share in equity investees
Acquisition of proved properties	\$ —	\$ 13,028
Acquisition of unproved properties	48,799	—
Exploration costs	8,004	3,775
Development costs	240,321	66,370
Total costs incurred	<u>\$297,124</u>	<u>\$ 83,173</u>

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III. Results of operations for oil and gas producing activities

The Group's results of operations for oil and gas producing activities are presented below. In accordance with ASC No. 932, transfers to Group companies are based on market prices estimated by management. Income taxes are based on statutory rates. The results of operations exclude corporate overhead and interest costs.

Year ended December 31, 2011	Consolidated subsidiaries	Group's share in equity investees
Sales	\$ 1,499,992	\$1,227,109
Transfers	3,350,651	141,961
Total revenues	<u>4,850,643</u>	<u>1,369,070</u>
Production costs (excluding production taxes)	(759,000)	(248,474)
Exploration expenses	(15,948)	(11,029)
Depreciation, depletion and amortization	(219,897)	(154,920)
Accretion expense	(23,237)	(2,271)
Taxes other than income tax	(1,937,304)	(545,930)
Related income tax	(379,051)	(93,848)
Total results of operation of producing activities	<u>\$ 1,516,206</u>	<u>\$ 312,598</u>
Year ended December 31, 2010	Consolidated subsidiaries	Group's share in equity investees
Sales	\$ 984,403	\$ 471,682
Transfers	2,343,576	188,737
Total revenues	<u>3,327,979</u>	<u>660,419</u>
Production costs (excluding production taxes)	(623,800)	(129,909)
Exploration expenses	(8,004)	(2,516)
Depreciation, depletion and amortization	(170,612)	(57,313)
Accretion expense	(11,969)	(839)
Taxes other than income tax	(1,257,987)	(254,785)
Related income tax	(251,121)	(47,642)
Total results of operation of producing activities	<u>\$ 1,004,486</u>	<u>\$ 167,415</u>
Nine months ended December 31, 2009	Consolidated subsidiaries	Group's share in equity investees
Sales	\$1,296,753	\$ —
Transfers	762,361	—
Total revenues	<u>\$2,059,114</u>	<u>\$ —</u>
Production costs (excluding production taxes)	(347,050)	—
Exploration expenses	(9,699)	—
Depreciation, depletion and amortization	(115,212)	—
Accretion expense	(9,611)	—
Taxes other than income tax	(698,775)	—
Related income tax	(120,100)	—
Total results of operation of producing activities	<u>\$ 758,667</u>	<u>\$ —</u>

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IV. Reserve quantity information

Proved reserves are the estimated quantities of oil and gas reserves for which geological and engineering data demonstrate their recoverability with reasonable certainty in future years from known reservoirs under existing economic and operating conditions. In accordance with ASC No. 932 existing economic and operating conditions are based on the 12-months average price. Proved reserves do not include additional quantities of oil and gas reserves that may result from applying secondary or tertiary recovery techniques not yet tested and determined to be economic.

Proved developed reserves are the quantities of proved reserves expected to be recovered through existing wells with existing equipment and operating methods.

Due to the inherent uncertainties and the necessarily limited nature of reservoir data, estimates of reserves are inherently imprecise, require the application of judgment and are subject to change as additional information becomes available.

Management has included within proved reserves significant quantities which the Group expects to produce after the expiry dates of certain of its current production licenses in the Russian Federation. The Subsoil Law of the Russian Federation states that, upon expiration, a license is subject to renewal at the initiative of the license holder provided that further exploration, appraisal, production or remediation activities are necessary and provided that the license holder has not violated the terms of the license. The law applies both to newly issued and old licenses and the management believes that licenses will be renewed upon their expiration for the remainder of the economic life of each respective field.

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Estimated net proved oil and gas reserves and changes thereto from the March 31, 2009 to December 31, 2009 and for the years ended December 31, 2010 and 2011 are shown in the tables set out below.

Thousands of barrels (proved developed and undeveloped reserves)	<u>Consolidated subsidiaries</u>	<u>Group's share in equity investees</u>
Crude oil		
March 31, 2009	1,667,600	—
Revisions of previous estimates	179,775	—
Extensions and discoveries	14,200	—
Production	(66,475)	—
Sales of reserves	—	—
December 31, 2009	<u>1,795,100</u>	<u>—</u>
Acquisition of equity interest in RussNeft		462,458
Revisions of previous estimates	181,512	36,298
Purchase of hydrocarbons in place	—	3,903
Extensions and discoveries	—	—
Production	(100,712)	(20,886)
Sales of reserves	—	—
December 31, 2010	<u>1,875,900</u>	<u>481,773</u>
Revisions of previous estimates	198,295	83,116
Extensions and discoveries	—	—
Production	(107,554)	(32,121)
Sales of reserves	—	—
December 31, 2011	<u>1,966,641</u>	<u>532,768</u>
Proved developed reserves		
March 31, 2009	1,625,112	—
December 31, 2009	1,728,473	—
December 31, 2010	1,763,800	323,945
December 31, 2011	1,799,986	328,915
Proved undeveloped reserves		
March 31, 2009	42,488	—
December 31, 2009	66,627	—
December 31, 2010	112,100	157,828
December 31, 2011	166,655	203,853

The noncontrolling interest included in the above total proved reserves was 609,487 thousand barrels and 506,493 thousand barrels as of December 31, 2011 and 2010, respectively. The noncontrolling interest included in the above proved developed reserves was 557,839 thousand barrels and 476,199 thousand barrels as of December 31, 2011 and 2010, respectively.

The Group's proved oil reserves are located entirely in the Russian Federation.

V. Standardized measure of discounted future net cash flows

The standardized measure of discounted future net cash flows, related to oil and gas reserves in the Group's most significant oil fields, is calculated in accordance with the requirements of ASC No. 932. Estimated future cash inflows from production are computed by applying the 12-months average price for oil and gas to year-end quantities of estimated net proved reserves. Adjustment in this calculation for future price changes is limited to those required by contractual arrangements in existence at the end of each reporting year. Future development and production costs are those estimated future expenditures necessary to develop and produce year-end estimated proved reserves based on year-end cost indices, assuming continuation of year-end economic conditions. Estimated future income taxes are calculated by applying appropriate year-end statutory tax rates. These rates reflect allowable deductions and tax credits and are applied to

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estimated future pre-tax net cash flows, less the tax bases of related assets. Discounted future net cash flows have been calculated using a ten percent discount factor. Discounting requires a year-by-year estimate of when future expenditures will be incurred and when reserves will be produced.

The information provided in the tables set out below does not represent management's estimate of the Group's expected future cash flows or of the value of the Group's proved oil and gas reserves. Estimates of proved reserve quantities are imprecise and change over time as new information becomes available. Moreover, probable and possible reserves, which may become proved in the future, are excluded from the calculations. The arbitrary valuation prescribed under ASC No. 932 requires assumptions as to the timing and amount of future development and production costs. The calculations should not be relied upon as an indication of the Group's future cash flows or of the value of its oil and gas reserves.

As of December 31, 2011	Consolidated subsidiaries	Group's share in equity investees
Future cash inflows	\$ 89,617,864	\$ 24,725,444
Future production and development costs	(48,995,633)	(15,045,873)
Future income tax expenses	(8,124,446)	(1,935,914)
Future net cash flows	32,497,785	7,743,657
Discount for estimated timing of cash flows (10% p.a)	(20,619,374)	(4,368,914)
Discounted future net cash flows	\$ 11,878,411	\$ 3,374,743
Noncontrolling interest in discounted future net cash flows	3,682,307	
As of December 31, 2010	Consolidated subsidiaries	Group's share in equity investees
Future cash inflows	\$ 66,653,165	\$ 15,166,680
Future production and development costs	(36,263,017)	(9,669,078)
Future income tax expenses	(6,078,030)	(1,099,520)
Future net cash flows	24,312,118	4,398,082
Discount for estimated timing of cash flows (10% p.a)	(15,216,083)	(2,439,139)
Discounted future net cash flows	\$ 9,096,035	\$ 1,958,943
Noncontrolling interest in discounted future net cash flows	2,455,929	
As of December 31, 2009	Consolidated subsidiaries	Group's share in equity investees
Future cash inflows	\$ 34,444,850	\$ —
Future production and development costs	(20,892,354)	—
Future income tax expenses	(2,710,499)	—
Future net cash flows	10,841,997	—
Discount for estimated timing of cash flows (10% p.a)	(6,824,445)	—
Discounted future net cash flows	\$ 4,017,552	\$ —
Noncontrolling interest in discounted future net cash flows	1,084,739	

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VI. Principal sources of changes in the standardized measure of discounted future net cash flows

Consolidated subsidiaries	2011	2010	2009
Discounted present value as at January 1, 2011,			
January 1, 2010 and March 31, 2009	\$ 9,096,035	\$ 4,017,552	\$ 2,110,046
Sales and transfers of oil and gas produced, net of production costs and taxes other than income tax	(2,138,391)	(1,438,187)	(1,003,589)
Net changes in prices and production costs estimates	6,558,516	4,235,993	3,387,078
Net changes in mineral extraction taxes	(3,700,969)	(1,442,021)	(1,176,304)
Development costs incurred during the period	471,955	240,321	162,069
Changes in estimated future development costs	(236,136)	(419,299)	(384,829)
Revisions of previous quantity estimates	1,307,855	2,180,360	771,135
Net changes in income taxes	(644,395)	(758,859)	(385,297)
Accretion of discount	959,147	437,130	170,927
Other changes	204,794	2,043,045	366,316
Discounted present value at December 31	\$11,878,411	\$ 9,096,035	\$ 4,017,552

Group's share in equity investees	2011	2010
Discounted present value as at January 1, 2011 and April 30, 2010	\$ 1,958,943	\$2,220,905
Net changes due to purchases of minerals in place	—	19,392
Sales and transfers of oil and gas produced, net of production costs	(563,637)	(273,208)
Net changes in prices and production costs estimates	2,869,933	38,964
Net changes in mineral extraction taxes	(1,195,214)	(434,834)
Extensions and discoveries, less related costs	—	—
Development costs incurred during the period	174,269	58,047
Changes in estimated future development costs	(177,524)	47,719
Revisions of previous quantity estimates	364,093	49,463
Net changes in income taxes	(322,407)	75,606
Accretion of discount	204,399	168,691
Other changes	61,888	(11,802)
Discounted present value at December 31	\$ 3,374,743	\$1,958,943

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SEC RESERVES DEFINITIONS

Reserves

Reserves are estimated remaining quantities of oil and gas and related substances anticipated to be economically producible, as of a given date, by application of development projects to known accumulations. In addition, there must exist, or there must be a reasonable expectation that there will exist, the legal right to produce or a revenue interest in the production, installed means of delivering oil and gas or related substances to market, and all permits and financing required to implement the project.

Reserves should not be assigned to adjacent reservoirs isolated by major, potentially sealing, faults until those reservoirs are penetrated and evaluated as economically producible. Reserves should not be assigned to areas that are clearly separated from a known accumulation by a non-productive reservoir (i.e., absence of reservoir, structurally low reservoir, or negative test results). Such areas may contain prospective resources (i.e., potentially recoverable resources from undiscovered accumulations).

Proved Oil and Gas Reserves

Proved oil and gas reserves are those quantities of oil and gas, which, by analysis of geoscience and engineering data, can be estimated with reasonable certainty to be economically producible—from a given date forward, from known reservoirs, and under existing economic conditions, operating methods, and government regulations—prior to the time at which contracts providing the right to operate expire, unless evidence indicates that renewal is reasonably certain, regardless of whether deterministic or probabilistic methods are used for the estimation. The project to extract the hydrocarbons must have commenced or the operator must be reasonably certain that it will commence the project within a reasonable time.

1. The area of the reservoir considered as proved includes:
 - a. The area identified by drilling and limited by fluid contacts, if any, and
 - b. Adjacent undrilled portions of the reservoir that can, with reasonable certainty, be judged to be continuous with it and to contain economically producible oil or gas on the basis of available geoscience and engineering data.
2. In the absence of data on fluid contacts, proved quantities in a reservoir are limited by the lowest known hydrocarbons as seen in a well penetration unless geoscience, engineering, or performance data and reliable technology establishes a lower contact with reasonable certainty.
3. Where direct observation from well penetrations has defined a highest known oil (“**HKO**”) elevation and the potential exists for an associated gas cap, proved oil reserves may be assigned in the structurally higher portions of the reservoir only if geoscience, engineering, or performance data and reliable technology establish the higher contact with reasonable certainty.
4. Reserves which can be produced economically through application of improved recovery techniques (including, but not limited to, fluid injection) are included in the proved classification when:
 - a. Successful testing by a pilot project in an area of the reservoir with properties no more favorable than in the reservoir as a whole, the operation of an installed program in the reservoir or an analogous reservoir, or other evidence using reliable technology establishes the reasonable certainty of the engineering analysis on which the project or program was based; and
 - b. The project has been approved for development by all necessary parties and entities, including governmental entities.
5. Existing economic conditions include prices and costs at which economic producibility from a reservoir is to be determined. The price shall be the average price during the 12-month period prior to the ending date of the period covered by the report, determined as an unweighted arithmetic average of the first-day-of-the-month price for each month within such period, unless prices are defined by contractual arrangements, excluding escalations based upon future conditions.

Developed Oil and Gas Reserves

Developed oil and gas reserves are reserves of any category that can be expected to be recovered:

1. Through existing wells with existing equipment and operating methods or in which the cost of the required equipment is relatively minor compared to the cost of a new well; and

2. Through installed extraction equipment and infrastructure operational at the time of the reserves estimate if the extraction is by means not involving a well.

Undeveloped Oil and Gas Reserves

Undeveloped oil and gas reserves are reserves of any category that are expected to be recovered from new wells on undrilled acreage, or from existing wells where a relatively major expenditure is required for recompletion.

1. Reserves on undrilled acreage shall be limited to those directly offsetting development spacing areas that are reasonably certain of production when drilled, unless evidence using reliable technology exists that establishes reasonable certainty of economic producibility at greater distances.
2. Undrilled locations can be classified as having undeveloped reserves only if a development plan has been adopted indicating that they are scheduled to be drilled within five years, unless the specific circumstances, justify a longer time.
3. Under no circumstances shall estimates for undeveloped reserves be attributable to any acreage for which an application of fluid injection or other improved recovery technique is contemplated, unless such techniques have been proved effective by actual projects in the same reservoir or an analogous reservoir, as defined below, or by other evidence using reliable technology establishing reasonable certainty.

Analogous Reservoir

Analogous reservoirs, as used in resources assessments, have similar rock and fluid properties, reservoir conditions (depth, temperature, and pressure) and drive mechanisms, but are typically at a more advanced stage of development than the reservoir of interest and thus may provide concepts to assist in the interpretation of more limited data and estimation of recovery. When used to support proved reserves, an “analogous reservoir” refers to a reservoir that shares the following characteristics with the reservoir of interest:

1. Same geological formation (but not necessarily in pressure communication with the reservoir of interest);
2. Same environment of deposition;
3. Similar geological structure; and
4. Same drive mechanism.

Reservoir properties must, in aggregate, be no more favorable in the analog than in the reservoir of interest.

Probable Reserves

Probable reserves are those additional reserves that are less certain to be recovered than proved reserves but which, together with proved reserves, are as likely as not to be recovered.

1. When deterministic methods are used, it is as likely as not that actual remaining quantities recovered will exceed the sum of estimated proved plus probable reserves. When probabilistic methods are used, there should be at least a 50% probability that the actual quantities recovered will equal or exceed the proved plus probable reserves estimates.
2. Probable reserves may be assigned to areas of a reservoir adjacent to proved reserves where data control or interpretations of available data are less certain, even if the interpreted reservoir continuity of structure or productivity does not meet the reasonable certainty criterion. Probable reserves may be assigned to areas that are structurally higher than the proved area if these areas are in communication with the proved reservoir.
3. Probable reserves estimates also include potential incremental quantities associated with a greater percentage recovery of the hydrocarbons in place than assumed for proved reserves.
4. See also guidelines in Items 4 and 6 under Possible Reserves.

Possible Reserves

Possible reserves are those additional reserves that are less certain to be recovered than probable reserves.

1. When deterministic methods are used, the total quantities ultimately recovered from a project have a low probability of exceeding proved plus probable plus possible reserves. When probabilistic methods are used, there should be at least a 10% probability that the total quantities ultimately recovered will equal or exceed the proved plus probable plus possible reserves estimates.
2. Possible reserves may be assigned to areas of a reservoir adjacent to probable reserves where data control and interpretations of available data are progressively less certain. Frequently, this will be in areas where geoscience and engineering data are unable to define clearly the area and vertical limits of commercial production from the reservoir by a defined project.
3. Possible reserves also include incremental quantities associated with a greater percentage recovery of the hydrocarbons in place than the recovery quantities assumed for probable reserves.
4. The proved plus probable and proved plus probable plus possible reserves estimates must be based on reasonable alternative technical and commercial interpretations within the reservoir or subject project that are clearly documented, including comparisons to results in successful similar projects.
5. Possible reserves may be assigned where geoscience and engineering data identify directly adjacent portions of a reservoir within the same accumulation that may be separated from proved areas by faults with displacement less than formation thickness or other geological discontinuities and that have not been penetrated by a wellbore, and the registrant believes that such adjacent portions are in communication with the known (proved) reservoir. Possible reserves may be assigned to areas that are structurally higher or lower than the proved area if these areas are in communication with the proved reservoir.
6. Pursuant to Item 3 under Proved Oil and Gas Reserves, where direct observation has defined a highest known oil (“**HKO**”) elevation and the potential exists for an associated gas cap, proved oil reserves should be assigned in the structurally higher portions of the reservoir above the HKO only if the higher contact can be established with reasonable certainty through reliable technology. Portions of the reservoir that do not meet this reasonable certainty criterion may be assigned as probable and possible oil or gas based on reservoir fluid properties and pressure gradient interpretations.

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