

## IMPORTANT NOTICE

**IMPORTANT: You must read the following before continuing.** The following applies to the prospectus following this page (the “**Prospectus**”), and you are therefore advised to read this disclaimer carefully before reading, accessing or making any other use of the Prospectus. In accessing the Prospectus you agree to be bound by the following terms and conditions, including any modifications to them any time you receive any information from us as a result of such access. You acknowledge that this electronic transmission and the delivery of the Prospectus is confidential and intended for you only and **you agree that you will not forward, reproduce or publish this electronic transmission or the Prospectus to any other person.**

NOTHING IN THE PROSPECTUS CONSTITUTES AN OFFER OF SECURITIES FOR SALE IN ANY JURISDICTION WHERE IT IS UNLAWFUL TO DO SO. THE SECURITIES (AS DEFINED IN THE PROSPECTUS) HAVE NOT BEEN AND WILL NOT BE REGISTERED UNDER THE U.S. SECURITIES ACT OF 1933, AS AMENDED (THE “**SECURITIES ACT**”), OR WITH ANY SECURITIES REGULATORY AUTHORITY OF ANY STATE OF THE UNITED STATES OR OTHER JURISDICTION AND 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 OR (2) IN AN OFFSHORE TRANSACTION IN ACCORDANCE WITH RULE 903 OR RULE 904 OF REGULATION S UNDER THE SECURITIES ACT, IN EACH CASE IN ACCORDANCE WITH ANY APPLICABLE SECURITIES LAWS OF ANY STATE OF THE UNITED STATES.

THIS PROSPECTUS IS ONLY ADDRESSED TO AND DIRECTED AT PERSONS OUTSIDE THE EUROPEAN ECONOMIC AREA (THE “**EEA**”), OR THOSE WHO, IF LOCATED IN MEMBER STATES OF THE EEA, ARE “QUALIFIED INVESTORS” WITHIN THE MEANING OF ARTICLE 2(1)(E) OF THE PROSPECTUS DIRECTIVE (DIRECTIVE 2003/71/EC AND AMENDMENTS THERETO, INCLUDING DIRECTIVE 2010/73/EU, TO THE EXTENT IMPLEMENTED IN THE RELEVANT MEMBER STATE) (“**QUALIFIED INVESTORS**”). AS REGARDS PERSONS LOCATED IN THE UNITED KINGDOM, THIS PROSPECTUS IS BEING DISTRIBUTED ONLY TO, AND IS DIRECTED ONLY AT, QUALIFIED INVESTORS (I) WHO ARE INVESTMENT PROFESSIONALS FALLING WITHIN ARTICLE 19(5) OF THE FINANCIAL SERVICES AND MARKETS ACT 2000 (FINANCIAL PROMOTION) ORDER 2005, AS AMENDED (THE “**ORDER**”) OR (II) WHO ARE HIGH NET WORTH ENTITIES FALLING WITHIN ARTICLE 49(2)(A) TO (D) OF THE ORDER AND OTHER PERSONS TO WHOM IT MAY OTHERWISE LAWFULLY BE COMMUNICATED (ALL SUCH PERSONS TOGETHER BEING REFERRED TO AS “**RELEVANT PERSONS**”). THIS PROSPECTUS MUST NOT BE ACTED ON OR RELIED UPON (I) IN THE UNITED KINGDOM, BY PERSONS WHO ARE NOT RELEVANT PERSONS, AND (II) IN ANY MEMBER STATE OF THE EEA OTHER THAN THE UNITED KINGDOM, BY PERSONS WHO ARE NOT QUALIFIED INVESTORS. ANY INVESTMENT OR INVESTMENT ACTIVITY TO WHICH THIS PROSPECTUS RELATES IS AVAILABLE ONLY TO (I) IN THE UNITED KINGDOM, RELEVANT PERSONS, AND (II) IN ANY MEMBER STATE OF THE EEA OTHER THAN THE UNITED KINGDOM, QUALIFIED INVESTORS, AND WILL BE ENGAGED IN ONLY WITH SUCH PERSONS.

THE PROSPECTUS MAY NOT BE FORWARDED OR DISTRIBUTED TO ANY OTHER PERSON AND MAY NOT BE REPRODUCED IN ANY MANNER WHATSOEVER. ANY FORWARDING, DISTRIBUTION OR REPRODUCTION OF THIS DOCUMENT IN WHOLE OR IN PART IS UNAUTHORISED. FAILURE TO COMPLY WITH THIS DIRECTIVE MAY RESULT IN A VIOLATION OF THE SECURITIES ACT OR THE APPLICABLE LAWS OF OTHER JURISDICTIONS.

**Confirmation of your representation:** In order to be eligible to view the Prospectus or make an investment decision with respect to the Securities (as defined in the Prospectus), you must have represented to us that (i) you are or are acting on behalf of (a) a “qualified institutional buyer” (as defined in Rule 144A) or (b) outside the United States, (ii) if you are in the United Kingdom, you are a relevant person, and/or a relevant person who is acting on behalf of relevant persons in the United Kingdom and/or Qualified Investors to the extent you are acting on behalf of persons or entities in the United Kingdom and/or the EEA; (iii) if you are in any Member State of the EEA other than the United Kingdom, you are a Qualified Investor and/or a Qualified Investor acting on behalf of Qualified Investors or relevant persons, to the extent that you are acting on behalf of persons or entities in the EEA and/or the United Kingdom; (iv) you are an institutional investor that is eligible to receive this document and (v) you consent to delivery by electronic transmission.

The GDRs (as defined below) are not eligible for “placement”, “public circulation”, “offering” or “advertising” (each as defined in Russian law) in the Russian Federation except as permitted by Russian law. The Prospectus

and information provided herein is not an advertisement, an offer, or an invitation to make offers, sell, exchange or otherwise transfer the GDRs in the Russian Federation or to or for the benefit of any Russian person or entity. This Prospectus is not intended to be, and must not be, distributed or circulated in the Russian Federation unless and to the extent otherwise permitted or required under Russian law.

The Prospectus may only be provided to persons in the United Kingdom in circumstances where Section 21(1) of the Financial Services and Markets Act 2000 does not apply to OJSC MegaFon.

You are reminded that you are accessing the Prospectus on the basis that you are a person by whom the Prospectus may be lawfully delivered in accordance with the laws of the jurisdiction in which you are located and you may not, nor are you authorised to, deliver the Prospectus, electronically or otherwise, to any other person.

The materials relating to the offering do not constitute, and may not be used in connection with, an offer or solicitation in any place where offers or solicitations are not permitted by law. If a jurisdiction requires that the offering be made by a licensed broker or dealer and any of the Joint Global Coordinators or Joint Bookrunners (both as named in the Prospectus), or any affiliate of any such person, is a licensed broker or dealer in that jurisdiction, the offering shall be deemed to be made by such person or such affiliate on behalf of OJSC MegaFon in such jurisdiction.

**Restrictions:** Nothing in this electronic transmission constitutes an offer of securities for sale to persons other than specified qualified institutional buyers to whom it is directed and access has been limited so that it shall not constitute a general solicitation. If you have gained access to this transmission contrary to the foregoing restrictions, you will be unable to purchase any of the securities described therein.

**You are responsible for protecting against viruses and other destructive items.** Your receipt of this electronic transmission is at your own risk and it is your responsibility to take precautions to ensure that it is free from viruses and other items of a destructive nature.

This Prospectus has been sent to you in an electronic form. You are reminded that documents transmitted via this medium may be altered or changed during the process of electronic transmission and, consequently, neither OJSC MegaFon nor any of the Joint Global Coordinators or Joint Bookrunners, or any person who controls any of them, nor any director, officer, employee or agent of it or affiliate of any such person accepts any liability or responsibility whatsoever in respect of any difference between the Prospectus distributed to you in electronic format and the hard copy version available to you on request from OJSC MegaFon or the Joint Global Coordinators or Joint Bookrunners.

## SUBJECT TO COMPLETION



an open joint stock company organised under the laws of the Russian Federation

**Offering of [●] ordinary shares  
in the form of Offer Shares and Global Depositary Receipts  
Offer Price**

**U.S.\$[●] per Global Depositary Receipt / Offer Share**

This is an offering (the “Offering”) by Sonera Holding B.V. (“Sonera”) and MegaFon Investments (Cyprus) Limited (“MIFL”, and together with Sonera, the “Selling Shareholders”), a subsidiary of Open Joint Stock Company MegaFon (“OJSC MegaFon” or the “Company”), of [●] ordinary shares with a nominal value of 0.1 rubles each in the share capital of OJSC MegaFon, consisting of [●] ordinary shares in the form of ordinary shares (the “Offer Shares”) and [●] ordinary shares in the form of global depositary receipts representing ordinary shares (the “GDRs”, and together with the Offer Shares, the “Securities”). One GDR represents an interest in one ordinary share. The Selling Shareholders will grant to the Joint Global Coordinators (as defined under “Plan of Distribution”) on behalf of the Joint Bookrunners (as defined under “Plan of Distribution”) an option (the “Over-allotment Option”) to purchase up to [●] additional ordinary shares in the form of ordinary shares and GDRs at the Offer Price for the purposes of meeting over-allotments in connection with the Offering, if any.

This document (the “Prospectus”) has been approved by the United Kingdom Financial Services Authority (the “FSA”) in accordance with the prospectus rules (the “Prospectus Rules”) of the FSA made under Section 73A of the Financial Services and Markets Act 2000, as amended (the “FSMA”), solely in relation to an admission to trading on a regulated market of the GDRs. This document constitutes a prospectus relating to OJSC MegaFon prepared in accordance with the Prospectus Rules. Application has been made (1) to the FSA, in its capacity as competent authority (the U.K. Listing Authority, or “UKLA”) under the FSMA, for a listing of up to [●] GDRs consisting of (i) [●] GDRs to be issued on or about [●] 2012 (the “Closing Date”), (ii) up to [●] additional GDRs to be issued in connection with the Over-allotment Option, and (iii) up to [●] additional GDRs to be issued from time to time against the deposit of ordinary shares (to the extent permitted by law) with a custodian acting on behalf of The Bank of New York Mellon (Luxembourg) S.A. (the “Depositary”), to be admitted to the official list of the FSA (the “Official List”) and (2) to the London Stock Exchange plc (the “London Stock Exchange”), for such GDRs to be admitted to trading on the London Stock Exchange’s regulated market for listed securities (the “Regulated Market”) through its International Order Book (the “IOB”), which is a regulated market for the purposes of Directive 2004/39/EC (the Markets in Financial Instruments Directive). Conditional trading in the GDRs on the London Stock Exchange through the IOB is expected to commence on an if-and-when-issued basis on or about [●] 2012. Admission to the Official List and unconditional trading on the London Stock Exchange (collectively, “Admission”) is expected to take place on or about [●] 2012. **All dealings in the GDRs prior to the commencement of unconditional dealings will be of no effect if Admission does not take place and will be at the sole risk of the parties concerned.** OJSC MegaFon’s GDRs are expected to be traded on the Regulated Market under the symbol “MFON”.

The Offering comprises (i) an offering of Offer Shares in the Russian Federation and (ii) an offering of Securities outside of the Russian Federation. The Securities are being offered outside the United States in reliance on Regulation S (“Regulation S”, and such Securities, the “Regulation S Offering”) under the U.S. Securities Act of 1933, as amended (the “Securities Act”) and within the United States to certain qualified institutional buyers (“QIBs”) as defined in, and in reliance on, Rule 144A (“Rule 144A”, and such Securities, the “Rule 144A Offering”) under the Securities Act. See “Plan of Distribution”.

Our ordinary shares have been listed on quotation list “V” of CJSC MICEX Stock Exchange (“MICEX”) since 27 September 2012 under the symbol MFON. Trading in our ordinary shares on MICEX is expected to commence on or about [●] 2012. Prior to the Offering, there has been no public market for the Securities. Prices for the Offer Shares traded on MICEX may not reflect the value of the GDRs.

The credit ratings included in this Prospectus have been issued, for the purposes of Regulation (EC) No 1060/2009 as amended by Regulation (EU) No 513/2011 (the “CRA Regulation”) by Standard & Poor’s Credit Market Services Europe Limited (“Standard & Poor’s”) and Moody’s Investors Service Ltd (“Moody’s”). Standard and Poor’s and Moody’s are established in the European Union (the “EU”) and registered under the CRA Regulation. As such, Standard and Poor’s and Moody’s 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.

**Investing in the Securities involves a high degree of risk. See “Risk Factors” beginning on page 22.**

The Offering does not constitute an offer to sell, or solicitation of an offer to buy, Securities in any jurisdiction in which such offer or solicitation would be unlawful. Neither the GDRs nor the Offer Shares have been or will be registered under the Securities Act or with any securities regulatory authority of any state or other jurisdiction of the United States and may not be offered or sold within the United States, except to persons reasonably believed to be QIBs or outside the United States in offshore transactions in reliance on Regulation S. Prospective purchasers are hereby notified that sellers of the GDRs may be relying on the exemption from the provisions of Section 5 of the Securities Act provided by Rule 144A. For a discussion of certain restrictions on transfers of the GDRs, see “Terms and Conditions of the Global Depositary Receipts” and “Selling and Transfer Restrictions”.

The GDRs will be issued in master form. The GDRs offered and sold in the United States (the “Rule 144A GDRs”) will be evidenced by a master Rule 144A global depositary receipt (the “Rule 144A Master GDR”) deposited with The Bank of New York Mellon in New York as custodian for The Depositary Trust Company (“DTC”), and registered in the name of Cede & Co., as nominee for DTC and the GDRs offered and sold outside the United States (the “Regulation S GDRs”) will be evidenced by a master Regulation S global depositary receipt (the “Regulation S Master GDR” and, together with the Rule 144A Master GDR, the “Master GDRs”) registered in the name of The Bank of New York Depository (Nominees) Limited as nominee for The Bank of New York Mellon, London Branch, as common depositary for Euroclear Bank SA/NV (“Euroclear”), and Clearstream Banking, société anonyme (“Clearstream”). The ordinary shares represented by the GDRs will be held by Sberbank of Russia, as custodian (the “Custodian”), for the Depositary. Except as described herein, beneficial interests in the Master GDRs will be shown as, and transfers thereof will be effected only through DTC with respect to the Rule 144A GDRs and Euroclear and Clearstream with respect to the Regulation S GDRs, and their direct and indirect participants, as applicable. It is expected that delivery of the GDRs will be made against payment therefor in U.S. dollars in same day funds through the facilities of DTC, Euroclear and Clearstream on or about the Closing Date. Each investor in the Offer Shares is required to pay for any such Offer Shares in U.S. dollars or rubles, as the case may be. In order to take delivery of the Offer Shares, an investor should either have a direct account with CJSC “Computershare Registrar”, our share registrar, or a deposit account with NSD or any other depositary that has an account with NSD or a direct account with our share registrar. See “Settlement and Delivery”.

**Joint Global Coordinators and Joint Bookrunners**

Morgan Stanley

Sberbank CIB

**Joint Bookrunners**

Citigroup

Credit Suisse

VTB Capital

Prospectus dated [●] 2012.

## IMPORTANT INFORMATION ABOUT THIS PROSPECTUS

Each prospective investor, by accepting delivery of this Prospectus, agrees that this Prospectus is being furnished by OJSC MegaFon solely for the purpose of enabling a prospective investor to consider the purchase of the Securities. Any reproduction or distribution of this Prospectus, in whole or in part, any disclosure of its contents or use of any information herein for any purpose other than considering an investment in the Securities is prohibited, except to the extent that such information is otherwise publicly available.

None of the Joint Bookrunners (as defined under “Plan of Distribution”) makes any representation or warranty, express or implied, nor accepts any responsibility, as to the accuracy or completeness of any of the information in this Prospectus. This Prospectus is not intended to provide the basis of any credit or other evaluation and should not be considered as a recommendation by any of OJSC MegaFon, the Selling Shareholders or the Joint Bookrunners that any recipient of this Prospectus should purchase the Securities. Each potential purchaser of Securities should determine for itself the relevance of the information contained in this Prospectus, and its purchase of Securities should be based upon such investigation, as it deems necessary.

This Prospectus, including the financial information included herein, is issued in compliance with the Prospectus Rules of the FSA, which comply with the provisions of Directive 2003/71/EC (the “**Prospectus Directive**”) as amended by Directive 2010/73/EU for the purpose of giving information with regard to OJSC MegaFon, the Selling Shareholders and the GDRs.

OJSC MegaFon accepts responsibility for the information contained in this Prospectus, and having taken all reasonable care to ensure that such is the case, the information contained in this Prospectus is, to the best of OJSC MegaFon’s knowledge, in accordance with the facts and contains no omissions likely to affect its import.

**This Prospectus does not constitute an offer to the public to purchase or otherwise acquire the Securities. In making an investment decision regarding the Securities, you must rely on your own examination of us and the terms of the Offering, including the merits and risks involved. You should rely only on the information contained in this Prospectus. None of OJSC MegaFon, the Selling Shareholders or the Joint Bookrunners has authorised any other person to provide you with different information. If anyone provides you with different or inconsistent information, you should not rely on it. You should assume that the information appearing in this Prospectus is accurate only as of its date. Our business, financial condition, results of operations, prospects and the information set forth in this Prospectus may have changed since the date hereof.**

We have included our own estimates, assessments, adjustments and judgments in preparing some market information, which has not been verified by an independent third party. Market information included herein is, therefore, unless otherwise attributed to a third party source, to a certain degree subjective. While we believe that our own estimates, assessments, adjustments and judgments are reasonable and that the market information prepared by us approximately reflects the industry and the markets in which we operate, there is no assurance that our own estimates, assessments, adjustments and judgments are the most appropriate for making determinations relating to market information or that market information prepared by other sources will not differ materially from the market information included herein.

The contents of OJSC MegaFon’s website, or the website of any member of our Group (as defined in “Presentation of Financial and Other Information”), do not form any part of this Prospectus.

You should not consider any information in this Prospectus to be investment, legal or tax advice. You should consult your own counsel, accountant and other advisors for legal, tax, business, financial and related advice regarding purchasing the Securities. None of OJSC MegaFon, the Selling Shareholders or the Joint Bookrunners makes any representation to any offeree or purchaser of the Securities regarding the legality of an investment in the Securities by such offeree or purchaser under appropriate investment or similar laws.

The Joint Bookrunners are acting exclusively for OJSC MegaFon and the Selling Shareholders and no one else in connection with the Offering and will not be responsible to any other person for providing the protections afforded to their respective clients or for providing advice in relation to the Offering.

In connection with the Offering, the Joint Bookrunners and any of their respective affiliates acting as an investor for its or their own account or accounts may subscribe for or purchase, as the case may be, Securities and, in that capacity, may retain, purchase, sell, offer to sell or otherwise deal for its or their own account or accounts in such



Securities, any other securities of OJSC MegaFon or other related investments in connection with the Offering or otherwise. Accordingly, references in this Prospectus to the Securities being issued, offered, subscribed or otherwise dealt with should be read as including any issue or offer to, or subscription or dealing by, the Joint Bookrunners and any of their respective affiliates acting as an investor for its or their own account or accounts. The Joint Bookrunners do not intend to disclose the extent of any such investment or transactions otherwise than in accordance with any legal or regulatory obligation to do so.

OJSC MegaFon and the Selling Shareholders may withdraw the Offering at any time before admission to the Official List, and OJSC MegaFon, the Selling Shareholders and the Joint Bookrunners reserve the right to reject any offer to purchase the Securities, in whole or in part, and to sell to any prospective investor less than the full amount of the Securities sought by such investor.

The distribution of this Prospectus and the offer and sale of the Securities may be restricted by law in certain jurisdictions. You must inform yourself about, and observe any such restrictions. See “Terms and Conditions of the Global Depositary Receipts”, “Selling and Transfer Restrictions” and “Plan of Distribution” elsewhere in this Prospectus. You must comply with all applicable laws and regulations in force in any jurisdiction in which you purchase, offer or sell the Securities or possess or distribute this Prospectus and you must obtain any consent, approval or permission required for your purchase, offer or sale of the Securities under the laws and regulations in force in any jurisdiction to which you are subject or in which you make such purchases, offers or sales. None of OJSC MegaFon, the Selling Shareholders or the Joint Bookrunners is making an offer to sell the Securities or a solicitation of an offer to buy any of the Securities to any person in any jurisdiction except where such an offer or solicitation is permitted.

The information set forth in this document is only accurate as of the date on the front cover of this document. OJSC MegaFon’s business and financial condition may have changed since that date. In making an investment decision, prospective investors must rely on their own examination of OJSC MegaFon and the terms of this document, including the risks involved.

## STABILISATION

**In connection with the Offering, Morgan Stanley and Co. International plc and Sberbank CIB (the “Stabilising Managers”) (or persons acting on behalf of the Stabilising Managers) may (but will be under no obligation to), to the extent permitted by applicable law, over-allot Offer Shares or GDRs or effect other stabilising transactions with a view to supporting the market price of the Offer Shares or GDRs at a level higher than that which might otherwise prevail in the open market for a limited period after the issue date. However, there is no assurance that the Stabilising Managers (or persons acting on behalf of the Stabilising Managers) will undertake stabilising action. Such stabilising, if commenced, may be discontinued at any time, and may only be undertaken during the period beginning on the date on which adequate public disclosure of the price of the Offer Shares and GDRs is made and ending no later than 30 calendar days thereafter (the “Stabilisation Period”). In no event will measures be taken to stabilise the market price of the Offer Shares or GDRs above the Offer Price (as defined in “The Offering”). Save as required by law, the Stabilising Managers do not intend to disclose the extent of any over-allotments and/or stabilisation transactions under the Offering. Any stabilisation action must be undertaken in accordance with applicable laws and regulations.**

## NOTICE TO CERTAIN INVESTORS

### Notice to U.K. and other EEA Investors

This Prospectus is only addressed to and directed at persons in member states of the European Economic Area (the “EEA”), who are “qualified investors” (“**Qualified Investors**”) within the meaning of Article 2(1)(e) of the Prospectus Directive. In addition, in the United Kingdom, this Prospectus is only being distributed to and is only directed at (1) Qualified Investors who are investment professionals falling within Article 19(5) of the Financial Services and Markets Act 2000 (Financial Promotion) Order 2005 (the “**Order**”) or high net worth entities falling within Article 49(2)(a)-(d) of the Order or (2) persons to whom it may otherwise lawfully be communicated (all such persons together being referred to as “**relevant persons**”). The Securities are only available to, and any invitation, offer or agreement to subscribe, purchase or otherwise acquire such Securities will be engaged in only with, (1) in the United Kingdom, relevant persons and (2) in any member state

of the EEA other than the United Kingdom, Qualified Investors. This Prospectus and its contents should not be acted upon or relied upon (1) in the United Kingdom, by persons who are not relevant persons or (2) in any member state of the EEA other than the United Kingdom, by persons who are not Qualified Investors.

This Prospectus has been prepared on the basis that all offers of the Securities will be made pursuant to an exemption under the Prospectus Directive from the requirement to produce a prospectus for offers of the Securities. Accordingly, any person making or intending to make any offer within the EEA of the Securities should only do so in circumstances in which no obligation arises for us, the Selling Shareholders or any of the Joint Bookrunners to produce a prospectus for such offer. None of OJSC MegaFon, the Selling Shareholders or the Joint Bookrunners has authorised or authorises the making of any offer of the Securities through any financial intermediary, other than offers made by the Joint Bookrunners which constitute the final placement of the Securities contemplated in this Prospectus.

For the purposes of this provision, the expression “Prospectus Directive” means Directive 2003/71/EC (and amendments thereto, including the 2010 PD Amending Directive, to the extent implemented in each relevant member state of the EEA), and includes any relevant implementing measure in each relevant member state of the EEA and the expression “**2010 PD Amending Directive**” means Directive 2010/73/EU.

#### **Notice to Investors in the Russian Federation**

This document and the information contained herein are not a public offer or advertisement of securities in the Russian Federation and are not an offer, or an invitation to make offers, to purchase, sell, exchange or transfer any securities in the Russian Federation or to or for the benefit of any Russian person or entity, unless and to the extent otherwise permitted under Russian law, and must not be made publicly available in the Russian Federation. Information contained in this document is intended only for persons who are “qualified investors” within the meaning of Article 51.2 of the Federal Law No. 39-FZ “On the Securities Market” dated 22 April 1996, as amended (the “**Russian QIs**”) and must not be made available to any persons who are not Russian QIs or otherwise permitted under Russian law to access such information. The GDRs have not been and will not be registered in the Russian Federation and are not intended for “placement”, “public circulation”, “offering” or “advertising” (each as defined in Russian law) in the Russian Federation except as permitted by Russian law.

#### **Notice to United States Investors**

Because of the following restrictions, purchasers in the United States are advised to consult legal counsel prior to making any offer, resale, pledge or transfer of Securities.

Neither the GDRs nor the Offer Shares have been or will be registered under the Securities Act or with any securities regulatory authority of any state or other jurisdiction in the United States and may not be offered or sold in the United States, except to persons reasonably believed to be QIBs or outside the United States in offshore transactions in reliance on Regulation S. Prospective investors are hereby notified that sellers of the Securities may be relying on the exemption from the registration requirements of Section 5 of the Securities Act provided by Rule 144A.

Any resale or other transfer, or attempted resale or other transfer, of such Securities, made other than in compliance with the above stated restriction, shall not be recognised by OJSC MegaFon. In addition, until 40 days after the commencement of the Offering of the Securities, an offer or sale of Securities within the United States by a dealer (whether or 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.

**NEITHER THE U.S. SECURITIES AND EXCHANGE COMMISSION NOR ANY STATE SECURITIES COMMISSION IN THE UNITED STATES NOR ANY OTHER U.S. REGULATORY AUTHORITY HAS APPROVED OR DISAPPROVED OF THE GDRs OR THE OFFER SHARES OR PASSED UPON OR ENDORSED THE MERITS OF THE OFFERING OF THE SECURITIES OR THE ACCURACY OR ADEQUACY OF THIS PROSPECTUS. ANY REPRESENTATION TO THE CONTRARY IS A CRIMINAL OFFENCE IN THE UNITED STATES.**

#### **Notice to New Hampshire Residents Only**

**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 LICENSED 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.

### *Japan*

Neither the GDRs nor the Offer Shares have been or will be registered under the Final Instruments and Exchange Law, as amended (the “**FIEL**”). This Prospectus is not an offer of securities for sale, directly or indirectly, in Japan or to or for the benefit of, any resident of Japan (which term as used herein means any person resident in Japan, including any corporation or entity organised under the laws of Japan) or to others for reoffer or resale, directly or indirectly, in Japan or to, or for the benefit of, any resident of Japan, except pursuant to an exception from the registration requirements under the FIEL, and otherwise in compliance with, the FIEL and other relevant laws and otherwise in compliance with such law and any other applicable laws, regulations or ministerial guidelines of Japan.

### *Australia*

No prospectus or other disclosure document has been lodged with, or registered by the Australian Securities and Investments Commission in relation to the offering of the GDRs or the Offer Shares. This Prospectus does not constitute a prospectus or other disclosure document under the Corporations Act 2001 (the “**Corporations Act**”) and does not purport to include the information required for a prospectus or other disclosure document under the Corporations Act.

This document is being distributed in Australia by the Joint Bookrunners to persons (the “**Exempt Investors**”) who are “sophisticated investors” (within the meaning of section 708(8) of the Corporations Act, to “professional investors” (within the meaning of section 708(11) of the Corporations Act) and/or otherwise pursuant to one of more exemptions contained in section 708 of the Corporations Act. The entity receiving this document represents and warrants that if it is in Australia, it is either a professional or a sophisticated investor or a person to whom it is lawful to offer the GDRs or the Offer Shares without disclosure to investors under Chapter 6D of the Corporations Act and that it will not distribute this document to any other person.

Any GDRs or Offer Shares applied for by Exempt Investors in Australia must not be offered for sale in Australia for 12 months from the date of issue, except in circumstances where disclosure to investors under Chapter 6D of the Corporations Act would not be required pursuant to an exemption under section 708 or 708A of the Corporations Act. This document is not supplied in connection with any offering or proposed offering of securities or financial products that require disclosure in accordance with Chapter 6D or Part 7.9 of the Corporations Act. Chapters 6D and 7 of the Corporations Act are complex. Any person acquiring the GDRs or the Offer Shares must observe such Australian on-sale restrictions and if in any doubt as to the application or effect of this legislation, should confer with its professional advisors.

## PRESENTATION OF FINANCIAL AND OTHER INFORMATION

### Presentation of Financial Information

Our financial information set forth herein has, unless otherwise indicated, been extracted without material adjustment from our audited consolidated financial statements as at and for the years ended 31 December 2011, 2010 and 2009 (the “**Audited Consolidated Financial Statements**”), as set forth on pages F-2 through F-43 of this Prospectus, and the unaudited interim condensed consolidated financial statements as at 30 September 2012 and for the three and nine months ended 30 September 2012 and 2011 as set forth on pages F-45 through F-62 of this Prospectus (the “**Unaudited Interim Condensed Consolidated Financial Statements**” and together with the Audited Consolidated Financial Statements, the “**Consolidated Financial Statements**”). The Consolidated Financial Statements are prepared in accordance with accounting principles generally accepted in the United States of America (“**U.S. GAAP**”). Our reporting and primary functional currency is the ruble.

### Auditors

The Audited Consolidated Financial Statements have been audited, in accordance with auditing standards generally accepted in the United States of America, by Ernst & Young LLC, independent auditors, who have expressed an unqualified opinion on each of those statements, as stated in their report dated 14 May 2012, appearing herein. The Unaudited Interim Condensed Consolidated Financial Statements have been reviewed, in accordance with standards established by the American Institute of Certified Public Accountants, by Ernst & Young LLC, who have issued their report dated 8 November 2012 appearing herein. The address of Ernst & Young LLC is Sadovnicheskaya Naberezhnaya 77, Building 1, Moscow, 115035, Russian Federation. Ernst & Young LLC is a member of the Audit Chamber of Russia.

### Non-U.S. GAAP Financial Measures

This Prospectus contains a financial measure that is not defined by U.S. GAAP, namely OIBDA. OIBDA is defined as, in relation to any relevant period, the consolidated operating income for such period plus depreciation and amortisation. We believe that OIBDA provides useful information and is an important supplemental indicator of the strength and performance of our business operations, including our ability to finance capital expenditures, acquisitions 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 the non-cash current period allocation of costs associated with long-lived assets acquired or constructed in prior periods. OIBDA calculations are commonly used as bases for some analysts, investors, credit rating agencies and other parties to compare the periodic and future operating performance and value of companies within our industry.

OIBDA has limitations as an analytical tool, and should not be considered in isolation as an alternative to net income attributable to MegaFon, operating income or any other measure of performance under U.S. GAAP.

### Currency

In this Prospectus, the following currency terms are used:

- “**ruble**” means the lawful currency of the Russian Federation;
- “**\$**”, “**U.S.\$**” or “**U.S. dollars**” means the lawful currency of the United States of America (the “**United States**” or “**U.S.**”);
- “**€**”, or “**euro**” means the single currency of the participating Member States in the third stage of the European and Economic Monetary Union pursuant to the Treaty establishing the European Community, as amended from time to time; and
- “**£**” means the lawful currency of the United Kingdom (the “**U.K.**”).

### References to “OJSC MegaFon” and “MegaFon”

In this Prospectus, references to “MegaFon”, “our Group”, “we”, “us”, “ourselves”, “ours”, and “our” mean OJSC MegaFon and its consolidated subsidiaries, unless the context requires otherwise. References to OJSC MegaFon are to OJSC MegaFon only.



### **References to “AF Telecom” and the “AF Telecom Group”**

In this Prospectus, references to “**AF Telecom**” are references to AF Telecom Holding Limited, a telecommunications holding company owned by Garsdale Services Investment Limited (“**Garsdale**”), which is ultimately controlled by Mr Alisher Usmanov, and references to the “**AF Telecom Group**” means AF Telecom and all of its subsidiaries.

### **References to the “TeliaSonera Group”**

In this Prospectus, references to the “**TeliaSonera Group**” are references to TeliaSonera AB, a major Swedish and Finnish telecommunications provider with world-wide operations whose shares are listed on the Stockholm and Helsinki stock exchanges, and all of its subsidiaries.

### **References to the “Big Three”**

In this Prospectus, references to the “**Big Three**” are a collective reference to the three largest universal telecommunications operators in the Russian Federation and their respective subsidiaries: OJSC MegaFon, OJSC Mobile TeleSystems (“**MTS**”) and OJSC VimpelCom (“**VimpelCom**”).

### **References to “Subscribers”**

In this Prospectus, “**Subscriber**” is defined as each SIM card that is connected to the network and that has had at least one chargeable traffic event (that is, use of voice, VAS or data transfer services) within the preceding three months, whether chargeable to the Subscriber or to a third party (for example, interconnection charges payable by other operators). Where an individual person holds more than one SIM card, each SIM card is included as a separate Subscriber.

### **References to “Yota”**

In this Prospectus, references to “**Yota**” are references to Scartel LLC, operating under the Yota brand.

### **Additional Definitions**

For details of certain other defined terms used in this Prospectus, please see “Glossary of Terms”.

### **Rounding**

Some numerical figures included in this Prospectus have been subject to rounding adjustments. Accordingly, numerical figures shown for the same category presented in different tables may vary slightly and numerical figures shown as totals in certain tables may not be an arithmetic aggregation of the figures that preceded them.

### **Credit Ratings**

The credit ratings included in this Prospectus have been issued, for the purposes of Regulation (EC) No 1060/2009 as amended by Regulation (EU) No 513/2011 (the “**CRA Regulation**”) by Standard & Poor’s Credit Market Services Europe Limited (“**Standard & Poor’s**”) and Moody’s Investors Service Ltd (“**Moody’s**”). Standard and Poor’s and Moody’s are established in the European Union (the “**EU**”) and registered under the CRA Regulation. As such, Standard and Poor’s and Moody’s 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.

### **Presentation of Third-Party Statistical and Other Information**

OJSC MegaFon has derived certain information and statistics in this Prospectus, including certain information and statistics concerning the Russian telecommunications market and its competitors, from private and publicly available information, including principally annual reports, industry publications, market research, press releases, filings under various securities laws and official data published by certain Russian Government agencies, such as the Central Bank of the Russian Federation (the “**CBR**”), and data published by AC&M Consulting. Such information is contained in this Prospectus under the captions “Presentation of Financial and Other Information”, “Currency Presentation and Exchange Rate Information”, “Prospectus Summary”, “Risk Factors”, “Management’s Discussion and Analysis of Financial Condition and Results of Operations”, “The Russian Mobile Telecommunications Industry” and “Business”. Where third-party information is set out, it has been sourced. Such information, data and statistics have been accurately reproduced and, as far as OJSC MegaFon is aware and is able to ascertain from relevant publicly available information published by the aforementioned sources, no facts have been omitted which would render the reproduced information, data and statistics inaccurate or misleading. None of the Joint Bookrunners accept liability for the accuracy of any such information and prospective investors are advised to use such information with caution.

## CURRENCY PRESENTATION AND EXCHANGE RATE INFORMATION

Certain amounts in this Prospectus have been translated from local currencies into U.S. dollars on a convenience basis. Unless otherwise stated, the ruble to U.S. dollar exchange rates referred to in this Prospectus refer to the applicable exchange rate of the CBR as of the date indicated. With respect to information extracted from financial statements, such exchange rate is as of the date of the relevant financial statements.

The following table sets forth, for the periods indicated, certain information regarding the exchange rate between the ruble and the U.S. dollar, based on the official exchange rate quoted by the CBR. The rates below may differ from the actual rates used in the preparation of MegaFon's financial statements and other financial information appearing in this Prospectus. MegaFon's inclusion of the exchange rates is not meant to suggest that the ruble amounts actually represent such U.S. dollar amounts or that such amounts could have been converted into U.S. dollars at any particular rate, or at all.

	Year ended 31 December					Nine months ended 30 September	
	2011	2010	2009	2008	2007	2012	2011
	(U.S. dollars per ruble)						
Exchange rate at end of period . . . . .	32.20	30.48	30.24	29.38	24.55	30.92	31.88
Average exchange rate during period <sup>(1)</sup> . . . . .	29.39	30.37	31.72	24.86	25.58	31.10	28.77
Highest exchange rate during period . . . . .	32.68	31.78	36.43	29.38	26.58	34.04	32.46
Lowest exchange rate during period . . . . .	27.26	28.93	28.67	23.13	24.26	28.95	27.26

(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).

	Highest exchange rate during the month	Lowest exchange rate during the month
January 2012 . . . . .	32.20	30.36
February 2012 . . . . .	30.41	28.95
March 2012 . . . . .	29.67	28.95
April 2012 . . . . .	29.80	29.28
May 2012 . . . . .	32.45	29.36
June 2012 . . . . .	34.04	32.13
July 2012 . . . . .	32.99	31.95
August 2012 . . . . .	32.54	31.48
September 2012 . . . . .	32.57	30.59
October 2012 . . . . .	31.53	30.72
November (up to 13 November 2012) . . . . .	31.61	31.30

## LIMITATION ON ENFORCEMENT OF CIVIL LIABILITIES

OJSC MegaFon is an open joint stock company incorporated under the laws of the Russian Federation. The Selling Shareholders, MICL and Sonera, are incorporated in Cyprus and the Netherlands, respectively. Our presence and that of the Selling Shareholders outside the United States and the United Kingdom may limit your legal recourse against us. All of our directors and executive officers named in this Prospectus reside outside the United States and the United Kingdom. Moreover, all of the assets of our Group and substantially all of the assets of its directors and officers are located outside the United States and the United Kingdom.

As a result, it may not be possible for you to:

- effect service of process within the United States or the United Kingdom upon us, the Selling Shareholders or our respective directors and executive officers; or
- enforce, in the English or U.S. courts, judgments obtained outside English or U.S. courts against us, the Selling Shareholders or our respective directors and executive officers, including actions under the civil liability provisions of U.S. securities laws or any state or territory of the United States.

In addition, it may be difficult for you 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 only 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; and/or
- a federal law of the Russian Federation provides for the recognition and enforcement of foreign court judgements.

No such federal law has been passed and 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), as a result of which new proceedings may have to be brought in the Russian Federation in respect of a judgment already obtained in any such jurisdiction against OJSC MegaFon or its officers or directors.

Even if an applicable international treaty is in effect or a foreign judgment might otherwise be recognised and enforced on the basis of reciprocity, the recognition and enforcement of a foreign judgment will in all events be subject to exceptions and limitations provided for in Russian law. For example, a Russian court may refuse to recognise or enforce a foreign judgment if its recognition or enforcement would contradict Russian public policy.

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 limit or delay, perhaps significantly, the enforcement of such judgment and thereby deprive the holders of the Securities of effective legal recourse against OJSC MegaFon.

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.

See “Risk Factors—Risks Relating to the Securities and the Trading Market—Investors may have limited recourse against the Selling Shareholders, OJSC MegaFon or OJSC MegaFon’s directors and executive officers because they generally conduct their operations outside the United States and the United Kingdom and all of its current directors and executive officers reside outside the United States and the United Kingdom”.

## FORWARD-LOOKING STATEMENTS

Certain statements in this Prospectus are not historical facts and constitute “forward-looking statements” within the meaning of Section 27A of the Securities Act and section 21E of the U.S. Securities Exchange Act of 1934, as amended. Forward-looking statements are identified by words such as “believes”, “anticipates”, “expects”, “estimates”, “intends”, “plans”, “will”, “may” 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”. OJSC MegaFon or our Group may from time to time make written or oral forward-looking statements in reports to shareholders and in other communications. Examples of such forward-looking statements include, but are not limited to:

- statements of OJSC MegaFon’s or our Group’s plans, objectives or goals, including those related to its strategy, products or services;
- statements of future economic performance; and
- statements of assumptions underlying such statements.

Forward-looking statements that may be made by OJSC MegaFon or our Group from time to time (but 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.

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. These factors include:

- the prevailing global and domestic economic environment;
- inflation, interest rate and exchange rate fluctuations;
- the health of the Russian economy;
- the effects of, and changes in, the policy of the Russian Government;
- OJSC MegaFon’s or our Group’s ability to finance its anticipated capital expenditures at least in part through the global capital markets, revenue from operations or otherwise;
- the effects of, and changes in, the policies of the Government of the Russian Federation;
- the effects of changes in laws, regulations, taxation or accounting standards or practices;
- the effects of competition in the geographic and business areas in which OJSC MegaFon or our Group conducts its operations;
- OJSC MegaFon’s or our Group’s ability to control expenses;
- acquisitions or divestitures;
- OJSC MegaFon or our Group’s expansion;
- technological changes; and
- OJSC MegaFon’s or our Group’s success at managing the risks associated with 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 OJSC MegaFon and our Group operate. Such forward-looking statements speak only as of the date on which they are made. Accordingly, OJSC MegaFon and our Group do not undertake any obligation to update or revise any of them, whether as a result of new information, future events or otherwise, except as required by law, the rules of the London Stock Exchange or the FSA. OJSC MegaFon and our Group 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.

## AVAILABLE INFORMATION

For so long as any Rule 144A GDRs, the ordinary shares represented thereby or the Offer Shares are “restricted securities” within the meaning of Rule 144(a)(3) under the Securities Act, we will, during any period in which we are neither subject to Section 13 or Section 15(d) of the Exchange Act, nor exempt from reporting pursuant to Rule 12g3-2(b) thereunder, provide to any holder or beneficial owner of such restricted Rule 144A GDRs or Offer Shares, or to any prospective purchaser of such restricted Rule 144A GDRs or Offer Shares designated by such holder or beneficial owner upon the request of such holder, beneficial owner or prospective purchaser, the information required to be delivered to such persons pursuant to Rule 144A(d)(4) under the Securities Act (or any successor provision thereto).



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## PROSPECTUS SUMMARY

Summaries are made up of disclosure requirements known as 'Elements'. These elements are numbered in Sections A – E (A.1 – E.7). This summary contains all the Elements required to be included in a summary for this type of securities and issuer. Because some Elements are not required to be addressed, there may be gaps in the numbering sequence of the Elements. Even though an Element may be required to be inserted in the summary because of the type of securities and issuer, it is possible that no relevant information can be given regarding the Element. In this case a short description of the Element is included in the summary with the mention of 'not applicable'.

<b>Section A — Introduction and Warnings</b>		
<b>A.1</b>		<ul style="list-style-type: none"> <li>• this summary should be read as an introduction to the Prospectus;</li> <li>• any decision to invest in the Securities should be based on consideration of the Prospectus as a whole by the investor;</li> <li>• where a claim relating to the information contained in the Prospectus is brought before a court, the plaintiff investor might, under the national legislation of the Member States, have to bear the costs of translating the Prospectus before the legal proceedings are initiated; and</li> <li>• civil liability attaches only to those persons who have tabled the summary including any translation thereof, but only if the summary is misleading, inaccurate or inconsistent when read together with the other parts of the Prospectus or it does not provide, when read together with the other parts of the Prospectus, key information in order to aid investors when considering whether to invest in such securities.</li> </ul>
<b>A.2</b>		Not applicable; OJSC MegaFon has not consented to the use of the Prospectus for subsequent resale or final placement of securities by financial intermediaries.

<b>Section B — Issuer</b>		
<b>B.1</b>	<i>The legal and commercial name of the issuer of the underlying shares.</i>	Open Joint Stock Company MegaFon (“ <b>OJSC MegaFon</b> ”).
<b>B.2</b>	<i>The domicile and legal form of the issuer of the underlying shares, the legislation under which it operates and its country of incorporation.</i>	OJSC MegaFon is an open joint stock company incorporated under the laws of the Russian Federation.
<b>B.3</b>	<i>A description of, and key factors relating to, the nature of the issuer of the underlying shares' current operations and its principal activities, stating the main categories of products sold and/or services performed and identification of the principal markets in which the issuer of the underlying shares competes.</i>	We are a leading universal telecommunications provider with approximately 63 million Subscribers in the Russian Federation as of 30 September 2012. We offer a broad range of voice, data and other mobile and fixed-line telecommunications services to retail customers, businesses, Government clients and other telecommunications services providers. Our total revenue increased by 13.5%, to 201,098 million rubles for the nine months ended 30 September 2012 as compared to the same period in 2011.

We focus on an integrated customer-centric business model, which reduces the division of the mobile and fixed-line businesses. This unified model is focussed on offering integrated services to four client segments. Besides retail clients (B2C), who have been our traditional focus, we also serve corporate (B2B), Governmental (B2G) and operator (B2O) segments.

We have been awarded licences to provide 2G and 3G services in each of the 83 micro-regions of the Russian Federation and, as of 30 September 2012, our 2G and 3G networks covered approximately 92% and 72%, respectively, of the Russian population. As of 31 March 2012 we operated the largest 3G network in the Russian Federation based on the number of 3G base stations. This has allowed us to become the leading operator in mobile data services. As of 30 September 2012, our data revenues were equal to 25,214 million rubles. This segment of the telecommunication market has recently demonstrated high growth rates and we believe it holds the greatest potential for future growth. We also operate a backhaul and backbone fibre-optic network spanning over 130,000 kilometres, as of 30 September 2012. We believe that our mobile assets coupled with our fixed-line assets will enable us to develop and provide fixed-mobile convergent telecommunications solutions to our clients by taking advantage of cross-selling opportunities.

We are also closely observing the developments in the next generation of wireless technology, known variously as long term evolution (“LTE”) standard or fourth generation (“4G”), for deployment on our networks. We have already conducted tests of the LTE/4G technology and we are planning to employ it during the 2014 Winter Olympic and Paralympic Games to be held in Sochi, for which we are the official mobile provider. Furthermore, on 25 July 2012, we were issued an LTE/4G licence covering the entire territory of the Russian Federation. While we believe we are well-positioned to create our own LTE/4G network in the near future (possibly in cooperation with other operators), in February 2012 we also entered into an MVNO agreement with Yota that has allowed us to provide LTE/4G services to our customers in fourteen major Russian cities as of the date hereof (Novosibirsk, Moscow, Sochi, Krasnodar, Samara, Vladivostok, Ufa, Kazan, St. Petersburg, Kostroma, Tula, Vladimir, Yoshkar-Ola and Khabarovsk) with expected coverage of more than 40 cities by the end of 2012.

We actively monitor our client base to hone our services, analysing statistical data to determine the preferences and needs of customers within each client sector in which we operate. We continue to develop new products and solutions to be offered to the public in an effort to grow in a competitive market. As part of this effort, we have developed MegaLabs, a subsidiary whose principal objective is to research, develop and bring to market innovative value-added services for our clients.

		<p>As of 30 September 2012, our distribution network included 1,841 owned-and-operated stores, 1,821 third-party points of sale operating solely under the “MegaFon” brand, approximately 16,500 independently-owned multi-brand telecommunications retailers and 27,000 additional third-party operated points of sale, our on-line shop, our direct sales force and our call centre. We focus on our distribution network as a key instrument to improve customer retention and lower SAC. In particular, we intend to continue increasing the number of our owned-and-operated stores, which offer higher quality customer service and boost customer loyalty. Our proposed acquisition of a stake in Euroset, the largest retailer of wireless equipment in the Russian Federation, is expected to further our initiative to reduce dealers’ commissions, and may reduce our subscriber acquisition costs.</p>
<b>B.4a</b>	<i>A description of the most significant recent trends affecting the issuer of the underlying shares and the industries in which it operates.</i>	<p>The most significant trends affecting us and the Russian telecommunications industry include:</p> <ul style="list-style-type: none"> <li>• increasing use of data and value added services (other than messaging) as a result of increasing 3G and smartphone penetration, coupled with a decrease in peer to peer messaging and a slower growth in voice services;</li> <li>• the development and implementation of new technology (such as LTE/4G); and</li> <li>• increased attention on customer retention and per-customer profitability rather than on pure customer additions.</li> </ul>
<b>B.4b</b>	<i>A description of any known trends affecting the issuer of the underlying shares and the industries in which it operates.</i>	<p>The recent trends affecting us and the Russian telecommunications industry include:</p> <ul style="list-style-type: none"> <li>• the expansion of alternative communication technologies, such as internet service providers and over the top service providers; and</li> <li>• an increasing focus on fixed-mobile convergence products and related fixed-mobile M&amp;A activity.</li> </ul>
<b>B.5</b>	<i>If the issuer of the underlying shares is part of a group, a description of the group and the issuer of the underlying shares’ position within the group.</i>	<p>Our Group consists of OJSC MegaFon and its subsidiaries. OJSC MegaFon is the parent company of the Group. All of our wireless operations are conducted through OJSC MegaFon, which operates through 8 regional branches. We intend for the most part to provide fixed-line communications services through our regional branches (except for B2C fixed broadband services, which, for the time being, will continue to be provided by our subsidiary NetByNet), and, in line with this integration plan, we are in the process of transferring the fixed-line business operations of the companies we have acquired to OJSC MegaFon to be operated through our branches.</p> <p>OJSC MegaFon has more than 35 subsidiaries involved in, <i>inter alia</i>, the provision of fixed-line services in the Russian Federation, development of new value-added service, the provision of mobile telecommunications services in South Ossetia, Abkhazia and Tajikistan and in retail activities.</p>

**B.6** *In so far as is known to the issuer, the name of any person who, directly or indirectly, has an interest in the issuer of the underlying shares' capital or voting rights which is notifiable under the issuer's national law, together with the amount of each such person's interest.*

*Whether the major shareholders have different voting rights if any.*

*To the extent known to the issuer of the underlying shares, state whether the issuer is directly or indirectly owned or controlled and by whom and describe the nature of such control.*

Insofar as is known to OJSC MegaFon, other than the shareholders described below and their beneficial owners, under the laws of the Russian Federation, no person directly or indirectly has a notifiable interest in OJSC MegaFon's capital or voting rights. None of our shareholders has any voting rights that are different from any other holders of our ordinary shares.

**Pre-Offering Shareholding Structure**

According to OJSC MegaFon's share register, the shareholders of OJSC MegaFon as of 31 October 2012, were as follows:

<u>Shareholder</u>	<u>Number of ordinary shares</u>	<u>Shareholding</u>
<b>AF Telecom</b>		
Telecominvest Holdings Limited ..	300,699,700	48.4999%
<b>CJSC</b>		
Telecominvest .....	9,300,300	1.50%
<b>LLC AF Telecom</b>		
Holding .....	100	0.0000161%
<b>TeliaSonera Group</b>		
<b>Sonera Holding</b>		
B.V. ....	211,420,100	34.10%
LLC Kontakt-S .....	9,300,300	1.50%
<b>Our wholly owned subsidiary</b>		
<b>MegaFon Investments</b>		
(Cyprus) Limited ...	89,279,500	14.3999%

As the percentages that appear in this table have been subject to rounding adjustments, the sum of the figures may not add up to 100%.

The entities noted in the table above under the heading **AF Telecom** are wholly owned subsidiaries of AF Telecom, which is a wholly owned subsidiary of Garsdale Services Investment Limited ("**Garsdale**"). The ultimate beneficial ownership of Garsdale is split between Mr Alisher Usmanov (82%), Telconet (13.5%), and The Russian Technologies State Corporation ("**Rostekhnologii**") (4.5%), an entity controlled by the Russian Government.

Garsdale is ultimately controlled by Mr Alisher Usmanov in relation to matters concerning us, except for certain limited matters where Yota Holding (Garsdale's other shareholder) must also be in agreement (such as changes in the nature and scope of our business; our winding up/liquidation; and restructuring of the Garsdale group resulting in a reduction of its control over us). Garsdale also controls Yota, one of our competitors.

The entities noted above under the heading **TeliaSonera Group** are wholly owned subsidiaries of TeliaSonera AB, which is the parent company of the TeliaSonera Group. As at 30 September 2012, according to its website, the major shareholders of TeliaSonera AB were: the Swedish State (37.3% of the outstanding shares), the Finnish State (11.7% of the outstanding shares), and Capital Group Funds (3.1% of the outstanding shares). All other shareholders held less than 3% of the outstanding shares of TeliaSonera AB.



### **Post-Offering Shareholding Structure**

After the completion of the Offering, AF Telecom will continue to own more than 50% of the share capital of OJSC MegaFon. AF Telecom is wholly owned by Garsdale, which is ultimately controlled by Mr Usmanov. Depending on the size of the Offering, TeliaSonera Group may own, directly and indirectly, 25.0% plus one ordinary share in our share capital after the completion of the Offering. In addition, pursuant to a voting agreement entered into by, inter alia, TeliaSonera Group and AF Telecom on 24 April 2012 (the “**Voting Agreement**”), all members of our present Board of Directors were nominated by AF Telecom and/or TeliaSonera Group. After the completion of the Offering, we expect that AF Telecom and TeliaSonera will continue to be able to nominate and elect the majority of the members of the Board of Directors.

As a majority indirect shareholder, AF Telecom will be able to control or otherwise exercise substantial influence over, and, depending on the size of the Offering, TeliaSonera Group (if it continues to own at least 25% plus one ordinary share in our share capital after completion of the Offering) may be able to exercise substantial influence over, our business, appointment of our General Director, any proposed amendments to our Charter, re-organisations, changes in the share capital, proposed substantial sales of assets or other corporate transactions. Under Russian law, any person holding above 25% (a “blocking interest”) in the share capital of a company has the ability to block certain proposed actions relating to such a company (including charter amendments, re-organisation of the company, approval of major transactions involving assets in excess of 50% of the total assets of the company, repurchase by the company of its shares and certain share issuances).

#### *Shareholder Restructuring*

Further to what has been reported in the media with respect to the ongoing re-organisation and consolidation of Mr Usmanov’s interests in internet, media, mining, steel and telecommunication assets into a new holding company, together with the interests of his long term partners (Mr Vladimir Skoch and Mr Ardavan Farhad Moshiri) in Metalloinvest, a leading Russian iron ore producer, Mr Alisher Usmanov has entered into a definitive shareholders’ agreement with these aforementioned long-term partners on [●] 2012. The agreement regulates the agreed future interests of each party in the new holding company (“**USM Holdings Limited**”), as it will in turn relate to: (i) the agreed interests of USM Holdings Limited in USM Telecom Holdings Limited; (ii) USM Telecom Holdings Limited’s agreed interest in Garsdale; and (iii) Garsdale’s interest in OJSC MegaFon.

The shareholders’ agreement therefore regulates the future respective indirect interests of Mr Usmanov, Mr Skoch and Mr Moshiri in OJSC MegaFon.

The key terms of the shareholders' agreement insofar as it relates to OJSC MegaFon are:

- Mr Usmanov will hold 100% of the voting rights with respect to USM Holdings Limited.
- The economic interest of Mr Usmanov in USM Holdings Limited will be 60%, of which a 10% economic interest in USM Holdings Limited may be allocated for the benefit of directors, officers, consultants, advisers and employees of USM Advisers Limited, a company indirectly controlled by Mr Usmanov, created to provide management services to USM Holdings Limited. Any allocation to such beneficiaries in the future will be at the discretion of Mr Usmanov and such beneficiaries will have no voting rights in respect of USM Holdings Limited.
- The economic interests of Mr Skoch and Mr Moshiri in USM Holdings Limited will be 30% and 10%, respectively, with no voting or management rights.
- USM Holdings Limited will own all except a single share in USM Telecom Holdings Limited. Mr Usmanov will, directly or indirectly, control that single remaining share, which will have special rights enabling Mr Usmanov, directly or indirectly, to elect the majority of the Board of Directors of USM Telecom Holdings Limited.
- Mr Skoch and Mr Moshiri will not be permitted to transfer their interests in USM Holdings Limited without the consent of Mr Usmanov.
- Mr Skoch and Mr Moshiri will have no veto rights over the management of USM Holdings Limited or, for the avoidance of doubt, in USM Telecom Holdings Limited, as it relates, directly or indirectly, to OJSC MegaFon.
- The shareholders' agreement provides that it will terminate upon certain actions being taken for the winding up or receivership of USM Holdings Limited.

Each party to the agreement has separately represented and warranted to OJSC MegaFon that, upon the consummation of the restructuring, it will be holding its interests in USM Holdings Limited for its own account and not for the account of any other person.

Subject to regulatory and banking review of the re-organisation, the parties to the shareholders' agreement have undertaken to use their best efforts to structure the re-organisation such that the terms therein, in particular those addressing effective control of OJSC MegaFon, are given effect to.

*Control of MegaFon upon the Offering*

Under the terms of the shareholders' agreement, Mr Usmanov will continue to indirectly control OJSC MegaFon, while Mr Skoch and Mr Moshiri will hold purely economic interests and exercise no control (voting or otherwise) or influence over management of OJSC MegaFon or on the appointment of directors of OJSC MegaFon. Mr Usmanov's control of OJSC MegaFon will be maintained through indirect voting control (through USM Holdings Limited, USM Telecoms Limited, Garsdale and AF Telecom). After the completion of the Offering, we expect that AF Telecom and TeliaSonera will (through the Voting Agreement) continue to be able to nominate and elect the majority of the members of the Board of Directors of OJSC MegaFon—the shareholder reorganization will not affect this arrangement. We therefore do not expect the shareholder re-organisation to have any impact on the governance or control of OJSC MegaFon.

*Pledges of shares in OJSC MegaFon*

Telecominvest Holdings Limited has pledged 33.8% of our shares to lenders in connection with loans, and 6.53% of our shares to TeliaSonera AB in connection with a commercial transaction, which, if enforced, could result in AF Telecom's shareholding in us falling below the current 50% of our share capital plus one hundred shares.

**B.7**

Selected historical key financial information regarding the issuer of the underlying shares, presented for each financial year of the period covered by the historical financial information, and any subsequent interim financial period accompanied by comparative data from the same period in the prior financial year except that the requirement for comparative balance sheet information is satisfied by presenting the year-end balance sheet information.

This should be accompanied by a narrative description of significant change to the issuer of the underlying shares' financial condition and operating results during or subsequent to the period covered by the historical key financial information.

The financial data set forth below as of 31 December 2009, 2010 and 2011 and for the years then ended have been extracted without material adjustment from our Audited Consolidated Financial Statements. The financial data set forth below for the nine-month periods ended 30 September 2012 and 2011, have been extracted without material adjustment from our Unaudited Interim Condensed Consolidated Financial Statements. Our Consolidated Financial Statements are prepared in accordance with U.S. GAAP. Our functional and reporting currency is the ruble. The Unaudited Interim Condensed Consolidated Financial Statements reflect all normal and recurring adjustments that are necessary for a fair presentation of the financial position and results of operations for the interim periods presented. Results of operations for the nine month period ended 30 September 2012, are not necessarily indicative of results for the full year ending 31 December 2012, for any other interim period or for any future fiscal year.

	Years Ended 31 December			Nine Months Ended 30 September	
	2011	2010	2009	2012	2011
	(in millions of rubles)				
<b>Consolidated Results of Operations</b>					
<b>Revenues</b>					
Wireless revenues . . .	218,994	202,837	178,824	178,608	161,054
Wireline revenues . . .	15,194	7,496	674	13,394	10,555
Sales of handsets and accessories . . . . .	8,420	5,182	2,385	9,096	5,537
<b>Total revenues . . . . .</b>	<b>242,608</b>	<b>215,515</b>	<b>181,883</b>	<b>201,098</b>	<b>177,146</b>
<b>Cost of revenues</b>					
Cost of services . . . . .	47,644	41,648	33,128	41,437	34,025
Cost of handsets and accessories sold . . .	11,252	6,775	4,076	8,708	8,241
<b>Total cost of revenues . . . . .</b>	<b>58,896</b>	<b>48,423</b>	<b>37,204</b>	<b>50,145</b>	<b>42,266</b>
Sales and marketing expenses . . . . .	21,841	19,471	17,361	15,727	15,230
Operating expenses . .	61,049	49,847	39,126	49,288	44,060
Depreciation . . . . .	42,377	35,035	28,269	35,489	31,253
Amortisation . . . . .	5,299	3,839	3,075	4,594	3,728
<b>Operating income . . .</b>	<b>53,146</b>	<b>58,900</b>	<b>56,848</b>	<b>45,855</b>	<b>40,609</b>
<b>Other income/ (expense)</b>					
Interest expense . . . . .	(706)	(837)	(1,657)	(4,549)	(726)
Interest income . . . . .	3,591	4,008	3,255	1,047	2,606
Other gain/(loss), net . . . . .	30	18	(89)	(9)	83
Loss on derivatives, net . . . . .	(51)	(203)	(300)	—	(27)
Foreign currency exchange loss, net . . . . .	(105)	(700)	(2,192)	(8,758)	(406)
<b>Total other income/ (expense), net . . . . .</b>	<b>2,759</b>	<b>2,286</b>	<b>(983)</b>	<b>(12,269)</b>	<b>1,530</b>

	Years Ended 31 December			Nine Months Ended 30 September	
	2011	2010	2009	2012	2011
	(in millions of rubles)				
<b>Income before income taxes and noncontrolling interest</b> .....	<b>55,905</b>	<b>61,186</b>	<b>55,865</b>	<b>33,586</b>	<b>42,139</b>
Provision for income taxes .....	12,320	11,962	10,565	7,593	8,276
<b>Net Income</b> .....	<b>43,585</b>	<b>49,224</b>	<b>45,300</b>	<b>25,993</b>	<b>33,863</b>
Net (gain)/loss attributable to noncontrolling interest .....	(6)	(52)	(11)	(93)	46
<b>Net income attributable to MegaFon</b> .....	<b>43,579</b>	<b>49,172</b>	<b>45,289</b>	<b>25,900</b>	<b>33,909</b>
<b>Consolidated Cash Flows Data</b>					
Net cash provided by operating activities .....	97,295	86,613	79,350	82,170	74,510
Net cash provided by/ (used in) investing activities .....	(102,656)	(88,821)	(60,303)	37,647	(77,940)
of which cash paid for capital expenditures <sup>(1)</sup> ...	(73,332)	(63,860)	(46,036)	(33,589)	(50,419)
Net cash provided by/ (used in) financing activities .....	5,945	(7,161)	(10,583)	(104,608)	7,343
	As of 31 December			As of 30 September	
	2011	2010	2009	2012	2011
	(in millions of rubles)				
<b>Consolidated Balance Sheet Data</b>					
Cash and cash equivalents .....	2,887	2,667	12,550	17,012	6,232
Short-term investments .....	84,509	63,554	49,114	2,213	84,878
Property, plant and equipment, net ...	223,718	194,872	147,231	213,824	208,882
Total debt <sup>(2)</sup> .....	43,709	32,921	27,146	159,114	44,270
Net debt <sup>(3)</sup> .....	(45,689)	(33,605)	(34,518)	139,887	(49,924)
Working capital <sup>(4)</sup> ..	70,320	48,299	45,515	(24,290)	72,211
Total equity .....	276,632	233,126	183,914	86,627	267,118



	As of 31 December			As of 30 September	
	2011	2010	2009	2012	2011
	(in millions, unless stated otherwise)				
<b>Key Industry Data, Russian Federation only</b>					
Estimated mobile Subscribers (end of period) . . . . .	227.6	219.2	207.9	229.8	225.2
Mobile penetration (end of period) . . . . .	156.8%	151.0%	143.2%	160.9%	155.1%
<b>MegaFon Operating Data, Russian Federation only</b>					
Wireless Subscriber base (end of period) <sup>(5)</sup> . . . . .	61.6	56.6	50.2	62.8	59.7
Share of total Subscribers (end of period) <sup>(6)</sup> . . . . .	27.1%	25.8%	24.2%	27.3%	26.5%
MOU (in minutes per month) <sup>(7)</sup> . . . . .	288	285	275	294	286
ARPU (in rubles) <sup>(8)</sup> . . . . .	311	312	322	316	308
Churn rate <sup>(9)</sup> . . . . .	48.3%	49.8%	45.8%	36.7%	36.1%
Data Services User Base (end of period) <sup>(10)</sup> . . . . .	19.1	16.2	12.6	20.0	17.2
DSU (in megabytes per month) <sup>(11)</sup> . . . . .	628	256	47	1,006	564
ARPDU (rubles) <sup>(12)</sup> . . . . .	133	113	86	144	132
APPMb (rubles) <sup>(13)</sup> . . . . .	0.21	0.44	1.83	0.14	0.23
<b>Key Financial Data</b>					
Total revenue . . . . .	242,608	215,515	181,883	201,098	177,146
Gross profit <sup>(14)</sup> . . . . .	183,712	167,092	144,679	150,953	134,880
Gross margin <sup>(15)</sup> . . . . .	75.7%	77.5%	79.5%	75.1%	76.1%
OIBDA <sup>(16)</sup> . . . . .	100,822	97,774	88,192	85,938	75,590
OIBDA margin <sup>(17)</sup> . . . . .	41.6%	45.4%	48.5%	42.7%	42.7%
Total debt/ OIBDA <sup>(18)</sup> . . . . .	0.43	0.34	0.31	1.39	0.44
Net debt <sup>(3)/</sup> OIBDA <sup>(18)</sup> . . . . .	(0.45)	(0.34)	(0.39)	1.22	(0.50)
OIBDA/interest expense . . . . .	143	117	53	19	104
<p>(1) This represents the actual cash paid for capital expenditures, which may relate to capital expenditures accrued in other periods.</p> <p>(2) Total debt includes short term loans, long-term debt and current portion of long-term debt.</p> <p>(3) Net debt is total debt minus cash, cash equivalents, short-term investments and long-term deposits.</p> <p>(4) Working capital is total current assets less total current liabilities.</p> <p>(5) We define "Subscriber" as each SIM card that is connected to the network and that has had at least one chargeable traffic event within the preceding three months, whether chargeable to the Subscriber or to a third party (for example, interconnection charges payable by other operators).</p> <p>(6) MegaFon's share of total Russian Subscribers is the total number of MegaFon's Russian Subscribers at the end of a period divided by the total number of Russian mobile Subscribers at the end of such period.</p> <p>(7) We calculate MOU by dividing the total number of minutes of usage (including both outgoing and incoming calls) during a given period by the average number of our Subscribers during such period and dividing the result by the number of months in such period.</p>					

		<p>(8) We calculate ARPU for a given period by dividing the aggregate of our wireless revenues from local subscribers, revenues from data transfer services and revenues from VAS, revenues from interconnection charges and revenues from roaming charges to other operators for the same period by the average number of our Subscribers during that period, and further dividing the result by the number of months in that period.</p> <p>(9) We calculate churn rate as the number of Subscribers who cease to be Subscribers within a given period divided by the average number of Subscribers during that period. Churn rate for the nine months ended 30 September 2011 and 2012 is not presented on an annualised basis.</p> <p>(10) We define a “Data Services User” as a Subscriber who has used any of our data transfer services within the preceding three months.</p> <p>(11) We calculate DSU by dividing the total number of megabytes transferred by our network during a given period by the average number of data services users during such period and dividing the result by the number of months in such period.</p> <p>(12) We calculate our ARPDU for a given period by dividing our data services revenues for a given period by the average number of our data services users during that period, and further dividing the result by the number of months in that period.</p> <p>(13) We calculate our APPMb by taking ARPDU for a given period, and dividing by DSU in that period.</p> <p>(14) Gross profit is calculated as the difference between cost of revenues for a given period and total revenues for such period. Because this measure is based on the exclusion or inclusion of specific items, it may not be comparable to measures used by other companies which adopt similar measures.</p> <p>(15) Gross margin is calculated as gross profit for a given period divided by total revenues for such period.</p> <p>(16) OIBDA is a non-U.S. GAAP financial measure. OIBDA is defined as, in relation to any relevant period, the consolidated operating income for such period plus depreciation and amortisation. While depreciation and amortisation are considered operating costs under U.S. GAAP, these expenses primarily represent the non-cash current period allocation of costs associated with long-lived assets acquired or constructed in prior periods. OIBDA has limitations as an analytical tool, and should not be considered in isolation as an alternative to net income attributable to MegaFon, operating income or any other measure of performance under U.S. GAAP.</p> <p>(17) OIBDA margin is calculated as OIBDA for a given period divided by total revenue for such period.</p> <p>(18) The nine months data is presented on an annualised basis (the nine months data multiplied by 4/3).</p> <p>There has been no significant change in the financial or trading position of MegaFon since 30 September 2012, the end of the last financial period for which financial information has been published.</p>
<b>B.9</b>	<i>Where a profit forecast or estimate is made, state the figure.</i>	Not applicable; the Prospectus does not include a profit forecast or estimate.
<b>B.10</b>	<i>A description of the nature of any qualifications in the audit report on the historical financial information.</i>	Not applicable; there are no qualifications in the audit reports on the historical financial information.
<b>B.31</b>	<i>Information about the issuer of the underlying shares</i>	Please see B.1, B.2, B.3, B.4a, B.4b, B.5, B.6, B.7, B.9, B.10 and D.4.
<b>B.32</b>	<i>Name and registered office of the issuer of the depository receipts.</i>	The Depository is The Bank of New York Mellon (Luxembourg) S.A. The registered office of the Depository is located at Vertigo Building, Polaris, 2-4 rue Eugene Ruppert, L-2453, Luxembourg, Grand Duchy of Luxembourg.



**C.4**

*A description of the rights attached to the securities.*

Holders of our ordinary shares have the right to vote at all General Shareholders' Meetings. As required by the Joint Stock Companies Law and the Charter, all of our ordinary shares have the same nominal value and grant to their holders identical rights. Each fully paid ordinary share, except for treasury shares, gives its holder the right to:

- freely transfer the ordinary shares without the consent of other shareholders;
- receive dividends;
- participate in General Shareholders' Meetings and vote on all matters within the competence of General Shareholders' Meetings;
- transfer rights to vote in a General Shareholders' Meeting to a representative pursuant to a power of attorney;
- if holding, alone or with other holders, 1% or more of the ordinary shares, to access the list of persons entitled to participate in the General Shareholders' Meeting and to sue in court, on our behalf, members of the Board of Directors, the General Director and members of the Management Board for damages incurred by us as a result of their wrongful actions or failures to act;
- if holding, alone or with other holders, 2% or more of the ordinary shares, within 60 days after the end of our fiscal year, make proposals for the annual General Shareholders' Meeting and nominate candidates to the Board of Directors and the Revision Commission;
- if holding, alone or with other holders, 10% or more of the ordinary shares, demand that the Board of Directors call an extraordinary General Shareholders' Meeting or an unscheduled audit by the Revision Commission;
- demand repurchase by us of all or some of our ordinary shares held by the shareholder if the shareholder voted against or did not participate in the voting on the decision approving any of the following actions:
  - our re-organisation,
  - the conclusion of a major transaction involving assets valued in excess of 50% of the balance sheet value of our assets; or
  - amendment to the Charter or approval of a new version of the Charter in a manner that restricts shareholders' rights;
- upon our liquidation, receive an amount of our residual assets (after fulfilment of our obligations to creditors) proportionate to their shareholding;

- have access to certain of our documents, receive copies for a reasonable fee, and if holding (alone or with other holders) 25% or more of the ordinary shares, have free access to minutes of our Management Board and accounting documents; and
- exercise other shareholder rights, provided by our Charter, Russian legislation or duly approved decisions of General Shareholders' Meetings.

Each GDR carries the right to vote one ordinary share, subject to the provisions of the Terms and Conditions of the GDRs and applicable Russian law. Each ordinary share carries one vote.

The Depositary has agreed to pay holders of the GDRs on the relevant record date the cash dividends or other cash distributions it or the Custodian receives on the underlying ordinary shares, subject to restrictions imposed by applicable law. Subject to applicable law, investors will receive these distributions in proportion to the number of ordinary shares their GDRs represent.

Each GDR represents an interest in one ordinary share on deposit with Sberbank of Russia as Custodian. A holder of GDRs will have the rights set out in the Terms and Conditions of the GDRs and the Master GDRs, which may be summarised as:

- the right to withdraw the underlying shares;
- the right to receive payment in United States dollars from the Depositary of an amount equal to cash dividends or other cash distributions received by the Depositary from the Company in respect of the underlying shares;
- the right to receive from the Depositary additional GDRs representing additional shares received by the Depositary from the Company by way of dividend or free distribution (or if the issue of additional GDRs is deemed by the Depositary not to be reasonably practicable, the net proceeds in United States dollars of the sale of such shares);
- the right to receive from the Depositary any dividend or distribution in the form of assets other than shares or cash received by the Depositary from the Company (or if such distribution is deemed by the Depositary not to be reasonably practicable, the net proceeds in United States dollars of the sale of such assets);
- the right to request the Depositary to exercise subscription or similar rights made available by the Company to holders of shares (or if such process is deemed by the Depositary not to be lawful and reasonably practicable, the right to receive the net proceeds in United States dollars of the sale of the relevant rights or the sale of the assets resulting from the exercise of such rights);

		<ul style="list-style-type: none"> <li>the right to instruct the Depositary regarding the exercise of any voting rights notified by the Company to the Depositary;</li> <li>the right to receive from the Depositary copies received by the Depositary of notices provided by the Company to holders of shares or other material information;</li> </ul> <p>in each case subject to applicable law, and the detailed terms set out in the Terms and Conditions of the GDRs and the Master GDRs.</p>
<b>C.5</b>	<i>A description of any restrictions on the free transferability of the securities.</i>	<p>The GDRs and the Offer Shares will be subject to certain restrictions on transfer designed to ensure compliance with the provisions of relevant laws in certain jurisdictions applicable to the transferor and/or the transferee. In particular, the GDRs cannot be transferred to or for the benefit of any persons resident, incorporated or located in the Russian Federation who are not qualified investors in accordance with Russian law. Furthermore, transfers of the Securities shall be made in compliance with any applicable securities law of any state or other jurisdiction of the United States.</p> <p>Under Russian law, a holder of our ordinary shares may freely transfer the shares without the consent of other shareholders and OJSC MegaFon.</p>
<b>C.6</b>	<i>An indication as to whether the securities offered are or will be the object of an application for admission to trading on a regulated market and the identity of all the regulated markets where the securities are or are to be traded.</i>	<p>Our ordinary shares have been listed on quotation list “V” of MICEX since 27 September 2012 under the symbol MFON. Trading in the ordinary shares on MICEX is expected to commence on or about [●] 2012. MICEX is not an EEA regulated market.</p>
<b>C.7</b>	<i>A description of dividend policy.</i>	<p>Pursuant to a voting agreement entered into by, <i>inter alia</i>, TeliaSonera Group and AF Telecom, our Board of Directors adopted a dividend policy on 8 June 2012 (the “<b>Dividend Policy</b>”).</p> <p>In making the decision on the amount of the dividend the following factors (the “<b>Relevant Factors</b>”) shall be taken into account:</p> <ul style="list-style-type: none"> <li>the amount of consolidated net profit of OJSC MegaFon for the first quarter, first six months or first 9 months of the current financial year or the results of the full financial year;</li> <li>our Group’s need for financial resources for business development and strategy implementation purposes;</li> <li>the ability of our Group to meet its obligations as they fall due;</li> <li>other factors that in the judgement of the Board of Directors should have an impact on the amount of the dividend, including, without limitation, factors that may lead to OJSC MegaFon losing its investment grade rating assigned by the international credit rating agencies Moody’s, S&amp;P or Fitch.</li> </ul>



When determining the amount of the dividend to be recommended for distribution, the Board of Directors of OJSC MegaFon shall proceed from the assumption that the total funds to be allocated to a payment of dividends as a general rule shall be equal to (subject to the restrictions established by the legislation of the Russian Federation (Article 43 of the Joint Stock Companies Law) and subject always to the Relevant Factors) the aggregate of:

- (a) the higher of:
  - 1) 70% of the value that is determined as the amount of “Net Profit” plus amortisation and depreciation minus “Investments” for the last financial year, and
  - 2) 50% of “Net Profit” for the last financial year; and
- (b) a value (which may be negative) corresponding to the Net Debt capacity of OJSC MegaFon within the bounds of the “Optimal Capital Structure”.

For the purposes of the Dividend Policy, the following definitions apply:

“**Net Profit**” means, for the 12 months ended December 31 of the last financial year, the amount of net profit exclusive of the effect of non-cash items based on data of the annual consolidated profit and loss statement of OJSC MegaFon prepared in accordance with U.S. GAAP or IFRS, as applicable.

“**Investments**” means the amount of capital expenditures on fixed assets and intangible assets excluding expenditures on acquisition of companies (M&A) based on the consolidated financial statements of OJSC MegaFon for the 12 months ended December 31 of the last financial year.

“**Optimal Capital Structure**” means the level of Net Debt that would result in a ratio of Net Debt to Adjusted OIBDA as recommended by the Board of Directors of the Company in the range of 1.2-1.5 as of and for the 12 months ended December 31 of the last financial year based on the consolidated financial statements of OJSC MegaFon as at and for the 12 months ended December 31 of the last financial year.

“**Net Debt**” at any time means the aggregate amount of financial indebtedness calculated according to the nominal, principal or other amount in which financial indebtedness should be reflected in the consolidated balance sheet as at December 31 of the last financial year of the Company less cash and cash equivalents (after giving effect to the dividend which is proposed to be paid). The Company expects also to deduct short-term investments and long-term deposits in the calculation of Net Debt for these purposes.

“**Adjusted OIBDA**” for the relevant financial year means the amount of Net Profit adding back depreciation and amortisation.

C.13	<i>Information about the underlying shares.</i>	Please see C.1, C.2, C.3, C.4, C.5, C.6 and C.7.
C.14	<p><i>Information about the depositary receipts.</i></p> <p><i>Describe the exercise of and benefit from the rights attaching to the underlying shares, in particular voting rights, the conditions on which the issuer of the depositary receipts may exercise such rights, and measures envisaged to obtain the instructions of the depositary receipt holders—and the right to share in profits and any liquidations surplus which are not passed on to the holder of the depositary receipt.</i></p>	<p>Please see C.1, C.2, C.4, and C.5.</p> <p>The Terms and Conditions of the GDRs set out the provisions relating to the exercise of and benefit from the rights attaching to the ordinary shares. The following summarises relevant provisions of the Terms and Conditions of the GDRs relating to the exercise of and benefit from rights attaching to the underlying shares.</p> <p><b>Voting Rights</b></p> <p>The rights of Holders of GDRs regarding voting rights arising in respect of the shares represented by GDRs may be summarised as follows.</p> <p>Each Holder, following receipt from the Depositary of copies of the information provided by the Company (including notice and agenda for a meeting of shareholders of the Company and any proposed written resolution of the Company) is entitled to give instructions to the Depositary to vote for or against, or abstain from voting on, each and any resolution specified in the agenda for the meeting or proposed as a written resolution. Each voting instruction from a Holder must be in the form required by the Depositary.</p> <p>Exercise of voting rights from Holders will be subject in each case to Russian law and the Depositary’s determination of what is reasonably practicable, which may mean that in some cases the Depositary can only procure the exercise of the number of votes representing the net positive difference between total votes in favour of a resolution and total votes opposed to such resolution, or cannot procure the exercise of any votes. In addition, if the Company notifies the Depositary that applicable Russian law or regulations permit Deposited Shares to be deprived of rights in certain circumstances, the Depositary is obliged to comply with reasonable written instructions from the Company to withhold such rights from Holders and/or owners of some or all of the GDRs.</p> <p><b>Rights issues</b></p> <p>The rights of Holders of GDRs regarding subscription or similar rights arising in respect of the shares represented by GDRs may be summarised as follows.</p> <p>Each Holder of GDRs is entitled, subject in each case to applicable law and to the provision by the Holder of relevant information required by the Depositary and relevant payments (including fees, taxes, duties, charges, costs and expenses required under the Deposit Agreement), and to the extent reasonably practicable, either: (i) to request the Depositary to exercise rights to subscribe for or to acquire Shares, securities or other assets where such rights are made available by the Company to Holders of Shares (and where applicable, to subscribe for additional rights not subscribed by other Holders of GDRs); or (ii) to receive a distribution of such rights or the proceeds of any sale thereof.</p>

	<p><i>Description of the bank or other guarantee attached to the depository receipt and intended to underwrite the issuer's obligations.</i></p>	<p>The Company has agreed it will not unreasonably withhold its consent to, and if it has consented will use all reasonable endeavours to facilitate, any such distribution, sale or subscription by the Depository or the Holders, as the case may be, pursuant to the GDR Conditions.</p> <p><b>Payment entitlements</b></p> <p>The only cash amounts to which a Holder of GDRs are entitled are:</p> <ul style="list-style-type: none"> <li>• a United States dollar amount equal to: (i) the amount of any cash dividend or other cash distribution on or in respect of the shares represented by the Holder's GDRs (including any amounts received in the liquidation of the Company) or otherwise in connection with such shares received by the Depository; or (ii) the net proceeds of sale of any shares received by the Depository from the Company by way of dividend or free distribution where issuance of GDRs representing such shares is deemed by the Depository not to be reasonably practicable; or (iii) the net proceeds of sale of assets (other than shares or cash) received by the Depository from the Company where distribution of such assets to GDR Holders is deemed by the Depository not to be reasonably practicable; or (iv) the net proceeds of sale of subscription or other rights made available to the Depository as a holder of shares by the Company (or the sale of the assets resulting from the exercise of such rights) where the exercise of such rights by the GDR Holders is deemed not to be lawful or reasonably practicable; and</li> <li>• on cancellation of GDRs or termination of the Deposit Agreement, amounts equal to the cash amounts currently held by the Depository for the Holder of each cancelled GDR or GDR in issue at the time of termination of the Deposit Agreement;</li> </ul> <p>in each case subject to applicable law, and the detailed terms set out in the Terms and Conditions of the GDRs and the Master GDRs.</p> <p>Not applicable; there are no bank or other guarantees attached to the depository receipts.</p>
<b>Section D — Risks</b>		
<p><b>D.2</b></p>	<p><i>Key information on the key risks that are specific to the issuer of the underlying shares.</i></p>	<p>There are a number of key risks: competition in the telecommunications market and the changing nature of the telecommunications market, dependence on the availability of licences and frequency allocations and the maintenance and development of our network infrastructure and the continued expansion of our business, including by way of investments in or mergers with other companies.</p>

		<p>There are also a number of legal risks, namely issues relating to competition law — including ongoing litigation — and possible changes to the legal and regulatory environment in the Russian Federation, in particular risks relating to future changes in the regulatory framework as it relates to the regulation of telecommunications companies and the services they provide.</p> <p>Further, we rely on senior management and our suppliers, and encounter difficulties in protecting various rights, including intellectual property rights, data protection rights, and those derived from interconnection agreements. In addition, risks arise from our engaging transactions with interested parties, our financial condition, the political, social, and economic environment in the Russian Federation and taxation issues.</p> <p>Risks may also arise in relation to the shareholder re-organisation and possible disagreements between our shareholders, one of which, Mr Alisher Usmanov, is our controlling shareholder. Further to what has been reported in the media with respect to the ongoing re-organisation and consolidation of certain of Mr Alisher Usmanov’s business interests into a new holding company, together with the interests of his long term partners (Mr Vladimir Skoch and Mr Ardavan Farhad Moshiri) in Metalloinvest, a leading Russian iron ore producer, Mr Usmanov has entered into a definitive shareholders’ agreement with these aforementioned long-term partners on [●] 2012. Pursuant to this, Mr Usmanov will hold 100% of the voting rights with respect to the holding company and so will continue to control OJSC MegaFon, while Mr Skoch and Mr Moshiri will hold purely economic interests and exercise no control over management of OJSC MegaFon.</p>
<b>D.4</b>	<i>Information about the issuer of the underlying shares:</i>	Please see D.2.
<b>D.5</b>	<i>Key information on the key risks that is specific to the securities.</i>	<p>There is a risk that an active and liquid market for the Securities may not develop. In addition, dividends may not be paid in the future, and GDR holders may be subject to limitations or delays on their ability to repatriate earnings from distributions made on the GDRs. There exist further risks for GDR holders that their ownership will not be recognised, that there are potential difficulties in depositing shares and further that they might not be taxed correctly.</p> <p>In addition, there is a risk that changes in Russian regulatory policy might occur with respect to the placement and circulation of shares outside the Russian Federation in the form of GDRs or otherwise. Also, potentially difficulties may arise in exercising voting and dividends rights in respect of the shares underlying the GDRs following the entry into force of new Russian legislation on 1 January 2013. Further, there is the risk of limitations on voting rights with respect to the ordinary shares underlying the GDRs arising from Russian law and the Terms and Conditions of the GDRs.</p>

**Section E — Offer**

<p><b>E.1</b></p>	<p><i>The total net proceeds and an estimate of the total expenses of the issue/offer.</i></p>	<p>The gross proceeds of the Offering will be approximately [●]. The net proceeds that we will receive from the Offering by virtue of the Securities sold by our subsidiary, MegaFon Investments (Cyprus) Limited, (assuming no exercise of the Over-allotment Option) and after deduction of underwriting commissions, fees and expenses incurred in connection with the Offering of approximately U.S.\$ [●], will be approximately U.S.\$ [●].</p> <p>We will not receive any proceeds from the sale of Securities by Sonera Holding B.V.</p>
<p><b>E.2a</b></p>	<p><i>Reasons for the offer, use of proceeds, estimated net amount of the proceeds.</i></p>	<p>The net proceeds of the Offering received by us will be used as follows:</p> <ul style="list-style-type: none"> <li>• approximately U.S.\$ [●] will be used to repay and/or refinance existing debt; and</li> <li>• the remainder will be used for general corporate purposes, including the continuing development and expansion of MegaFon’s network.</li> </ul>
<p><b>E.3</b></p>	<p><i>A description of the terms and conditions of the offer.</i></p>	<p><b>The Offering</b></p> <p>The Selling Shareholders are offering an aggregate of up to [●] of our ordinary shares, consisting of [●] GDRs and [●] Offer Shares. One GDR will represent an interest in one ordinary share.</p> <p>The Offering comprises (i) an offering of GDRs and Offer Shares outside of the Russian Federation, and (ii) an offering of Offer Shares in the Russian Federation. The GDRs and Offer Shares are being offered outside the United States in reliance on Regulation S and within the United States to certain QIBs, as defined in, and in reliance on, Rule 144A of the Securities Act.</p> <p>The offer price is U.S.\$[●] per Offer Share / per GDR.</p> <p>The GDRs are expected to be issued, and payment for them to be made, on or about [●] 2012.</p> <p>The Offer Shares are expected to be sold from [●] 2012, and payment for them is expected to be made on or about [●] 2012.</p> <p><b>Over-allotment Option</b></p> <p>The Selling Shareholders have, <i>pro rata</i> to the number of GDRs and Offer Shares being sold by each of them, granted an Over-Allotment Option to the Joint Global Coordinators on behalf of the Joint Bookrunners to acquire up to [●] additional ordinary shares in the form of ordinary shares and GDRs at the Offer Price for the purpose of covering over-allotments and other short positions, if any, in connection with the Offering. The Over-Allotment Option is exercisable upon written notice to the Selling Shareholders at any time up to and including the thirtieth day following the announcement of the Offer Price. If the Joint Global Coordinators on behalf of the Joint Bookrunners exercise the Over-Allotment Option, the Selling</p>

		Shareholders will be obligated to sell and each Joint Bookrunner will be severally obligated, subject to the conditions contained in the Underwriting Agreement, to purchase, a number of additional ordinary shares in the form of ordinary shares and GDRs proportionate to that Joint Bookrunner's initial amount indicated in the table in "Plan of Distribution". The Over Allotment Option is granted to the Joint Bookrunners as part of the Underwriting Agreement for no additional consideration to the Selling Shareholders from the Joint Bookrunners.
<b>E.4</b>	<i>A description of any interest that is material to the issue/offer including conflicting interests.</i>	Not applicable.
<b>E.5</b>	<i>Name of the person or entity offering to sell the security.</i>  <i>Lock-up agreements.</i>	The Securities are being offered by MegaFon Investments (Cyprus) Limited (a subsidiary of OJSC MegaFon), and Sonera Holding B.V.  Each of OJSC MegaFon, the Selling Shareholders, TeliaSonera AB, Garsdale, Telecominvest Holdings Limited and CJSC Telecominvest has agreed not to, without the consent of the Joint Global Coordinators on behalf of the Joint Bookrunners (except in limited circumstances), issue, offer, sell or otherwise transfer any of our ordinary shares or securities convertible or exchangeable into or exercisable therefor for a period of 180 days after the Closing Date.
<b>E.6</b>	<i>The amount and percentage of immediate dilution resulting from the offer.</i>	Not applicable; there will be no immediate dilution resulting from the offer, since the GDRs being offered represent ordinary shares which are already outstanding.
<b>E.7</b>	<i>Estimated expenses charged to the investor by the issuer or the offeror.</i>	Not applicable; no expenses will be charged to the investor.



## RISK FACTORS

*An investment in the Securities involves a high degree of risk. Prospective investors should consider carefully, among other things, the risks set forth below and the other information contained in this document prior to making any investment decision with respect to the Securities. The risks highlighted below could have a material adverse effect on our business, financial condition, results of operations or prospects, in which case the trading price of the Securities could decline and you could lose all or part of your investment. Prospective investors should note that the risks described below are not the only risks we face. We have described only the risks we consider to be material. However, there may be additional risks that we currently consider immaterial or of which we are currently unaware, and any of these risks could have the effects set forth above.*

### **Risks Relating to our Business and Industry**

#### ***We face intense competition***

The Russian telecommunications market is highly competitive (see “The Russian Telecommunications Industry—Our Key Competitors”). Currently, our principal competitors are the other two members of the Big Three, MTS and VimpelCom, and OJSC Rostelecom (“**Rostelecom**”), an operator controlled by the Russian Government.

MTS and VimpelCom have actively invested in acquisitions of fixed-line operators in the Russian Federation, which led to the diversification of their business from mobile to fixed. By comparison, notwithstanding our recent acquisitions, we have not been as aggressive in our diversification from pure mobile into fixed-mobile business. Were MTS and VimpelCom able to effect fixed-mobile convergence synergies (for example, by lowering their customer churn due to bundled triple and quadruple play offerings), this might result in erosion of our market share. MTS and VimpelCom have also actively invested in acquisitions of mobile and fixed-line operators outside the Russian Federation. As we have not chosen a similar acquisition path, it may create synergies for their businesses which are not available to ours. It also allows them to diversify their risk profiles through several markets. MTS’ and VimpelCom’s geographical scale means that, due to bulk buying discounts, they may obtain better terms than we may from their suppliers, thus lowering their capital and operational expenditures and improving the efficiency of their businesses.

On 1 April 2011, the Russian Government completed the first phase of the re-organisation of the state controlled telecommunications companies OJSC Svyazinvest (“**Svyazinvest**”) and Rostelecom, by transferring to Rostelecom the fixed-line business of Svyazinvest. This re-organisation fits with the recent strategy of the Russian Government of playing a greater role in the telecommunication sector (demonstrated also by the allocation on 8 September 2011 of LTE/4G frequency band in the range of 2300-2400 MHz to Osnova Telecom, a company affiliated with the Ministry of Defence), an approach also pursued by potentially creating a “national champion” out of Rostelecom. As a result, Rostelecom is currently the largest fixed-line operator and fifth largest mobile operator in the Russian Federation. In addition, in March 2011 Rostelecom was awarded 39 out of 40 licences offered to provide LTE/4G services within the 2300-2400 MHz frequency band and on 30 November 2011 received permission for the use of such frequencies for the deployment of an LTE/4G network. Furthermore, Rostelecom was, along with us and the other members of the Big Three, awarded a nationwide LTE/4G licence in July 2012. Moreover, in the second half of 2012, Rostelecom acquired 100% of SkyLink, a mobile operator holding 2G and 3G licences in various micro-regions of the Russian Federation, with a coverage capability of more than 90% of the population of the Russian Federation. Rostelecom’s Government support might give it a significant advantage in building its network and improving its market share. There is a strong possibility that the Government might overtly favour the activities of Rostelecom, either by providing administrative and financial resources to it or by holding back our activities and those of our other two principal competitors using its regulatory and other powers.

In addition, we face competition from regional operators such as Tele2, the fourth largest mobile operator in the Russian Federation by number of subscribers as of 30 September 2012<sup>1</sup>, which is gaining mobile market share with the acquisition of new licences and frequencies and through aggressive pricing. Furthermore, there has been speculation in the press in the past that Rostelecom and Tele2 might be exploring a merger; a consolidation of these two entities would create a powerful competitor, with both a strong position in the mobile market and the influential backing of the Russian Government.

The increasing appetite of the market for state of the art telecommunication services implies that we also compete with our partner and recent affiliate Yota (see “Business—Certain Contracts and Projects Relating to the

<sup>1</sup> Source: AC&M Consulting.

Operation of our Business—Yota MVNO Agreement” and “Principal and Selling Shareholders—Changes in Shareholding Structure and Ultimate Beneficial Owners—AF Telecom Shareholder Arrangements”). Yota launched the first commercial LTE/4G network in the Russian Federation at the end of 2011 and its bandwidth capacity in the upper frequencies remains greater than that granted to us in connection with the LTE/4G licence that we were issued on 25 July 2012. Yota has a very strong consumer-oriented brand and is quickly converting its pre-existing WiMAX network to the LTE/4G standard. Despite our mobile virtual network operator (“MVNO”) agreement with Yota, as a result of which in 2012 we started offering LTE/4G services to our customers in fourteen major Russian cities (Novosibirsk, Moscow, Sochi, Krasnodar, Samara, Vladivostok, Ufa, Kazan, St. Petersburg, Kostroma, Tula, Vladimir, Yoshkar-Ola and Khabarovsk) and expect to cover more than 40 cities by the end of the year, we cannot give any assurances that the earlier launch of Yota’s LTE/4G service will not adversely affect our subscriber base or result in Yota gaining a larger share of the LTE/4G market than we can achieve.

We also face competition from players involved in alternative communications technologies, such as internet service providers and over the top (“OTT”) service providers. There are strong national and regional fixed ISPs in the Russian retail market, including our direct competitors MTS and VimpelCom, and specialised broadband providers such as ErTelecom and Akado. Not only are these companies direct competitors to our fixed broadband offering, they also represent a threat to our mobile data services business as an increasing percentage of mobile data is consumed while stationary. In addition, OTT service providers (both Russian and international) such as VKontakte, Odnoklassniki, Yandex, Google and Facebook pose a threat to our business since customers are increasingly focussing on the content that they receive by virtue of our services (such as e-mail, social networks, video, music, games and other content) as opposed to the communication services themselves. As a result, customers might begin to view our services as merely a conduit to receive other services, rather than a service in and of itself. This would negatively affect our relationship with our customers and so affect the amount they are willing to pay for our services. To combat this trend, we developed MegaLabs, our wholly owned subsidiary. The goal of MegaLabs is to develop new products and services to be brought onto our networks. We cannot, however, give any assurances that MegaLabs will be successful in preventing this risk from materialising. For further details on MegaLabs, see “Business—Certain Contracts and Projects Relating to the Operation of our Business—MegaLabs”.

Accordingly, while the existing competitive landscape poses significant challenges for us, the future suggests only increased competition. We cannot assure you that we will be able to meet these competitive challenges successfully.

***We rely heavily on our wireless business and on the retail (B2C) customer segment***

Despite our position as a universal telecommunication provider, we remain highly dependent on our wireless business. During the nine months ended 30 September 2012, 88.8% of our total revenue was derived from wireless services. There are certain business benefits to offering both fixed and wireless services, as such integration reduces customers’ churn and can attract the promising B2B market. In light of this, we have broadened our fixed-line business and we currently own an extensive fixed-line network. However, our principal competitors have entered the fixed-line market before us. Furthermore, the integration of our services is not yet complete and might further delay our capacity to provide fully integrated services to our clients. This in turn might have a material adverse effect on our business, financial condition, results of operations and prospects.

Within the wireless business, we continue to rely heavily on voice and short messaging services (“SMS”) as two primary products from which we derive the majority of our revenues. Should trends such as price competition in these products, Voice over IP or customer preference for data over voice significantly accelerate and start materially influencing our business, as has already occurred in other markets outside of the Russian Federation, we may be faced with a significant decline in our revenues.

We are also greatly dependent on the retail (B2C) segment of the market. While the B2C segment has historically been the largest customer segment in the Russian telecommunications market, the other customer segments (B2B, B2G and B2O) are also growing (see “Business—Operations—Client Base”). Moreover, a strong presence in the B2B segment may help reduce churn in the B2C segment as B2B customers may choose to use their family’s telecommunications budget with the same telecommunication provider that provides them with business services. We have tried to mitigate this risk with the acquisition of companies with a strong foothold in the B2B sector, such as Synterra, and we plan to continue to diversify our sources of revenue in the future. We cannot, however, give any assurances that our efforts will prove successful and that our dependence on the B2C segment might not have a material adverse effect on our business, financial condition, results of operations and prospects.

***Mobile telephony in the Russian Federation is a mature industry and, in order to continue to grow meaningfully, we must develop new products and services***

As of 30 September 2012, mobile penetration in the Russian Federation was estimated to be 160.9%<sup>2</sup>. Even allowing for subscribers who hold multiple SIM cards, it is estimated that, as of 31 December 2011, approximately 94.6% of the Russian population living in urban conglomerates of over 100,000 inhabitants were mobile subscribers<sup>3</sup>. Accordingly, there are clearly limits on the extent to which we can continue to grow our subscriber base. While it is possible to take subscribers from other operators, subscriber loyalty in the Russian Federation is relatively low and there is no assurance that subscribers, once induced to switch to us, would not soon go elsewhere. Competition for subscribers has in the past, and may in the future, create additional pricing pressure among operators, which could have a material impact on our margins and profitability. For example, if one or more of our competitors decide to aggressively pursue increases in their market share, we may be forced to follow suit, a race which would result in higher subscriber acquisition costs (“SAC”).

As a result of these factors, we have started to develop other platforms, products and services to attract and retain subscribers. We have started expanding into the broadband data transfer and fixed-mobile convergence sectors, both by developing our own network and through acquisitions, and we have also created MegaLabs. However, we face significant challenges. While our backbone and backhaul fibre-optic network spanned over 130,000 kilometres as of 30 September 2012, additional investment will be required should we wish to expand it further. In addition, we cannot give any assurances that we will be able to create and maintain competitive broadband and fixed-mobile convergent offerings. While we may consider further potential acquisitions in this sector, there is a limited number of attractive targets and there is no assurance that we would be successful in obtaining the requisite regulatory approvals from the Federal Anti-Monopoly Service (the “FAS”). Accordingly, no assurance can be given that we will be successful in providing broadband and convergent fixed-mobile offerings and other new products and services in the future, or that, if successful, it will result in an increased customer base and greater profits for us.

In addition, MegaLabs, which is tasked with developing and bringing to market new value-added products and services, is a new venture with no proven track record and, accordingly, we cannot give any assurances as to the degree of its success.

***Any failure to keep pace with technological changes and evolving industry standards could harm our competitive position***

In the telecommunications industry, technology changes rapidly and standards evolve over time. Our success depends, in part, on our ability to identify and deploy the most promising new technologies quickly, as well as on our ability to retire obsolete technologies. In this respect, among the most important challenges facing us are the needs to:

- effectively integrate new and leading technologies;
- continue to develop our technical expertise;
- influence emerging industry standards; and
- respond to other technological changes.

We may not be able to meet all of these challenges in a timely and cost-effective manner.

Additionally, technologies we utilise today may become obsolete or be subject to competition from new technologies for which we may be unable to obtain appropriate licences. In particular, while 3G technology, which we currently deploy throughout the country, is significantly superior to existing second generation standards, such as GSM, particularly in providing advanced data and content services, the industry is already moving towards the next generation of wireless technology, known as the long term evolution (“LTE”) standard or fourth generation (“4G”), which promises to provide even greater access to data and services through enhanced download and upload speeds. Accordingly, our future success might partly depend on Government policy towards and regulation of LTE/4G and other future standards, as well as on our being among the first licensees of any such technology. To this end, we started offering LTE/4G services to our customers in fourteen major Russian cities in 2012 (Novosibirsk, Moscow, Sochi, Krasnodar, Samara, Vladivostok, Ufa, Kazan, St. Petersburg, Kostroma, Tula, Vladimir, Yoshkar-Ola and Khabarovsk), by virtue of our MVNO agreement

<sup>2</sup> Source: AC&M Consulting.

<sup>3</sup> Source: Comcon.

with Yota and expect to cover more than 40 cities by the end of the year (for more information on Yota, see “—We face intense competition” and “Business—Certain Contracts and Property Relating to the Operation of Our Business—Yota MVNO Agreement”). In addition, on 25 July 2012 we were issued a nationwide LTE/4G licence (see “Business—Licences—LTE/4G and MVNO Licences”). However, we may not be able to successfully implement our own LTE/4G network or to deal with any other future technological changes in the industry which could adversely affect our business, financial condition, results of operations and prospects.

***Expansion of mobile virtual network operators may increase competition and churn in the Russian mobile services market***

On 29 December 2008, the Ministry of Communications and Mass Media (the “**Ministry of Communications**”) adopted a decree establishing the legal framework for mobile virtual network operators (“**MVNOs**”) in the Russian Federation. MVNOs are companies that provide mobile communications services but do not own the radio frequencies and, often, the network infrastructure, required to do so. MVNOs in the Russian Federation are required to obtain a special licence, and their use of radio frequencies and infrastructure is to be exercised on the basis of agreements entered into between MVNOs and frequency holders. However, as a general rule, there is no legal obligation for the frequency holders to enter into such agreements with MVNOs. Such an obligation, however, might be imposed in specific cases by the regulator as a way to favour competition. For example, FAS has recently prescribed that Yota make its LTE/4G frequencies available pursuant to the MVNO model to other telecommunications operators as a condition for the approval of the transaction that has changed the shareholdings of AF Telecom and made Yota one of our related parties. See “Principal and Selling Shareholders—Changes in Shareholding Structure and Ultimate Beneficial Owners—AF Telecom Shareholders Arrangements”.

While we may, along with other frequency holders, receive revenues from MVNOs for the use of our frequencies and network infrastructure, we expect these revenues to be lower than those we would receive by providing services directly to subscribers. In addition, in the event we lose subscribers to MVNOs that lease their frequencies and infrastructure from an operator other than us, we will be deprived of the revenue streams from both the subscribers and the MVNOs. The MVNOs may also establish favourable tariffs, which could increase churn and/or drive down the tariffs of all Russian mobile operators.

While we think that the MVNO model might be attractive for our business in some cases (such as our MVNO agreement with Yota), MVNOs’ further expansion may increase competition and churn in the Russian telecommunications market, and, as a result, have a material adverse effect on our business, financial condition, results of operations and prospects.

***Changes to the regulations concerning roaming tariffs may adversely affect our business***

In 2010, the Russian Government announced its intent to monitor the pricing of roaming services. As a result, FAS conducted an investigation of the activities of Russian telecommunications operators and found that we, MTS and VimpelCom violated antimonopoly laws relating to our pricing for roaming services. Subsequently, on 22 February 2011, FAS imposed an administrative fine of approximately 4.2 million rubles on us (being 1.0% of the revenues we derived from roaming communication services in the Commonwealth of the Independent States (“**CIS**”). 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. Furthermore, the Minister of Communications has recently announced that the Ministry of Communications is currently preparing a revised version of the Telecommunications Law which is intended, *inter alia*, to eliminate the intra-network roaming charges. It is not currently clear whether this legislation will be adopted. However, if the new legislation is adopted, we believe that our revenues from the provision of roaming services would decline considerably, which could have a material adverse effect on our financial condition and results of operations.

In addition, in 2011, the Russian Government continued its efforts to decrease the level of prices for 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. Following the Governmental initiatives and discussions with FAS, we were the first among the Big Three mobile operators to renegotiate contracts with our international roaming partners in Europe, including the European part of the CIS and Turkey, with a view to reducing tariffs and increasing roaming traffic. See “Business—Operations—Our Services—Roaming”. However, if the Russian Government considers the recent reduction of our roaming tariffs as insufficient, it may require us to further reduce our roaming tariffs, which could adversely affect our revenues and financial condition.



***Proposed changes to Russian legislation may adversely affect our business***

FAS has repeatedly expressed its intention to oblige mobile operators to base all their tariffs on per-second billing for domestic calls, or at least to decrease the maximum possible billing interval, which is currently minute-based. As a result, in the current draft of the rules on rendering mobile communication services (the “**Draft Rules**”), which is being developed by the Ministry of Communications, a provision has been introduced requiring mobile operators to establish in each Russian micro-region at least one tariff with per-second billing and at least one tariff with a 10-second billing interval in roaming. In addition, the Draft Rules also contain certain provisions concerning an operator’s obligations to alert subscribers about changes in the terms of certain services provided, including change of tariffs, availability of roaming services, services not included in certain packages, etc. The Draft Rules have not been adopted yet, but if they become effective, the proposed changes may lead to additional expenses, including those for expansion of our billing and information systems, and therefore might adversely affect our revenues and results of operations.

Additionally, former President Dmitry Medvedev recently called for the implementation of new rules to allow customers in the Russian Federation to retain their mobile phone numbers after switching their mobile operator and asked the Ministry of Communications and the Prosecutor General’s Office to review this issue. On 28 May 2012, the Ministry of Communications published a draft law containing amendments to the Telecommunications Law. Such amendments would permit mobile subscribers to use the mobile number portability (“**MNP**”) service free of charge from 1 January 2014. However, as far as we are aware, the Government of the Russian Federation is considering launching MNP from March 2014, and requiring subscribers to pay nominal fees for using such service. Furthermore, MNP would initially be implemented only at the regional level (thus allowing subscribers to retain their mobile phone numbers only after switching their mobile operator within the same region). The MNP service will entitle mobile users to retain their mobile telephone numbers when changing mobile network operator without obtaining the approval of the Federal Communications Agency (as was previously required). In addition, the Ministry of Communications plans to set up a number database for subscribers who have taken advantage of MNP. The expenses involved in establishing and maintaining this database will be financed by mobile operators. The total expense to be shared by mobile operators encompasses: (i) a one-off cost of approximately U.S.\$10 million, and (ii) ongoing annual costs of approximately U.S.\$100 million (as estimated by the Ministry of Communications in the explanatory note to the draft amendments). It is estimated that the total expense that will be incurred by all mobile operators for the network upgrades required to launch MNP will be around U.S.\$400 million. According to our current estimates, our own expenses associated with the MNP launch may be approximately U.S.\$60 million in case it is implemented at regional level and up to U.S.\$100 million in case of federal implementation. If the draft rules that require MNP are brought into force, they may result in changes in the current market shares of the Russian telecommunications operators and have a material adverse effect on our financial condition and results of operation.

Furthermore, potential regulatory changes that may be enacted in the future, such as the introduction of new rules regulating MVNOs or the elimination of intra-network roaming charges in the Russian Federation, could weaken our competitive position in the mobile telecommunications market and, as a result, materially adversely affect our financial condition and results of operations.

***A finding by FAS that we have acted in contravention of antimonopoly legislation could have a material adverse effect on our business, financial condition and results of operation***

Our business has grown in recent years in part through acquisitions and incorporation of new companies. Many of these operations require the prior approval of, or subsequent notification to, FAS in accordance with antimonopoly legislation. This legislation is however sometimes vague and subject to varying interpretations.

While we believe that we have complied with the applicable legislation for all our acquisitions and formation of new companies, if FAS were 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 such company or other assets, which could have a material adverse effect on our business, financial condition and results of operations.

In October 2010, FAS found that we, MTS and VimpelCom violated antimonopoly laws on competition relating to our pricing for roaming services (see “—Changes to the regulations concerning roaming tariffs may adversely affect our business” above).

In addition, we are currently dealing with certain claims and investigations concerning alleged breaches of anti-competition laws advanced by FAS (see “Business—Litigation—Claims on Breach of Anti-Competition Laws”).

These proceedings might lead to substantial fines (even if the value of such possible fines cannot currently be assessed) and could establish significant precedents, and force us to reconsider our tariffs across the Russian Federation, which may have a material adverse effect on our business, results of operations, financial condition and prospects.

Future inquiries and enforcement by FAS could harm us (see also “—Our status as a company “holding a dominant position” in the market may lead to restrictions on our commercial activities” below).

Accordingly, we cannot assure you that action will not be taken against us by FAS in the future, having a negative effect on our business.

***Changes in court practice concerning recovery of indebtedness from our subscribers’ different accounts may adversely affect our business***

On 25 January 2011, one of our major competitors, MTS, was held liable by the Krasnoyarsk Region Department of the Federal Service for Protection of Consumer Rights for a consumer rights-related administrative offence. While MTS appealed the resolution, it was ultimately upheld on 14 February 2012 by the Supreme Arbitrazh Court of the Russian Federation. In its judgment, the Supreme Arbitrazh Court stated that payment for mobile services provided to a certain subscriber must be charged under the specific agreement which assigned the phone number used for such services. This implies that a telecommunications operator is not allowed to suspend the provision of services under one agreement if that same subscriber fails to fulfil its obligations under other agreements that he or she has in place with the same telecommunications operator.

This precedent might be detrimental to our business. Currently, we use the amounts pre-paid by our subscribers with respect to one agreement to offset obligations of these subscribers under any other agreements that they might have entered with us. However, we do not suspend services under one agreement if subscribers fail to perform their obligations under any of their other agreements. In any event, this precedent creates a risk that we might not be able to make setoffs in the future and have to change the method of recovery for accounts receivables, which might create additional (but currently unquantifiable) costs for our operations and which, in turn, could have an adverse effect on our business.

***We operate in an uncertain telecommunications regulatory environment, which could cause our operations to become more complicated and expensive and at times could result in our operating without all of the required permissions***

The principal legislation governing the provision of telecommunications services in the Russian Federation is Federal Law No. 126-FZ “On Communications” of 7 July 2003, as amended (the “**Telecommunications Law**”), which became effective on 1 January 2004. The Telecommunications Law establishes general guidelines for the telecommunications industry in the Russian Federation including licensing, basic service guidelines, numbering and interconnection. As a result, much of the implementation of the Telecommunications Law has depended on the enactment of regulations to fill out its general guidelines. While many implementing regulations required in connection with the Telecommunications Law have been adopted, there remain areas where there are still no regulations, such as IP telephony. In those cases, regulations enacted prior to the Telecommunications Law may continue to apply, which may result in difficulties in determining the governing standards, particularly where new and old regulations overlap and/or are inconsistent.

In addition, the Telecommunications Law re-organised the bodies responsible for regulating the telecommunications sector, as a result of which a number of Government agencies were given responsibility for various aspects of the Russian telecommunications industry, without their specific functions always being clearly defined. In addition, as the enactment of new regulations is a relatively simple process and does not require actual amendments to the Telecommunications Law itself, this complex system of regulation created by the Telecommunications Law has also been subject to frequent revision.

The principal issues that we could encounter under the existing telecommunications regulatory regime are:

- difficulties having our licences, frequencies and permissions reissued or new licences, frequencies and permissions issued;
- restrictions on, or delays in, receiving new licences and frequencies, receiving regulatory approvals for rolling out our networks in the regions for which we have licences, receiving regulatory approvals for changing our frequency plans, obtaining additional numbering capacity and importing and certifying our equipment;



- significant increase in compliance costs;
- necessity to locate mobile communications switches in each constituent unit of the Russian Federation;
- necessity to interconnect communications networks and terminate traffic in accordance with the complicated system of communications networks build-out in the Russian Federation; and
- delays in obtaining permits by the Federal Service for Supervision in the Sphere of Communications, Information Technologies and Mass Communications (“**Roscomnadzor**”), for use of radioelectronic equipment.

Regulators, judicial authorities or third parties may challenge our compliance with applicable laws, decrees and regulations. Communications regulators conduct periodic inspections and have the right to conduct additional unscheduled inspections. To date, we believe that we are in substantial compliance with all applicable legal requirements. However, we cannot assure you that in the course of future regulatory inspections, regulators will not find us to have violated any laws, decrees or regulations or that we will be able to cure any such violations within applicable grace periods or that regulators will be satisfied with the remedial actions we take. In addition, in this field, Government officials enjoy a high degree of discretion and therefore political influence or manipulation could be used to affect decisions against us on the basis of other than legal considerations.

The Telecommunications Law also imposes financial burdens on all telecommunications operators in the Russian Federation, including us. For example, the Telecommunications Law has established a “universal services fund” financed by non-tax levies on all telecommunications operators in the amount of 1.2% of each operator’s revenues. In 2011, we incurred an obligation to pay 2,339 million rubles into this fund. Additionally, the Telecommunications Law provides for payments for allocation of numeration resources, including through auctions in cases where numeration resources are scarce. For other requirements under the Telecommunication Law, also see “—We may be subject to substantial increases in fees for use of frequency spectrum under the terms of some of our licences” below.

***Regulatory uncertainties could result in our inability to renew our licences on comparable terms or at all***

Our licences are integral to our operations (See “Business—Licences”). Our GSM, 3G, and LTE/4G licences expire in various years from 2013 to 2022. Although we can apply to Roscomnadzor to renew our licences before their expiration, no assurance can be given that Roscomnadzor will necessarily grant such an application.

Under the Telecommunications Law, Roscomnadzor can reject an application for licence renewal if the applicant’s telecommunication activity does not conform with telecommunication standards, regulations and rules, or if uncured violations of licence requirements exist on the date of the renewal application. See “Regulation of the Russian Telecommunications Industry—Licensing of Telecommunications Service Providers—Licence Renewal and Re-issuance”. At such time, we might have such uncured violations which could result in delays in licence renewal, or even an outright refusal to renew. So far, we have not experienced delays or refusals in the renewal of our licences, but we cannot give any assurances that our licences will be renewed in the future. Furthermore, although the Telecommunications Law does not authorise Roscomnadzor to impose additional conditions upon licence renewal, in practice broad discretion by Governmental officials is commonplace and our licences might nonetheless contain such additional conditions, including payment obligations, or might be issued for smaller areas than those previously granted. Because our licences are integral to our operations, any inability to extend our existing licences on the same or comparable terms could materially affect our business.

***The requirement that licences be re-issued and frequencies be re-allocated in the event of a merger could undermine our ability to consummate acquisitions or mergers***

Under the Telecommunications Law, the successor entity in a merger does not acquire its predecessor’s licences by operation of law. Instead, the successor entity must apply for re-issuance of such licences. Roscomnadzor theoretically cannot refuse to issue a licence to the successor entity, but in practice, Roscomnadzor may retain some discretion in its decision-making. See “Regulation of the Russian Telecommunications Industry—Licensing of Telecommunications Service Providers—Licence Renewal and Re-issuance”. In the future, we may seek to expand through further acquisitions and such acquisitions may require us to merge the target with us. We cannot give any assurances that in such cases, or in any other case where we seek to integrate a subsidiary into our business, Roscomnadzor will re-issue to us the licences of entities that merge into us.

In addition, under the Telecommunications Law, frequencies allocated to a particular company do not automatically transfer to any company into which it might be merged. If we acquire another operator by way of merger into us, we would have to apply for new frequency allocations to be able to handle satisfactorily the additional traffic which the merged company brought to us and there is no assurance that such allocations would be made. If we were unable to obtain additional frequency, this could limit, perhaps severely, our ability to accommodate both our new customers and our existing customers, and adversely affect our business.

***We may be subject to substantial increases in fees for use of frequency spectrum under the terms of some of our licences***

Russian legislation and the terms of our licences in the Russian Federation require us to pay for the use of frequency spectrum. In the years ended 31 December 2011, 2010 and 2009, we incurred 3,527 million rubles, 2,963 million rubles and 2,651 million rubles, respectively, in radio fees. In the nine months ended 30 September 2012 and 2011, we incurred 3,012 million rubles and 2,633 million rubles, respectively, in radio frequency fees. Any significant increase in the fees payable for the frequencies that we use or for additional frequencies that we may need in the future could have a negative effect on our financial results.

***Any failure to fulfill the terms of our licences could result in their suspension or termination***

Our licences require that we meet certain conditions, including capital commitments and coverage requirements (see “Business—Licences”). If a licensee does not fulfil the terms of a licence, the licensing authority may suspend or terminate that licence. Licensees may appeal the decisions on suspension or termination of licences in court. While we received notices of immaterial violations with respect to certain of our licences in the past, to date, there have been no legal actions seeking to suspend or terminate any of our current licences. However, if we fail to comply with the requirements of applicable Russian law, or we fail to meet the terms of our licences, our licences and other authorisations necessary for our operation may be suspended or terminated, which could negatively impact our business and results of operations. For example, if we failed to comply with the minimum capital commitments, and other conditions attached to our recently issued nationwide LTE/4G licence (as to which, see “Business—Licences—LTE/4G and MVNO Licences”), this licence could be suspended or terminated which could adversely impact our business, results of operations and prospects.

***Any failure to obtain sufficient frequency, or renewals or extensions of our frequency allocations, for our networks, or any order to vacate part of the frequency spectrum we are allocated or that, in any case, we currently use, could disrupt our business***

Frequency allocations for our GSM and 3G networks, and for our LTE/4G licences, in some cases are limited in comparison to frequencies allocated to mobile operators in other countries, due to practices of the Russian telecommunication regulator. The fewer frequencies are allocated to a mobile operator, the fewer subscribers a network can accommodate. Such limited frequency allocations could cause us to incur significant additional costs in building out our networks, interfere with our ability to provide mobile telecommunications services and limit our growth, each of which could harm our business.

We hold a licence to operate a 3G network throughout the entire Russian Federation and have been assigned frequencies to operate everywhere in the Russian Federation, except for a part of the Moscow region and the city of Komsomolsk-on-Amur (a city with a population of approximately 260,000 inhabitants as of 1 January 2012<sup>4</sup>). 3G frequency allocations in Moscow and environs, and in Komsomolsk-on-Amur, were conditional upon completion of the conversion of military and other Governmental networks that used certain 3G frequency band to different frequency bands. In December 2009, the conversion process was completed in the city of Moscow and part of Moscow’s environs. However, we have not yet been assigned all required frequencies for a part of Moscow’s environs with a total area of approximately 11,300 square kilometres and for the city of Komsomolsk-on-Amur. While we wait for such frequencies to be assigned, we are further extending our 2G network in these areas. If we are unable to develop the full potential of our services in the Moscow region and Komsomolsk-on-Amur, or experience delays in fully deploying our network in the Moscow region and Komsomolsk-on-Amur, our business could be adversely affected.

Additionally, Russian law permits the partial or full withdrawal of previously assigned frequency spectrum, including for purposes of national defence and security. There have been precedents for these provisions being employed to require the whole or partial re-allocation of frequency spectrum that had previously been assigned to

<sup>4</sup> Source: Federal State Statistics Service.

certain operators so that it could be wholly or partly re-allocated in favour of “new advanced” communications technologies and/or other communications operators. Generally, operators who have had frequency re-allocated to other operators have received compensation. While we have never experienced such a request, we cannot give any assurances that we will not be forced to vacate part of our frequency spectrum in the future, particularly in light of development of new communication technologies; or whether the compensation, if any, would be adequate to cover the loss of such frequency spectrum. Moreover, if this were to happen, we would need to coordinate the use of our frequencies with other licence holders and we might experience a loss of quality in our network.

Furthermore, while no claim has been advanced in relation to the frequency spectrum assigned to us in connection with the award of our nationwide LTE/4G license in July 2012, the refusal to assign some frequencies in the bandwidth 2.5-2.7 GHz to Summa Telecom, another telecommunications operator, has recently been challenged before the Moscow Arbitrazh Court. These frequencies are currently used by certain other LTE/4G licensees, in particular Yota, MTS and Rostelecom. Summa Telecom’s claim was granted at first instance by the Moscow Arbitrazh Court and was then appealed to the 9th Arbitrazh Appellate Court which joined us as a “third party” to these proceedings, because the court believed the decision in the case might affect our rights and obligations (see “Business—Litigation—Summa Telecom Case”). On 1 November 2012, the 9th Arbitrazh Appellate Court reversed the decision of the Moscow Arbitrazh Court. The resolution of the 9th Arbitrazh Appellate Court can be appealed by Summa Telecom to the Federal Arbitrazh Court of the Moscow District within two months from the date of this resolution. If Summa Telecom decides to appeal the resolution of the 9th Arbitrazh Appellate Court, its appeal is successful and its claim in respect of this bandwidth is finally upheld, and the affected bandwidth is bandwidth used by Yota, this could adversely affect our ability to provide LTE/4G services to our customers through the MVNO agreement we have in place with Yota. We are currently unable to determine whether and to what extent these developments might affect our business. In addition, while none of the frequencies challenged by Summa Telecom were distributed to us as a result of the LTE/4G tender, if Summa Telecom decides to challenge the results of the LTE/4G tender because some frequencies in the affected bandwidth were distributed to certain other operators as a result of this tender, and if such challenge is successful and the results of the LTE/4G tender are partially or wholly invalidated, this could adversely affect our ability to provide LTE/4G services. However, any such challenge would require additional, separate proceedings, and it is not currently possible to estimate the probability of such further challenge by Summa Telecom or its prospects, if made. Given the uncertainties, it is not currently possible to quantify the financial impact that an adverse decision in the Summa Telecom case might have on us.

In August 2012, LLC EROS (a small regional broadband operator) submitted a claim to the Moscow Arbitrazh Court challenging certain provisions of the decision of the State Radio Frequencies Commission (the “**SRFC**”) dated 8 September 2011 (the “**SRFC Decision**”), including the distribution of some frequencies in the 2.5-2.7 GHz bandwidth in the LTE/4G tender and the allocation of certain other such frequencies directly to Yota. On 31 October 2012, the Moscow Arbitrazh Court announced the operative part of its decision to dismiss the claim of LLC EROS in its entirety. While no claim has been advanced against us (nor have we been involved in these proceedings as a “third party” to date), if LLC EROS decides to appeal the decision of the Moscow Arbitrazh Court, its appeal is successful and its claim is finally upheld, and if the results of the LTE/4G tender themselves were further challenged and/or partially or wholly invalidated on the basis of any court decision or otherwise, this could adversely affect our ability to provide LTE/4G services, including through the MVNO agreement we have in place with Yota. We are currently unable to determine whether, and to what extent, these developments might affect our business and accordingly are not able to quantify the financial impact on us, if any.

Furthermore, certain provisions of the SRFC Decision on the basis of which some frequencies in the bandwidth 2.5-2.7 GHz were recommended to be distributed as part of the LTE/4G tender and some other such frequencies were directly assigned to us, Yota and MTS, were challenged by CJSC Kosmos-TV and CJSC Kaskad-TV in the Moscow Arbitrazh Court in December 2011. The court has also joined us as a “third party” to this claim. Later, the parties to these proceedings agreed to enter into a settlement agreement according to which the SRFC, among other things, would require that each of the claimants would be compensated for the loss of the challenged frequencies—and ultimately this was one of the conditions imposed on the winners of the LTE/4G tender, including us, that made the settlement of the dispute possible. See “Business—Licences—LTE/4G and MVNO Licences”. However, the settlement agreement has not been yet approved by the court as required by Russian law to make it effective. A court hearing expected to grant such approval was held on 11 October 2012, at which time the proceedings were suspended until a final decision in the dispute initiated by LLC EROS is made, because LLC EROS’ claims might affect the claims of CJSC Kosmos-TV and CJSC Kaskad-TV and therefore approval of the settlement agreement cannot be granted until conclusion of the LLC EROS case. On 31 October 2012, the Moscow Arbitrazh Court announced the operative part of its decision to dismiss the claim of LLC EROS in its

entirety. We are unable to assess the effect of the settlement of the proceedings initiated by CJSC Kosmos-TV and CJSC Kaskad-TV being delayed or even blocked by any resolution of the proceedings initiated by LLC EROS in case LLC EROS appeals the decision of the Moscow Arbitrazh Court, and any impact that this might have on the results of the LTE/4G tender. We are not, therefore, currently able to quantify the financial impact, if any, that this may have on us.

In some of our macro-regions, our frequency allocations for GSM service expire before our corresponding licences (all of our frequency allocations for 3G service are co-terminous with the term of the 3G licence). We cannot predict whether we will be able to obtain extensions of our frequency allocations and whether Roscomnadzor, the body that assigns the spectrum of frequencies allocated by the State Commission on Radio Frequencies, will grant such extensions in a timely manner and without significant additional costs.

We may experience similar difficulties associated with frequency allocations for the LTE/4G network that we are aiming to develop. Significant amounts of LTE/4G frequencies are currently controlled and used by the military, so the award of our nationwide LTE/4G licence requires us to finance the conversion of networks used by the military to other frequencies as a condition to such award, which might result in a significant increase in the frequency acquisition cost or a delay in the roll-out of our LTE/4G network.

Any failure to obtain, renew, or extend frequency allocations for our networks, or any order to vacate part of the frequency spectrum we currently use, could adversely affect our business, as could the granting of overlapping frequencies to other licence holders.

***Any failure to build-out network infrastructure or failure to comply with all applicable laws and regulations on ownership title or lease rights or to obtain all necessary approvals and permits necessary for the launch and operation of our base stations, data centres or fibre-optic lines could negatively affect our business; furthermore, changes in regulation on cable placement could make us incur significant additional costs***

We have expended and continue to expend considerable resources to build and maintain our network. The build-out of our network, and its maintenance, is subject to risks and uncertainties, including:

- The potential difficulty in obtaining base station sites in suitable locations and on commercially attractive terms or in obtaining title or lease rights to use land (or buildings) where our data centres are located as well as the rights to use land to lay our fibre-optic lines; and
- Potential challenges to, and the loss of, agreements for the use of base stations which are in the form of service or storage agreements rather than lease agreements, which give us less security of tenure and could result in us having to remove our telecommunications equipment from the premises that we currently use under such agreements.

Failure to obtain rights to use land may result in court actions compelling us to demolish certain of our communication facilities. In addition, approximately 76% of our tower and antenna-mast facilities (communication towers), and approximately 54% of our telecommunication linear cable facilities, all of which are subject to title registration (by virtue of being “capital constructions” under relevant legislation), are not duly registered as immovable property and therefore are potentially subject to demolition. State authorities may also impose fines on us of up to 1 million rubles or administratively suspend our operations for a term of up to 90 days for operating communication facilities that are considered to be “capital constructions” under relevant legislation without prior approval or the required construction permissions. Since 2010, we have been actively working to rectify this irregularity in relation to our communication towers. As of 31 October 2012, we had registered title to 1,610 communication towers, out of a total of 6,521 which are capital constructions and therefore require registration. We expect to complete the registration process for the remaining towers by the end of 2013. Moreover, we consider some of our communication facilities, such as masts and columns, to be temporary facilities. As a result, we do not register them as immovable property. While there were certain attempts by the competent authorities to challenge our approach, such interpretation is generally supported by Russian courts. However, if the position of the courts changes, the respective facilities will also become subject to potential demolition and we will need to register all of them. In case our communications facilities are demolished by court order, the span and quality of our network may decrease, which could have a material adverse effect on our business. In addition, line-cable telecommunication constructions are also capital constructions, and certain of our line-cable telecommunication constructions are not currently registered despite this being required. By 31 March 2012, we had registered approximately 7,200km of our line-cable telecommunication constructions. We are currently working towards obtaining registration for an additional 8,600km. We spent 635 million rubles and 1,271 million rubles in 2010 and 2011, respectively, on the registration process, and in 2012 we plan to spend approximately 1,600 million rubles.



Also, Russian state authorities, including Roscomnadzor and the Federal Service for Ecological, Technological and Nuclear Supervision, may claim that we operate certain of our base stations in violation of telecommunication, construction, land, health care and environmental legislation. For example, from time to time, Roscomnadzor has found that we operated certain base stations in a number of micro-regions without: (i) the relevant authorisations for spectrum usage (frequency permissions); (ii) statutory registration of such base stations as radio-electronic devices; and/or (iii) permission to operate communications facilities. As of 31 August 2012, approximately 7% of our base stations operate within our mobile network without the required authorisation for frequency usage and registration.

In September 2010, the Middle-Caucasian division of the Federal Service for Ecological, Technological and Nuclear Supervision imposed a fine on us in the amount of 515,000 rubles for the launch of fibre-optic lines without its prior approval and without construction permission, in violation of statutory construction approval requirements. For similar violations in the future we may be exposed to fines in the amount of up to 1 million rubles per fibre-optic line and forced to suspend some of our operations for a period of up to 90 days. Such suspension of a significant number of our operations in any micro-region for any prolonged period could have a material adverse effect on our business.

Furthermore, several Russian regions are considering the possibility of implementing “clear sky” regulations, *i.e.* regulations prescribing the relocation underground of all telecommunications cables. Similar regulations are currently already in force in one Russian micro-region, Tatarstan (in the municipal units of Kazan, Naberezhniye Chelny, and Elabuga). In addition, the Administration of Ekaterinburg, in the Urals, adopted a similar regulation, but this was subsequently invalidated by FAS. The Administration of Ekaterinburg appealed this decision to the Moscow Arbitrazh Court and the case is currently under consideration. If more local authorities were to adopt “clear sky” regulations, this could lead to an expensive and complicated relocation process of aerial cables underground, which would lead to significant additional costs for us and could therefore materially impact our financial condition and results of operations.

***Any failure by our suppliers to obtain all permits required to import and operate telecommunications equipment could disrupt our business***

Substantially all of our telecommunications equipment is imported by our suppliers and, therefore, requires customs clearance. Russian customs legislation is frequently subject to change, which often results in significant revisions of customs clearance procedures. In particular, in December 2010, the Customs Code of the Russian Federation was effectively replaced with a new set of legislation including the Customs Code of the Customs Union of the Russian Federation, the Belarus Republic and the Kazakhstan Republic. The new customs legislation has been in force for a relatively short period of time, which leads to unclear and inconsistent implementation thereof and may result in inconsistent enforcement and delays in customs clearance of imported telecommunications equipment. Delays in or disruption of supply of equipment necessary for the continuing development of our network and for implementation of new communications technologies could adversely affect our business.

Russian law prohibits the operation of certain telecommunications equipment without a relevant permit from the Federal Communications Agency. Generally, it is the equipment supplier’s responsibility to obtain such certification. However, due to the strict Russian regulatory framework and the long waiting period to obtain permissions from Governmental bodies, our suppliers may be unable to obtain in a timely manner all permissions required for us to operate new equipment and such delays could adversely affect our business.

***We depend heavily on our senior management and cannot give any assurances that they will remain with us in the future or that we will be able to attract, retain and motivate qualified key personnel***

Our business depends, in significant part, upon the continued contributions of our key senior managers and highly-qualified personnel, including our CEO, Ivan Tavrin. In addition, many of our senior managers have worked with us for many years and can be directly associated with creating our successful track record. We cannot be certain that the current members of the senior management team will remain with us in the future nor do we have “key man” insurance covering any of our senior managers.

In addition, the shareholder re-organisation in April 2012 has led to the departure of several senior figures and resulted in the appointment of new key figures who might have a more limited knowledge of our business (see “Principal and Selling Shareholders—Changes in Shareholding Structure and Ultimate Beneficial Owners—April and May 2012 Shareholding Change” below).

Furthermore, to manage our growth and development successfully, we depend upon our ability to attract, train, motivate and retain highly skilled employees and management. However, we face significant competition for employees with relevant experience (especially in finance, marketing, technology, network infrastructure and information systems), due to the relatively small number of such qualified individuals. Therefore it may be difficult for us to hire qualified personnel in the future. Furthermore, although we attempt to structure our compensation packages in a manner consistent with the evolving Russian labour market, we may lose some of our talented personnel to our competitors. If we cannot attract, train, motivate and retain qualified personnel, we may be unable to manage our growth or otherwise compete effectively, which could adversely affect our business.

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

Our ability to attract new subscribers and retain existing subscribers depends, in part, on our ability to maintain what we consider our favourable brand image. Negative information or rumours regarding our company or our services, even if unsubstantiated, could harm this brand image, which could lead to loss of market share. This loss of market share could negatively affect our revenues. Lastly, our marketing efforts might prove unsuccessful or our competitors could improve their branding to the point where their brand images are more favourable or well-known than ours, also potentially reducing our market share.

In the recent past, we have experienced certain issues that might negatively influence our brand image. See “—Negative media speculation or other negative public statements could adversely affect our reputation, which in turn could adversely affect our business”, “—Allegations and/or findings of corruption and money-laundering against persons linked or alleged to have been linked with MegaFon in the past could adversely affect our reputation, which in turn could result in a reduction in the value of the Securities” and “—Any failure to comply with laws on protection of subscribers’ personal data as well as security breaches of our subscriber database could result in adverse publicity, as well as civil and criminal proceedings which could negatively impact our business” below.

***Negative media speculation or other negative public statements could adversely affect our reputation, which in turn could adversely affect our business***

The media and others have speculated negatively from time to time about us and certain of our existing and prospective beneficial owners, which could adversely affect our reputation, potentially disrupting our ability to do business with counterparties who give weight to media comment, distracting our senior executive officers from their management responsibilities, and adversely affecting the trading price of our Securities. See “Principal and Selling Shareholders” and “Shareholder Restructuring”.

For example, the press has in the past speculated, and may in the future speculate, about the background of our largest ultimate beneficial owner. Mr Usmanov spent six years in an Uzbek jail after he had been convicted in 1980 of fraud and embezzlement. In 1989, however, a Soviet court removed his criminal record, and, in 2000, the Supreme Court of Uzbekistan vacated the judgment of 1980 and terminated the case due to the absence of the constituent elements of a crime. Accordingly, the original conviction was not in accordance with law. Nonetheless, media and others have speculated negatively about Mr Usmanov in the past and may do so in the future. For example, an Observer article in the late 1990s quoted Mr Usmanov as having stated that he knew Mr Gafur Rakhimov, whom the article claimed was a “drugs baron”. It was also reported that Sergei Adoniev, who owns a small, minority, indirect stake in us, pleaded guilty to a charge (in fact for fraud) in the United States and was deported to Russia in 1996. Future negative speculation in the media related to us and our existing and prospective direct or indirect shareholders could adversely affect our reputation, which in turn could result in a reduction in the value of the Securities.

***Allegations and/or findings of corruption and money-laundering against persons linked or alleged to have been linked with MegaFon in the past could adversely affect our reputation, which in turn could result in a reduction in the value of the Securities***

In the past some of our former shareholders and their affiliates were engaged in arbitration proceedings and litigation in various jurisdictions arising from the 2003 acquisition of CT Mobile LLC (“CT Mobile”), which then owned a 25.1% interest in OJSC MegaFon, by certain wholly owned subsidiaries of Alfa Group, a Russian company with holdings in various industries, including telecommunications. IPOC International Growth Fund Limited (“IPOC”), which was at that time a shareholder of OJSC MegaFon, challenged that acquisition on the



grounds that it violated IPOC's rights under two option agreements with the then owner of CT Mobile, LV Finance Group Limited. In 2008, however, all claims were released, all arbitration and litigation proceedings were terminated—accordingly, the shareholder dispute was definitively settled.

Although Mr Jeffrey Galmond, a Danish lawyer, claimed to be the beneficial owner of IPOC and, therefore, a beneficial owner of OJSC MegaFon, disclosures and claims made during the dispute gave rise to media speculation regarding the true ownership of the stakes he claimed to beneficially own. In particular, press reports focused on allegations that Mr Galmond was in fact an agent of a number of powerful individuals in the Russian state, particularly Leonid Reiman, and that the true owner of IPOC was Mr Reiman. Mr Reiman was the Russian telecommunication minister between 1999 and 2008 and served as an adviser to the President of the Russian Federation until 2010.

The press also reported that the activities of IPOC and Mr Reiman were the subject of broader investigations for money laundering in Germany. The Wall Street Journal reported that the “Bafin [(the German financial regulator)] closed its enquiry in 2005, without imposing any sanctions”. The Wall Street Journal, in 2012, further reported that “German authorities have settled money-laundering charges against four banking officials, closing a high-profile corruption investigation that had implicated a former Russian government minister, but that Russian authorities said had failed to show that any Russian laws were broken”. The Wall Street Journal also stated that under “German law, a money-laundering conviction in the case would be possible only if prosecutors prove that the illicit funds resulted from a crime committed in Russia”. No case was brought in Russia. In addition, in the context of considering the shareholder disputes, the Wall Street Journal also reported in 2006 that a Swiss tribunal referred to Mr Reiman as being “the owner of the Russian telecom business” and that “he had misused his position to build the business empire from assets that once belonged to the Russian state, and expanded it by abusing his office as minister”. Future similar negative speculation in the media relating to money laundering and/or corruption or any findings thereof could damage our reputation and/or have a material adverse affect on the value of the Securities.

***Our intellectual property rights are costly and difficult to protect and we cannot give any assurance that the steps we have taken to protect our property rights will be adequate***

We regard our copyrights, trademarks, trade dress, trade secrets, and similar intellectual property, including our rights to certain domain names, as important to our continued success. We rely primarily upon trademark and copyright legislation, as well as upon trademark licences, trade secret protection and confidentiality or licence agreements with our employees, customers, partners and others to protect our proprietary rights. Intellectual property rights are especially difficult to protect in the markets in which we operate. In these markets, the regulatory agencies charged with protecting intellectual property rights are generally inadequately funded, legislation is underdeveloped, piracy is commonplace and enforcement of court decisions is difficult. Furthermore, Russian legislation in the area of copyrights, trademarks and other types of intellectual property is still developing, and Russian courts have limited experience in applying and interpreting the new laws.

Litigation may be necessary to enforce our intellectual property rights, to determine the validity and scope of 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 and results of operations. We also may incur substantial acquisition or settlement costs to strengthen or expand our intellectual property rights or limit our exposure to intellectual property claims of third parties. We cannot assure you that we will be able to successfully protect our property rights in the future.

***Any failure to comply with laws on protection of subscribers' personal data as well as security breaches of our subscriber database could result in adverse publicity, as well as civil and criminal proceedings which could negatively impact our business***

When we sign up subscribers, we are obliged to collect certain personal data from them, such as names and addresses, ID number, etc. Such personal data enjoys special protection under Russian legislation, must be properly safeguarded and must not be disclosed to third parties other than in certain exceptional cases provided for by law.

In July 2011, certain amendments to the Federal Law on Personal Data No. 152-FZ of 27 July 2006 (“**Personal Data Law**”) were introduced. These amendments, together with the new regulations adopted thereunder, impose significant technical, financial and managerial undertakings on us. For example, to meet the technical requirements on information protection set by the Government, only certain specially certified information

protection facilities can be used; we might be held directly liable to our subscribers for the actions of third-party data processors where we outsource such functions. In addition, we are obliged to publish our data protection policies, which before the amendments to the Personal Data Law constituted a trade secret, and this may increase the vulnerability of our data protection system. We have upgraded our data protection systems to make them compliant with the new regulation. In March 2012, Roscomnadzor audited the status of our compliance with the new personal data protection regulations and reported several immaterial infringements of the new law. We believe that we have now fully rectified any such infringements. Nevertheless, Roscomnadzor may in the future decide that we do not fully comply with data protection laws (whether in relation to matters arising from the March 2012 audit or otherwise), and this decision could expose us to negligible administrative fines and be detrimental to our reputation.

Amendments which entered into force on 10 August 2010 to the Russian Federal Law “On Enforcement Proceedings” and the Russian Federal Law “On Court Bailiffs” have given bailiffs the right to obtain personal data on subscribers from mobile operators for law enforcement purposes. We could lose subscribers as a result of these amendments, which could have a material adverse effect on our business, financial condition and results of operations.

Improper or forced disclosure of personal information, or the theft of such information as a result of piracy or hacking into our subscriber database, could result in negative publicity and adversely affect our reputation, as well as give rise to administrative proceedings and fines (which are currently largely nominal), the criminal prosecution of the responsible employees, and lawsuits by the affected subscribers. Each of these factors, individually or in the aggregate, could negatively impact our revenues and results of operations.

For example, in 2003, certain subscriber databases of several operators in the North-West region, including ours and those of MTS, Delta Telecom and two other operators, were stolen and thereafter were made available for sale in the Russian Federation.

Furthermore, on 18 July 2011, more than 2,500 personal text messages, containing various types of private data, that had been sent to our subscribers using our website (rather than through our telecommunications network using a mobile device) became available for general viewing online for several hours through the major Russian search engine Yandex due to a fault with a third-party service provider. Despite the search results being deleted in a few hours, certain users managed to copy messages and post them on other websites. As a matter of law, the subscribers affected by the leak still have a right to file claims against us. As compensation, we offered the affected subscribers free SMSs, free air-time and the option to change their phone numbers, but only few of them took advantage of this possibility. In addition, because of this leak we were fined 30,000 rubles by the Moscow Arbitrage Court for violating the terms of our licence following an application by Roscomnadzor.

We continuously employ measures aimed at preventing such incidents from occurring again in the future, but we cannot be certain that such breaches will not occur again. Negative publicity concerning any such security breach could also lead us to lose subscribers or deter new customers from subscribing to our services.

***If we fail to properly manage the expansion of our retail network, our business may be negatively impacted as a result of a decrease in our subscriber growth rate, market share and revenues***

We are currently expanding our retail business. If we are not successful in implementing our retail growth strategy effectively and expeditiously, our market share may decline and our business, financial condition, results of operations and prospects may be materially adversely affected. Furthermore, the expansion of our retail business will result in the need to carry greater levels of inventory and, as retail is not currently a core business of ours, it may also create management difficulties, and could create downward pressure on our aggregate margins.

***Our status as a company “holding a dominant position” in the market may lead to restrictions on our commercial activities***

On 8 April 2009, FAS classified us as a company “holding a dominant position”, since we hold a market share exceeding 25% in the mobile communication services market and we also offer services involving the use of cryptographic technologies. Under Russian law, under certain circumstances, this classification could result in:

- increased Government control of our tariffs and other restrictions on our commercial activities;
- restrictions on expansion into, or mandatory withdrawal from, certain regions or markets;

- the invalidation of, or the requirement that we enter into, amend or terminate, certain agreements or perform other actions believed by the regulator to be necessary to promote competition in the relevant market;
- a requirement that FAS pre-approve certain transactions we plan to enter into;
- fines or penalties against us and our officers, directors and shareholders; and/or
- revocation or suspension of our licences at the initiative of FAS.

Each of these consequences could harm our competitive position, negatively affect our expansion plans, diminish our subscriber base and lead to a significant decline in revenues.

***Acquisitions of, investments in, or mergers with other companies to expand our operations may pose risks to our business***

As part of our growth strategy, we will continue to evaluate opportunities to acquire, invest in or merge with other existing operators or licence holders in the Russian Federation, as well as other complementary businesses. Growth through these types of transactions entails a number of risks that could materially and adversely affect our business, financial condition, results of operations and prospects, including the following:

- incorrect assessment of the value of any acquired target;
- assumption of the acquired target's liabilities and contingencies, including tax liabilities which may not become apparent for many years;
- failure to realise any of the anticipated benefits or synergies from any acquisitions or investments we complete;
- problems associated with integration of the acquired businesses, technologies or products into our operations;
- difficulties in retaining business relationships of the acquired business with suppliers and customers;
- risks associated with markets in which we lack experience;
- potential loss of our and the acquiree's key employees, as a result of the transaction;
- need to write-down or write-off acquired assets;
- lawsuits arising out of disputes over ownership of acquired assets and/or the enforcement of indemnities related to the title to such assets;
- our inability to enforce our rights to the fullest because of ceilings on recoverable damages and/or time limits to the assertion of claims;
- burden of the debt used to finance acquisitions which is usually significantly more expensive than our direct sourcing of funds; and
- more onerous Government regulations.

In addition, companies that we acquire may have internal policies, including accounting policies and internal control procedures that are less stringent than ours, or not compatible, compliant or easily integrated with ours.

If any of our future business combinations is structured as a merger with another company or we merge a company subsequent to its acquisition by us, such a merger would be considered a corporate re-organisation under Russian law. This would provide our creditors with a statutory-based right to file a claim seeking to accelerate their claims or terminate the respective obligations, as well as seek damages. To prevail, the creditors would need to prove in court that we will not perform our obligations in due course, as well as substantiate the amount of damages suffered. Secured creditors would be required to further prove that the security provided by us, our shareholders or third parties is not sufficient to secure our obligations. Creditors whose claims are secured by pledge do not have the right to claim additional security.

Furthermore, a merger, as well as any corporate re-organisation and any business combination that constitutes a major transaction involving assets worth more than 50% of the book value of our assets as of the then latest reporting date, would, under Russian law, trigger the right of any of our shareholders who abstain from voting on, or vote against, such re-organisation or transaction, to sell, and our obligation to buy, an amount of their shares equal in value to up to 10% of our net assets as calculated under Russian Accounting Standards ("RAS").

See also “—Shareholder rights provisions of Russian law may impose additional costs on us, which could cause our financial results to suffer”. The realisation of these risks could materially and adversely affect our business, financial condition, results of operations and prospects.

***The return on, and benefits from, our recent investment in Euroset might be affected by disagreements among Euroset shareholders***

On 28 September 2012, Lefbord Investments Limited (“**Lefbord**”) entered into an agreement to acquire a 50% stake in Euroset, the biggest wireless equipment retailer in the Russian Federation. The remaining 50% of Euroset will be owned by VimpelCom, one of our competitors.

Lefbord is currently wholly-owned by Garsdale, which is our controlling shareholder. Before the completion of such acquisition by Lefbord, we expect to enter into agreements to subscribe for shares in Lefbord representing a 50% stake of its issued share capital. Pursuant to an agreement to be entered into by us, MICL and Garsdale as to the governance of Lefbord (the “**Lefbord Governance Agreement**”), we will also undertake to purchase, one year from the closing of the Euroset acquisition (with the possibility for this obligation to be deferred for up to two further years, upon agreement of the parties), Garsdale’s remaining interest in Lefbord. We are currently negotiating an agreement to be entered into by us, VimpelCom, Euroset Holding N.V., Garsdale and Lefbord with respect to the governance of Euroset. The details of the Euroset transaction have not yet been finally agreed and they could depart, potentially materially and adversely to us, from the description of the transaction set out in the Prospectus. The execution of the Euroset transaction is subject to the satisfaction of a number of conditions, including obtaining FAS approval for the transaction. These conditions may not ultimately be satisfied and may result in the Euroset acquisition not being consummated thereby frustrating the commercial objectives we are targeting with this acquisition. For more information, see “Management’s Discussion and Analysis of Financial Condition and Results of Operations—Key Factors Affecting our Result of Operations—Acquisitions and Strategic Partnerships—Euroset”.

The Lefbord Governance Agreement is expected to provide for an undertaking of Garsdale to indemnify Lefbord in relation to any claim that might raise in the future in connection to the part of the Euroset consideration to be contributed by Garsdale and other potential liabilities related to Garsdale’s participation in the transaction. However, no assurance can be given that such indemnity will ultimately be provided for in the Lefbord Governance Agreement, or, if included, that it will be drafted in a form that provides us with adequate protection. In particular, even if such indemnity is provided for in the Lefbord Governance Agreement, we are controlled by the entity against whom indemnification would be sought, and this clause may not in practice be effective.

The agreement we expect to enter into with VimpelCom regarding governance of Euroset is not expected to include any mechanism to deal with deadlocks between Euroset’s shareholders. Conflicts between VimpelCom and Lefbord as to the management of Euroset could therefore lead to deadlock situations, which could hinder the timely and effective management of Euroset and thus affect the return on, and expected benefits from, our investment in it, thus adversely affecting our business, financial condition and results.

***Difficulties integrating the operations of VAS Media, NetByNet and other recently acquired companies with our existing operations may prevent us from achieving the expected benefits from such acquisitions***

In 2010 and 2011 we acquired a number of local fixed-line operators, including Metrocom, NetByNet, Yugratel, Chebnet, Nakhodka Telecom, Luchshe.net and Web Plus. We believe that these acquisitions will allow us to enhance our data transmission network and strengthen our position in the growing fixed-line broadband market. Furthermore, in 2012 we acquired VAS Media, which we believe will create valuable synergies with MegaLabs in the value-added services field. Our approach to these acquisitions is premised on our belief that, where applicable, our assets and the assets of VAS Media, NetByNet and the other recently acquired companies are complementary and that we will be able to retain the client base of the companies we have acquired. If either of these assumptions is incorrect or if we are unable to effect the projected synergies, the return on our substantial investment in the recent acquisitions may not materialise and our business would be materially adversely affected.

In addition, some of our management will be required to devote a substantial amount of time and resources over the next several years to the integration of these companies into us, which could limit the energy that they are able to devote to managing the combined company’s business.

***Our network equipment and systems may be subject to disruption and failure, which could prevent us from operating our business and lead to a loss of customers, damage our reputation and violate the terms of our licences and customer contracts***

Problems with our switches, controllers, microwave links, fibre-optic lines, base stations or other network and IT equipment, whether or not within our control, could result in service interruptions and/or significant damage to our networks. From time to time, we have experienced network service interruptions due to factors such as power failures, weather conditions, equipment and software upgrades, peaks in usage during holiday periods, system overload and terrorist attacks (see “—Risks Relating to the Political Environment in the Russian Federation—Ethnic and other conflicts create an uncertain operating environment that could hinder our long-term planning ability and decrease the value of investments in the Russian Federation”). Although we consider such interruptions to date insignificant, we might experience a significant interruption in the future.

We protect our computer and communications hardware through physical and software safeguards. However, it is still vulnerable to human error, fire, earthquake, storm, flood, loss of power, telecommunications failures, interconnection failures, software hacking, physical break-ins, terrorist attacks and similar events. We do not carry business interruption insurance to protect us in the event of a catastrophe, even though such an event could have a significant negative impact on our business.

We have backup capacity for our network management, operations and maintenance systems, but automatic transfer to backup capacity is limited and may itself cause interruptions in network service. If our primary network management centre were unable to function, significant disruptions to our system would occur, including our inability to provide services.

As mobile phones increase in technological capacity, they may become increasingly subject to computer viruses and other disruptions. These viruses can replicate and distribute themselves throughout a network system. This phenomenon slows the network through the unusually high volume of messages sent across the network and affects data stored in individual handsets. Although, to date, most computer viruses have been targeted at computer networks, mobile phone networks are also at risk.

Any significant interruption of services, virus or other disruption could harm our business reputation, reduce the confidence of our subscribers and deter new customers from subscribing to our services. It could also violate the terms of our licences. Each of these consequences could adversely affect our business.

***Termination or disruption of the supply of network equipment, or increases in the price of such equipment, could adversely affect our business***

The successful build-out and operation of our networks depend heavily on obtaining adequate supplies of switching equipment, base stations, routers, multiplexers and other network equipment on a timely basis and at reasonable prices. We currently purchase our GSM and 3G network equipment from a small number of suppliers, principally Nokia Siemens Networks Oy, and Huawei Tech. Investment Co. Ltd (the latter generally also provides our fixed-line equipment), although some of the equipment that we use is available from other suppliers. See “Business—Network and Information Technology—Network—Mobile Network—Network Equipment Supply”. From time to time, we have experienced delays receiving this equipment in the regions.

Our business could be adversely affected if we are unable to obtain adequate supplies or equipment from these or other suppliers in a timely manner and on reasonable terms.

***Telecommunications operators with whom we interconnect may not adhere to the terms of our interconnection agreements or may limit access to their network capacity***

Our ability to provide commercially viable services depends on our ability to continue to interconnect cost-effectively with zonal, intercity and international fixed-line and mobile operators. 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.

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, we believe that, in practice, some operators attempt to impede mobile 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 our ability to provide



services at competitive prices or at all, causing us to lose market share and revenues, which would have a material adverse effect on our business and results of operations. See also “—If we or any of our existing or future subsidiaries is recognised as an operator occupying a “substantial position” or a natural monopoly, we might be subject to price regulations and this may adversely affect our business, financial condition and results of operations”.

In addition, the Russian Government has expressed its intent to establish Rostelecom as 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), a mobile operator established as part of the Rostelecom group may receive preferential terms for interconnecting with these operators, which would allow it greater flexibility in setting tariffs and put us at a competitive disadvantage. See also “—We face intense competition”.

***The Company’s interconnection agreements and other transactions may implicate certain international economic sanctions***

In the course of its business the Company engages in transactions, most significantly roaming contracts, with persons or entities that may be or become in the future subject to trade embargoes and sanctions imposed by the European Union, the United States, or other jurisdictions. While the Company is a Russian entity primarily subject to Russian law, there can be no assurance that the relevant non-Russian authorities will not conclude that the Company’s activities violate applicable sanctions and seek to impose penalties upon it, potentially including restriction on the Company’s ability to do business with or obtain goods and services from the relevant jurisdictions, which could be material.

***We engage in interested party transactions that our shareholders could contest or that may be concluded on terms not determined by market forces***

Russian law, which contains very strict and formalistic requirements applicable to various corporate transactions, imposes particular restrictions upon so-called “interested party transactions”, which are matters in which a related party (as defined below) is a party to, or a beneficiary of, a transaction with a certain company, whether directly or as a representative or intermediary. A “related party” is any of the following:

- a member of the board of directors of a company;
- a member of the management board of a company;
- any person that owns, together with its affiliates, at least 20% of a company’s ordinary shares;
- any person entitled to give binding instructions to a company; or
- any relative or affiliate of such persons.

We and our subsidiaries each engage in related party transactions that are important to our business. See “Transactions with Related Parties”. Furthermore, many transactions among members of our corporate group may be interested party transactions under Russian law.

Although we attempt to obtain all corporate approvals required to consummate interested party transactions, including intra-group transactions, we cannot be certain that we have obtained all such approvals, particularly since some of the concepts relating to interested party transactions are subject to differing interpretations under Russian law. Additionally, although we generally attempt to engage in interested party transactions at the same or similar terms as unrelated parties, we may conclude some of them on terms not determined by market forces. Furthermore, we may not always be aware of who our related parties are at any moment in time. For example, while we keep a register of all entities affiliated with Mr Alisher Usmanov, TeliaSonera, members of our Board of Directors and Management Board and other related parties, it has not always been possible to keep a complete register as it relies on obtaining information from persons we do not control. We are currently developing enhanced internal procedures which will endeavour to better detect when a counterparty is indeed a related party (see “Description of Share Capital and Certain Requirements of Russian Law—Certain Requirements of Russian Legislation—Interested Party Transactions”). However, we cannot assure you that these procedures will be successful and, accordingly, that in the future we will always be able to detect who our related parties are in a timely manner. Therefore, there is a risk that we could enter into related parties transactions without our knowledge and without following the special approval procedures provided for by Russian law. If an interested party transaction were conducted without the required corporate approvals and/or not at arm’s length, one of our shareholders could contest such transactions and cause their invalidation. If such a shareholder were to contest such transactions in the future, it could limit our operational flexibility and adversely affect our business.



***Proposed laws and regulations on prevention of unlawful use of mobile devices in the Russian Federation may lead to technical difficulties and additional expenses***

In May 2011, a draft law was introduced to the State Duma allowing subscribers to register their mobile devices with Russian mobile operators to prevent their unlawful use. The Ministry of Communications supported this legislative initiative and in January 2012 published a draft regulation that will require assigning unique International Mobile Equipment Identities (IMEI) to all mobile devices in the Russian Federation, in an effort to discourage their theft. It is currently unclear whether these draft documents will be adopted, but if they are, we might be required to develop a system to monitor IMEI numbers, and we may need to establish and maintain a database of IMEI numbers, which would necessitate the expenditure of significant technical and financial resources, which could adversely affect our business.

***The adoption of regulations allowing mobile subscribers to select long distance services providers may adversely affect our financial condition and results of operations***

We provide long distance mobile services to our subscribers according to our licence for mobile services and route the long distance traffic through long distance transit operators. We receive payments from our subscribers for these calls, and then pay interconnection fees to the long distance transit operators. We select the transit operators at our own discretion based on cost and quality considerations. Our mobile subscribers making domestic or international long distance calls do not have an option to select their long distance services provider.

In contrast, fixed-line services users in the Russian Federation have the legal right to select a long distance operator, either by pre-selecting the operator for all of their future calls, or through a “hot choice” option, allowing callers to select their preferred long distance provider before each long distance call. While the “hot choice” option is not yet technically available in certain Russian micro-regions, under the relevant regulations it is to be implemented across the entire Russian territory by 1 January 2013.

The Ministry of Communications is currently considering whether to extend the right to select long distance providers to individuals making calls on mobile networks. Should this occur, we would be required to make substantial investments in our network infrastructure to support the “hot choice” feature. In addition, allowing our subscribers to select their long distance providers may result in their selection of higher cost providers, causing higher interconnect fees to be payable by us and so result in increased costs. As a result, extending the right to select long distance providers to mobile subscribers could have a material adverse effect on our financial condition and results of operations.

***The recent accession of the Russian Federation to the WTO may lead to changes in the business and legal environment in the Russian Federation***

On 16 December 2011, the Russian Federation signed the protocol of accession to the World Trade Organisation (the “WTO”). The protocol was ratified on 21 July 2012 and since 22 August 2012, the Russian Federation has become a fully-fledged WTO member. Russian membership of the WTO 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 in the markets where 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, this could have a material adverse effect on our financial condition and results of operations.

***Allegations of health risks related to the use of wireless telephones could have an adverse effect on mobile operators, including us***

Certain public health experts have alleged that the use of portable wireless telecommunications devices may cause serious health risks. The Cellular Telecommunications Industry Association in the United States has researched these potential health risks and publicly announced its belief that no risk exists. Nonetheless, the actual or perceived health risks of wireless telecommunications devices could diminish subscriber growth, reduce network usage per subscriber, increase the difficulty of obtaining or maintaining sites for base stations, give rise to product liability lawsuits or limit available financing. Each of these possibilities has the potential to cause adverse consequences for us and for the entire wireless telecommunications industry.

## **Risks relating to shareholder re-organisations**

*The concentration of ownership of our ordinary shares with AF Telecom and TeliaSonera Group, and certain agreements between them which govern the composition of the board and our dividend policy will limit the ability of investors to influence corporate matters and these shareholders' interests could conflict with those of the investors*

As a result of the shareholder re-organisation, Share Redemption and changes in the shareholding of AF Telecom in April 2012 (see “Principal and Selling Shareholders—Changes in Shareholding Structure and Ultimate Beneficial Owners” below), as at the date hereof, we are owned by two principal shareholders:

- AF Telecom which currently owns 50.0% plus one hundred ordinary shares of our share capital. AF Telecom is wholly owned by Garsdale Services Investment Limited (“**Garsdale**”), a company incorporated under the laws of the British Virgin Islands. Garsdale is ultimately controlled by Mr Alisher Usmanov, who has interests in the metals, mining, internet and media fields; and
- TeliaSonera Group, which owns 35.6% of our share capital.

The remaining 14.4% of our share capital is held by MICL, a wholly owned subsidiary of OJSC MegaFon.

After the completion of the Offering, AF Telecom will continue to own more than 50% of the share capital of OJSC MegaFon. AF Telecom is wholly owned by Garsdale, which is ultimately controlled by Mr Usmanov. Depending on the size of the Offering, TeliaSonera Group may own, directly and indirectly, 25.0% plus one ordinary share in our share capital after the completion of the Offering. In addition, pursuant to a voting agreement entered into by, inter alia, TeliaSonera Group and AF Telecom on 24 April 2012 (the “**Voting Agreement**”), all members of our present Board of Directors were nominated by AF Telecom and/or TeliaSonera Group. After the completion of the Offering, we expect that AF Telecom and TeliaSonera will continue to be able to nominate and elect the majority of the members of the Board of Directors.

As a majority indirect shareholder, AF Telecom will be able to control or otherwise exercise substantial influence over, and, depending on the size of the Offering, TeliaSonera Group (if it continues to own at least 25% plus one ordinary share in our share capital after completion of the Offering) may be able to exercise substantial influence over, our business, appointment of our General Director, any proposed amendments to our Charter, re-organisations, changes in the share capital, proposed substantial sales of assets or other corporate transactions. Under Russian law, any person holding above 25% (a “blocking interest”) in the share capital of a company has the ability to block certain proposed actions relating to such a company (including charter amendments, re-organisation of the company, approval of major transactions involving assets in excess of 50% of the total assets of the company, repurchase by the company of its shares and certain share issuances).

While Federal Law No. 208-FZ “On Joint Stock Companies” dated 26 December 1995 (the “**Joint Stock Companies Law**”) requires that the directors of a company act in the company’s best interest, we cannot assure you that AF Telecom or TeliaSonera Group will not seek to advance or defend their own interests or the interests of their beneficial owners which may conflict with the interests of OJSC MegaFon or your interests.

For example, AF Telecom is a subsidiary of Garsdale. Garsdale also owns Yota, a competing Russian telecommunications company that also provides services to MegaFon. We cannot assure you that our controlling shareholder will not favour Yota’s interests over ours (including by approving transactions involving Yota and/or us that favour Yota over us). Such actions could have a material adverse effect on our business, financial condition and results of operations.

Further to what has been reported in the media with respect to the ongoing re-organisation and consolidation of Mr Usmanov’s interests in internet, media, mining, steel and telecommunication assets into a new holding company, together with the interests of his long term partners (Mr Vladimir Skoch and Mr Ardavan Farhad Moshiri) in Metalloinvest, a leading Russian iron ore producer, Mr Alisher Usmanov has entered into a definitive shareholders’ agreement with these aforementioned long-term partners on [●] 2012. Pursuant to the terms of the shareholders’ agreement, Mr Usmanov will hold 100% of the voting rights with respect to the holding company and so will continue to control OJSC MegaFon, while Mr Skoch and Mr Moshiri will hold purely economic interests and exercise no control over management of OJSC MegaFon. See “Shareholder Restructuring”.

In addition, to the extent that we derive benefit from the control exercised by AF Telecom, the enforcement of either the Telecominvest Pledge or the Sberbank Pledge (as defined in “Principal and Selling Shareholders”) (or of other pledges of shares in the indirect chain of control of MegaFon) could result in a fall in the level or loss of such control.

***Disagreements among our shareholders might hinder the timely management of OJSC MegaFon***

In the past, we have experienced significant disagreements among our shareholders, which adversely affected the management of OJSC MegaFon. The shareholders' re-organisation in April 2012 resolved the issues between our shareholders and a prior shareholder (see "Principal and Selling Shareholders—Changes in Shareholding Structure and Ultimate Beneficial Owners—April and May 2012 Shareholding Changes"). However, we cannot ensure that such disagreements, and their negative consequences on us, will not occur again in the future.

**Risks Relating to Our Financial Condition**

***Adverse macro-economic conditions in the markets in which we operate, particularly the Russian Federation, could impact the results of our operations***

Adverse macro-economic conditions and any deterioration in the global or domestic economic environment might cause a deepening recession or economic slowdown in the Russian Federation, resulting in layoffs, reduced working hours, reductions in salaries and wages, and bankruptcies of companies. This may lead to a reduction in the level of demand from our customers for existing and new products and services. In difficult economic conditions, consumers may seek to reduce discretionary spending by reducing their use of our products and services, including data services, or by switching to lower-cost alternatives, including those offered by our competitors. Similarly, under these conditions the business customers we serve may delay purchasing decisions, delay full implementation of service offerings or reduce their use of our services. In addition, adverse economic conditions may lead to an increased number of our consumer and business customers being unable or unwilling to pay for existing or additional services. If these events were to occur, they could have a material adverse effect on our results of operations.

***The ongoing uncertainty in global financial markets could materially adversely affect our ability to access capital needed to fund business operations, limiting our operations and resulting in a negative impact on our operating results***

The expansion of our GSM, 3G and LTE/4G and fixed-line networks, our development of wireless and fixed-line broadband and other new products and services and our ability to make investments and acquisitions all require substantial capital expenditures. Our total capital expenditure amounted to 52,476, 67,240 and 70,871 million rubles in the years ended 31 December 2009, 2010 and 2011, respectively. This amounted to 28.9%, 31.2% and 29.2% of revenue in the years ended 31 December 2009, 2010 and 2011, respectively. We estimate that our total capital expenditures for 2012 will be approximately 45,000 to 50,000 million rubles, of which we had incurred 28,226 million rubles during the nine months ended 30 September 2012. Our 3G licences are subject to a number of capital commitments including the construction of a certain number of base stations supporting 3G standards by certain specified dates. Furthermore, the nationwide LTE/4G licence that was issued to us on 25 July 2012 was granted subject to our meeting substantial capital commitments relating to the rollout of the LTE/4G network (See "Management's Discussion and Analysis of Financial Condition and Results of Operations—Liquidity and Capital Resources—Capital Expenditures"), such as expenditures of at least 15,000 million rubles per annum until the network is fully deployed. Furthermore, we have committed to clear certain frequency bandwidth (the cost of which cannot be estimated at present), and compensated two other operators for losses associated with termination of their rights to use certain frequencies in Moscow and the Moscow region that have been assigned to us in the aggregate amount of 401 million rubles. To the extent that the cash generated by our operations is insufficient to satisfy these needs, we will require additional financing. However, the ongoing instability in the global financial markets and uncertainty affecting these markets resulted in extreme volatility in the credit, equity and fixed income markets. This volatility has at times limited, in some cases severely, companies' access to the credit markets, leading to significantly higher borrowing costs for companies or even the inability of these companies to fund their ongoing operations. While we have not been affected by any of these problems in any material way to date, any of the following potential developments could mean that future financing that we may require may not be available in sufficient amounts or at all:

- Repetition of the worldwide liquidity crisis;
- Continuation of the European sovereign debt crisis;
- Any restraints on the ability of banks to make loans at all, or to make loans on reasonable terms;
- The need to accelerate network development to meet competition;
- Higher network construction costs than anticipated;
- Substantial acquisitions or capital investments to meet competitive pressures to provide fixed mobile convergent services;

- Need for greater than anticipated service and customer support;
- Adverse regulatory developments;
- Deterioration in our financial condition;
- Deterioration in the Russian economy; or
- Negative perceptions of the investment climate in the Russian Federation.

To meet our financing requirements, we may need to attract additional equity or debt financing. If we cannot obtain adequate funds to satisfy our capital requirements, we may need to limit our product and service offerings or scale down our operations significantly, which could have a negative impact on our market share and operating results.

***Fluctuations in the value of the ruble against the U.S. dollar or the euro could adversely affect our financial condition***

A devaluation of the ruble against certain foreign currencies, primarily the U.S. dollar and the euro, could adversely affect our financial condition unless effectively hedged. Over the past two decades, the ruble has fluctuated, at times substantially over short periods of time, against the U.S. dollar. The recent global economic crisis and general economic conditions in the Russian Federation caused the ruble to depreciate against the U.S. dollar, in the period from August 2008 to February 2009, by up to approximately 56% (while in the same period it depreciated by approximately 26% against the euro). This depreciation was partially due to significant declines in the price of oil and other commodities, which are the principal generators of Russian export earnings, as well as deteriorating investor sentiment towards emerging markets. Although such downward trend halted in the first half of 2011 (with the ruble appreciating by 24% against the dollar and approximately 14% against euro), since the second half of 2011 a new depreciation trend has started. The ruble depreciated against the U.S. dollar from 29.3282 rubles per U.S. dollar as at 31 March 2012 to 30.9169 rubles per U.S. dollar as at 30 September 2012, representing a decline of 5.4%.

Under Russian law, we must collect revenues from our subscribers, as well as interconnection fees from other Russian telecommunications operators, in rubles. Conversely, a significant amount of our capital expenditures, borrowings and operating expenses (for example, international roaming expenses) is linked to foreign currencies, primarily the U.S. dollar and the euro. If the ruble declines significantly in value against the U.S. dollar or euro, we could have difficulty repaying or refinancing our foreign currency denominated indebtedness. In addition, any devaluation of the ruble against such foreign currencies could increase our operating and financing burdens in ruble terms, resulting in a net foreign exchange loss and a decrease of our net income. Lastly, any devaluation of the ruble also results in the decline in value of ruble denominated assets, such as rubles held in local bank accounts, although to mitigate against such risk, we can hold some of our readily available cash in U.S. dollars and euros. However, we could also face limits on our ability to convert rubles into foreign currency if the Central Bank of Russia decides to control capital flows. We have had difficulty buying U.S. dollars in the past, and we cannot be certain that a market for converting rubles into foreign currency will continue to exist in the future.

***Because our cash holdings and our indebtedness are denominated in different currencies, we may engage in hedging activity, which may expose us to risk of actual loss, as well as the need to take write downs for financial reporting purposes***

In order to limit the effect of currency fluctuations on both our balance sheet and income statement, we periodically engage in hedging operations. Because of our large holdings of cash before the shareholder restructuring (see “Principal and Selling Shareholders—Changes in Shareholding Structure and Ultimate Beneficial Owners—April and May 2012 Shareholding Changes” below), we sometimes hedged both sides of our balance sheet by matching the absolute amount and the currency mix of our assets and liabilities. With the recent depletion of our cash holdings and increase in foreign currency denominated debt (see “—Our dividend and share buyback have increased our indebtedness and substantially depleted our working capital”), we may have to engage in more complex financial derivative instruments to hedge our FX exposure.

Should we engage in derivative transactions, we may face the risk of loss from these operations not being successful, as well as loss from unhedged positions. While we may endeavour to limit the amount of our unhedged positions by maintaining an optimal currency structure of our debt portfolio and also limit the duration of hedging operations to minimise the potential loss, we cannot assure you that these hedging operations will not result in substantial loss.

***Our revenues may be unpredictable and our revenue sources short-lived***

Future revenues from our pre-paid subscribers, our primary source of revenues, are unpredictable, because such subscribers can cease to use our services at any time without significant penalty. Our wireless churn rate, which is calculated as the number of subscribers disconnected from our network within a given period divided by the average number of subscribers during that period, fluctuates significantly and is difficult to predict. Also, there is no uniform or universally agreed way to measure churn, which may make it difficult to compare churn rates among operators. Nevertheless, we believe that our churn rates are substantially similar to those of our competitors. Our wireless churn rate was 48.1%, 49.8% and 45.5% for the years ended 31 December 2011, 2010 and 2009, respectively, and 36.7% and 36.1% in the nine months ended 30 September 2012 and 2011, respectively. In Moscow, where mobile penetration was 196.5% as of 30 September 2012<sup>5</sup>, our churn rate is significantly higher than in other regions. See “Management’s Discussion and Analysis of Financial Condition and Results of Operations—Key Factors Affecting Our Results of Operations—Key Performance Indicators—Wireless Churn Rate”. Many of our new subscribers may be low income users of mobile telecommunications services, who may migrate to cheaper tariff plans and other operators more often than established users of mobile telecommunications services. The loss of a larger number of subscribers than anticipated could result in a loss of a significant amount of expected revenues. Because we incur costs based on our expectations of future revenues, any failure to accurately predict revenues could have a negative effect on our business.

***Our dividend and share buyback have increased our indebtedness and substantially depleted our working capital***

We underwent changes in our shareholding structure in April 2012, including the acquisition by MICL, one of our wholly-owned subsidiaries, of 14.4% of our ordinary shares from Allaction Limited for an amount of 63,883 million rubles. In connection with these changes in shareholding structure, on 24 April 2012, we paid a special dividend to our shareholders of 151,863 million rubles. See “Principal and Selling Shareholders—Changes in Shareholding Structure and Ultimate Beneficial Owners—April and May 2012 Shareholding Changes”. The purchase of ordinary shares and the special dividend were financed from our existing cash and short-term investments, and additional borrowings of approximately 142,400 million rubles, net of repayments. See “Management’s Discussion and Analysis of Financial Condition and Results of Operations—Liquidity and Capital Resources—Indebtedness”. Following these transactions, as at 30 September 2012, our consolidated total debt was approximately 159,114 million rubles.

As a consequence of these transactions, we have substantially depleted our working capital, including available cash and short term investments. We may therefore defer capital expenditures, if necessary, to meet short-term liquidity requirements. Our lower levels of available resources to fund capital and operating expenditures may reduce funds available to finance our operations and pursue new business opportunities, limit our flexibility to respond to changing business and economic conditions, including technological changes and increased competition, and potentially make us more vulnerable to a future downturn in the economy.

In addition, our investment grade credit rating is under threat as a result of this increase in our indebtedness, as Standard & Poor’s has given us a “negative outlook” while Moody’s has put our rating “Under review for possible downgrade” and has stated that this might lead to a possible downgrade. Any downgrade could result in an increase in our borrowing costs, which could have a material adverse effect on our financial condition.

In the event that cash flow from operations is less than anticipated and we are unable to secure additional funding to cover our expenses, our financial condition, business, expansion plans and operations could be materially adversely affected.

***Our debt agreements contain restrictive covenants that may limit our ability to engage in various actions***

The agreements that govern our debt instruments contain certain restrictions limiting our flexibility to operate our business. Such restrictions limit our ability to, among other things:

- Borrow money;
- Create liens;
- Give guarantees;
- Sell or otherwise dispose of assets; and
- Engage in mergers or consolidations.

<sup>5</sup> Source: WBIS.



These restrictions could hinder our ability to execute our business plans and our ability to make payments on our indebtedness.

### **Risks Relating to the Political Environment in the Russian Federation**

Virtually all of our revenues are derived from within the Russian Federation and virtually all of our fixed assets are located in the Russian Federation. Investments in the Russian Federation, such as the Securities, carry certain country-specific risks.

#### ***Political and Governmental instability could adversely affect the value of investments in the Russian Federation***

As a result of the dismantling of the political and economic apparatus of the former Soviet Union and the widespread privatisation of state assets, political conditions in the Russian Federation were highly volatile in the 1990s, which negatively impacted the business and investment climate. Although the political situation in the Russian Federation has stabilised since 2000, future political instability, in particular in light of the recent parliamentary and presidential elections, could result in a worsening of the overall economic situation, including capital flight and a slowdown of investment and business activity.

Following both the Russian parliamentary elections in December 2011 and presidential elections in March 2012, controversy concerning alleged electoral fraud in favour of the current ruling party, United Russia, and the newly elected President, Mr Vladimir Putin, respectively, as well as criticism towards the political system implemented under Mr Putin, led to organised political demonstrations in numerous Russian cities, including demonstrations in Moscow attended by tens of thousands of citizens. Mr Putin has rejected calls by opposition leaders that the parliamentary elections be annulled and re-run, but after the protests certain limited political reforms have been initiated. On the eve of the presidential inauguration on 7 May 2012 the opposition resumed its protests, which led to clashes between demonstrators and riot police as well as numerous arrests in Moscow. Renewed protests might also occur in the future. Future shifts in Governmental policy and regulation in the Russian Federation could also lead to political instability and disrupt or reverse political, economic and regulatory reforms, which could have a material adverse effect on the value of investments relating to the Russian Federation and the Securities in particular, as well as on our business, our ability to obtain financing in the international markets and our financial position or prospects.

Additionally, the potential for political instability resulting from the 2008-2009 global financial and economic crisis as well as the European sovereign-debt crisis, the recent growth slow-down in the markets (both emerging and developed), budgetary and fiscal crises and political uncertainties in the United States and any associated worsening of the economic situation in the Russian Federation and deteriorating standards of living should not be underestimated. Any such instability could negatively affect the economic and political environment in the Russian Federation, particularly in the short term.

#### ***Reversal of reform policies could harm our business and investments in the Russian Federation generally***

In recent years the political and economic situation in the Russian Federation has, we believe, become more stable and conducive to investment, although the 2008-2009 economic crisis and its after-effects had a destabilising effect on the Russian economy. Any significant struggle over the direction of future reforms, major policy shifts, Government reshuffles and a lack of consensus among key political groups could hinder or reverse political, economic and regulatory reforms. Reform may also suffer if key Government officials engage in private business while in office, particularly when these business interests are in the industry that these officials regulate. Any such deterioration of the Russian investment climate might constrain our ability to obtain future financing in the international capital markets and otherwise harm our business. However, shifts in Governmental policy and regulation in the Russian Federation may be less predictable than in many Western democracies. The Russian political system remains vulnerable to social and ethnic unrest, and our business could be harmed if political instability recurs. Such instability could lead to a deterioration of the Russian investment climate, which could result in a reduction in the value of the Securities.

In the recent past, Russian authorities have prosecuted some Russian companies, their senior managers and their shareholders on tax evasion and related charges. In some cases, the result of such prosecutions has been significant claims for unpaid taxes with respect to companies such as Yukos, Mechel, TNK-BP and VimpelCom and/or the imposition of prison sentences for individuals. Some analysts contend that these prosecutions occurred in connection with certain persons' involvement in Russian political affairs and some believe that they portend a



willingness to reverse key political and economic reforms of the 1990s, including certain privatisations. Other analysts, however, believe that these prosecutions were isolated events that relate to the specific individuals and companies and that they do not signal any deviation from broader political and economic reforms or a wider programme of asset redistribution. In any event, we cannot assure you that we or our employees will not be subject to such prosecutions in the future.

***Conflict between federal and regional authorities creates an uncertain operating environment that could hinder our long-term planning ability and decrease the value of investments in the Russian Federation***

The Russian Federation consists of various sub-federal political units (micro-regions), some of which (mostly national republics) exercise considerable autonomy in their internal affairs pursuant to arrangements with the federal Government. The delineation of authority among and within sub-federal units is, in many instances, uncertain and remains contested, although there has been a reassertion of centralised control, for instance, through the replacement of the election of regional governors by a system of appointment by the sub-federal unit's legislature of nominees of the Russian President. Recent legislative amendments which came into force on 1 June 2012 reversed this appointment system and reinstated direct elections of regional governors (with certain new conditions which may limit the extent of this change). In any case, the Russian political system remains vulnerable to tension and conflict between federal, regional and local authorities over various issues, including regional autonomy, the sharing of tax revenues and authority over regulatory matters. In addition, lack of consensus among Governments often results in the enactment of conflicting legislation at various levels and may result in political instability. This lack of consensus creates uncertainties in the operating environment in the Russian Federation, which hinders our planning ability and may prevent us from carrying out our business strategy effectively.

***Ethnic and other conflicts create an uncertain operating environment that could hinder our long-term planning ability and decrease the value of investments in the Russian Federation***

Ethnic, religious, historical and other divisions have, on occasion, given rise to tensions and military conflict. Russian military and paramilitary forces were engaged in Chechnya in 1994-96 and since 1999 have continued to maintain a presence there. Violence and attacks relating to this conflict have spread to other parts of the Russian Federation. Terrorist attacks have been reported on a periodic basis in the neighbouring republics of Ingushetia and Dagestan. In the last two decades, the Russian Federation suffered a number of terrorist attacks, including bombings in Moscow and other Russian cities, the destruction of passenger jets and trains, over 850 people being taken hostage in a theatre in Moscow and over 1,000 people being taken hostage in a school in Beslan, North Ossetia. As a result of these terrorist attacks, more than 2,000 people were killed. MegaFon has suffered equipment loss and damage in the Southern micro-regions due to terrorist activity or other violent acts, resulting in service disruptions.

Further intensification of violence, including terrorist attacks and suicide bombings, or its spread to other parts of the Russian Federation could have significant political consequences, including the imposition of a state of emergency in some or all of the Russian Federation. Moreover, any terrorist attacks and the resulting heightened security measures are likely to cause disruptions to domestic commerce and exports from the Russian Federation and could materially adversely affect the value of investments in the Russian Federation, such as the Securities, as well as our business. Our property and operations could be the subject of further attacks. However, in addition to the countrywide risk that future terrorist attacks could damage our network, intensified conflict and violence in the South could harm us disproportionately, since we are one of the largest mobile operators by both revenues and number of subscribers in that macro-region.

***Russian involvement into military and political conflicts may lead to negative publicity for, or even international retaliation against, us***

Following the military conflict in August 2008 between the Russian Federation and Georgia involving South Ossetia and Abkhazia and the resulting recognition by the Russian Federation of independence of South Ossetia and Abkhazia, the Government of the Republic of Georgia has started challenging the operations of Russian companies in the disputed territories of South Ossetia and Abkhazia on grounds that we view as political. Several Russian companies, including major television companies and us, were charged with fines for operating in Abkhazia and South Ossetia without obtaining a licence from Georgian authorities. In addition, the Government of the Republic of Georgia claimed that we had been operating mobile services in Georgia without a licence since 2005, although we do not have operations in Georgia. An initial fine of approximately U.S. \$3,750 was imposed by the Georgian National Communication Commission ("GNCC"), and a further fine of approximately

U.S.\$350,000 was subsequently levied in September 2008. We appealed these fines to the Tbilisi City Court, the Court of Appeal and the Supreme Court of Georgia, all of which rejected the appeals. The GNCC further fined us in the amount of approximately U.S.\$590,000 in September 2009, but we have not taken any action to appeal this fine. We have not paid (and have no intention of paying) any of the fines described above. These events may lead to negative publicity for us and other Russian companies operating in the region, which may adversely affect the price of listed Russian securities and may have negative effects on our ability to raise debt or equity capital in the international capital markets and on the price of the Securities.

In addition, the GNCC referred its complaints against us to the General Prosecutor of Georgia for a possible criminal prosecution. Reportedly, in March 2010, the Principal Prosecutor's Office of Georgia began the investigation of our allegedly illegal activity in Tskhinval Region, which comprised transfer of subscribers from calling prefix +7-928 to calling prefix +7-929. While we have received no official communications or notifications indicating any proceedings will be brought (the reports originated in the media and were never subsequently confirmed by any real fact or report), if this investigation results in official indictment, criminal judgment is obtained, and other countries with extradition treaties with Georgia are willing to cooperate in the enforcement of this judgment, this could complicate, perhaps severely, the ability of our management to travel freely outside the Russian Federation. Each of these factors could negatively impact our revenues and results of operations.

### **Risks Relating to the Social Environment in the Russian Federation**

#### ***Crime and corruption could disrupt our ability to conduct business***

The political and economic changes in the Russian Federation since the early 1990s have resulted in ineffective policing of society and increased lawlessness. Organised criminal activity, particularly property crimes in large metropolitan centres, increased significantly in the first years after the dissolution of the Soviet Union and, although greatly reduced, continues to be an issue today. In addition, the Russian and international press have reported high levels of official corruption in the Russian Federation and the former Soviet Union, including bribery of officials for the purpose of initiating investigations by Government agencies. Press reports have also described instances in which Government officials have engaged in selective investigations and prosecutions to further the interests of the Government and individual officials. Additionally, published reports indicate that a significant number of Russian media outlets regularly publish biased articles in exchange for payment. Finally, non-Governmental watchdog organisations (including the National Anti-corruption Committee) and official investigative bodies have stated that they have investigated, or are investigating, the telecommunications industry in the Russian Federation, including the process by which valuable licences were granted to telecommunications companies. Our business and the value of the Securities could be adversely affected by illegal activities or corruption or by claims implicating us in illegal activities.

#### ***Social instability, particularly that caused by worsening economic conditions and turmoil in the Russian financial markets, could lead to labour and social unrest, adversely affecting our business***

The failure of the Russian Government to adequately address social problems has led in the past, and could lead in the future, to labour and social unrest. Moreover, the recent worsening economic conditions and turmoil in the financial markets in the Russian Federation resulted in high unemployment, the failure of state and private enterprises to pay full salaries on time and the failure of salaries and benefits generally to keep pace with the increasing cost of living. These conditions led to a certain amount of labour-related and social unrest that may continue or escalate in the future. Such labour and social unrest could have political, social and economic consequences, such as increased support for a renewal of centralised authority, increased nationalism, including support for re-nationalisation of property, or expropriation of, or restrictions on, foreign involvement in the economy of the Russian Federation as well as increased violence. Such sentiments could lead to restrictions on foreign investment in Russian companies in the telecommunications industry or large-scale nationalisation or expropriation of foreign-owned assets or businesses, which could have adverse effect on confidence in the Russian political and social environment and the value of investments in the Russian Federation and have a material adverse effect on our business. We do not anticipate nationalisation or expropriation of our assets, because neither our company nor any of our subsidiaries were created as a result of a privatisation of any state enterprise. However, we have the status of "strategic company" (a company of special importance to state security and defence), which may imply that at some point the Government may be interested in our assets. In addition, there is not a great deal of experience in the Russian Federation in enforcing legislation enacted to protect private property against nationalisation and expropriation. As a result, we might not be able to obtain redress in the courts, and we might not receive adequate compensation if, in the future, the Russian Government decides to nationalise or expropriate some or all of our assets.

## **Risks Relating to the Economic Environment in the Russian Federation**

***Emerging markets such as the Russian Federation are subject to greater risks than more developed markets, and global financial and economic crisis or financial turmoil in any emerging market could disrupt our business as well as cause the price of the Securities to suffer***

Generally, investment in emerging markets is only suitable for investors who fully appreciate the significance of the risks involved in, and are familiar with, investing in emerging markets. Investors should also understand that emerging markets such as the Russian Federation are subject to rapid change and that the information set out herein may become outdated quickly. Moreover, financial turmoil in any emerging market country tends to adversely affect prices in stock markets and prices for debt securities of all emerging market countries as investors move their money to more stable, developed markets. Russian equity markets have been highly volatile since the second half of 2008, principally due to the impact of the global financial and economic crisis on the Russian economy. Such volatility caused market regulators to temporarily suspend trading on the MICEX and RTS stock exchanges multiple times. The MICEX and RTS composite indexes (currently the relevant parameters after MICEX and RTS merged in December 2011) have experienced significant overall decline since their peaks in May 2008, although both have recovered significantly from their troughs in early 2009. 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 foreign funding sources are withdrawn. Thus, global financial and economic crises or financial turmoil in any emerging market country could seriously disrupt the business of companies operating in the Russian Federation as well as result in a decrease in the price of the Securities.

In addition, emerging markets such as the Russian Federation are also subject to heightened volatility based on military and political conflicts. For example, the military conflict in August 2008 between the Russian Federation and Georgia involving South Ossetia and Abkhazia (where we have operations) resulted in significant overall price declines on the Russian stock exchanges. The emergence of any new tensions or the escalation of existing tensions in the region could negatively affect the economy of the Russian Federation and other countries that are involved. Such tensions or conflicts may lead to reduced liquidity, trading volatility and significant reductions in the price of listed Russian securities and may have negative effects on our ability to raise debt or equity capital in the international capital markets and on the price of the Securities.

### ***Economic instability in the Russian Federation could adversely affect our business***

From 2000 through the first half of 2008, the Russian Federation experienced rapid growth in its gross domestic product, higher tax collections and increased stability of the ruble, providing a certain degree of economic soundness. However, the Russian economy was adversely affected by the global financial and economic crisis that affected the Russian Federation in the second half of 2008, which manifested itself through extreme volatility in debt and equity markets, reductions in foreign investment and sharp decreases in gross domestic product around the world. A continued deterioration of the economic situation in the world may lead to a renewed economic crisis in the Russian Federation, and, as a result, is likely to impact our business. Any of the following risks, which the Russian economy experienced at various times in the past, including during the 2008-2009 crisis, may have or have already had a significant adverse effect on the investment climate in the Russian Federation and, in turn, may affect our operations:

- Significant declines in gross domestic product;
- High levels of inflation;
- An unstable currency;
- A weak banking system providing limited liquidity to Russian enterprises;
- High numbers of loss-making enterprises that continue to operate due to the lack of effective bankruptcy proceedings;
- Significant use of barter transactions and illiquid promissory notes to settle commercial transactions;
- Widespread tax evasion;
- Growth of “black” and “grey” market economies;
- High levels of capital flight;
- Corruption and extensive penetration of organised crime into the economy;

- Significant increases in unemployment and underemployment; and
- High poverty levels among the Russian population.

The Russian economy has been subject to abrupt downturns. In particular, on 17 August 1998, in the face of a rapidly deteriorating economic situation, the Russian Government defaulted on its ruble-denominated securities, the CBR stopped its support of the ruble and a moratorium was declared on certain hard currency payments. These actions resulted in an immediate and severe devaluation of the ruble and a sharp increase in the rate of inflation, a dramatic decline in the prices of Russian debt and equity securities and an inability of Russian issuers to raise funds in the international capital markets.

***We are only able to conduct banking transactions with a limited number of creditworthy banks in the Russian Federation, and another banking crisis could place severe liquidity constraints upon our business and financial condition***

There are currently a limited number of creditworthy banks in the Russian Federation (including Russian subsidiaries of certain well-known western banks) with which we conduct banking transactions. Our ability to reduce bank risk is limited due to the small number of creditworthy banks operating in the Russian Federation.

From April through July 2004, the Russian banking sector experienced its first serious turmoil since the financial crisis of August 1998. As a result of the circulation of various rumours and, in some cases, regulatory and liquidity problems, several privately owned Russian banks collapsed or ceased or significantly limited their operations. Several other privately owned Russian banks experienced liquidity problems and were unable to attract funds on the interbank market or from their client base. Simultaneously, they faced large withdrawals of deposits by both retail and corporate customers. Russian banks owned or controlled by the Russian Government and the CBR, as well as foreign-owned banks, generally remained unaffected by the turmoil.

Prior to the 2008-2009 global financial crisis, there was a rapid increase in lending by Russian banks, which many believe has been accompanied by deterioration in the credit quality of the borrowers. In addition, a robust domestic corporate debt market was leading to Russian banks (including the banks with which we conduct banking transactions) increasingly holding large amounts of Russian corporate ruble-denominated bonds in their portfolios; this further deteriorated the risk profile of Russian bank assets.

The 2008-2009 global financial crisis has led to the collapse or bailout of some Russian banks and to significant liquidity constraints for others. Profitability levels of most Russian banks were adversely affected. Indeed, the global crisis has prompted the Government to inject substantial funds into the banking system amid reports of difficulties among Russian banks and other financial institutions. Notwithstanding the implementation of such anti-crisis measures, some Russian financial institutions have continued to demonstrate liquidity problems, and while some improvement of the situation in the financial markets is reported, no assurance can be given that similar liquidity problems will not occur in the future, or that the Government will continue to implement state support measures to support the Russian banking sector. Accordingly, any deterioration in the liquidity of the Russian banking system generally—and of the banks with which we conduct banking relationships in particular—could prevent us from accessing our funds or affect our ability to complete banking transactions in the Russian Federation or may result in the loss of our deposits altogether, which could have a material adverse effect on our business, results of operations, financial condition and prospects; our ability to meet our obligations under the Securities may also be adversely affected.

As a result of the current state of the banking sector, considerable delays may occur in the transfer of funds within, and the remittance of funds out of, the Russian Federation. Any delay or other difficulty in transferring or remitting funds could limit our ability to meet payment and debt obligations as they become due, which could result in the acceleration of debt obligations and cross-defaults and, in turn, have a material adverse effect on our business, revenues, financial condition, results of operations and prospects.

***Russian physical infrastructure is in very poor condition and further deterioration of the physical infrastructure could have a material adverse effect on our business***

Russian physical infrastructure largely dates back to Soviet times and has not been adequately funded and maintained in recent years. Particularly affected are the rail and road networks, power generation and transmission facilities, communications systems, and building stock. The federal Government is actively pursuing plans to re-organise the nation's rail, electricity and telephone systems, as well as public utilities. Any such re-organisation may result in increased charges and tariffs, potentially adding costs to our business, while

failing to generate the anticipated capital investment needed to repair, maintain and improve these systems. The deterioration of Russian physical infrastructure harms the national economy, disrupts the transportation of goods and supplies, adds costs to doing business in the Russian Federation and can interrupt business operations.

For instance, 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 rubles in damage. As a result of the accident, the plant halted power production, leading to severe power shortages for both residential and industrial consumers. These difficulties can impact us directly; for example, we need to have portable electrical generators available to help us to maintain base station operations in the event of power failures. Further deterioration in the physical infrastructure could have a material adverse effect on our business.

### ***Sustained periods of high inflation could adversely affect our business***

The Russian Federation has experienced high levels of inflation since the early 1990s. Inflation increased dramatically after the August 1998 financial crisis, reaching a rate of 84.4% in that year. The annual inflation rate was approximately 9.0% in 2006, 11.9% in 2007 and 13.3% in 2008.<sup>6</sup> As a result of the overall reduction of business activity, rising unemployment and a fall in consumption and investment during the global financial crises, the inflation rate was 8.8% in both 2009 and 2010, 6.1% in 2011 and 6.5% for the twelve-month period between October 2011 and October 2012. Despite this recent reduction, a short-term return to high and sustained inflation is possible. Any return to high and sustained inflation could lead to market instability, new financial crises, reductions in consumer purchasing power and an erosion of consumer confidence. Although we can try to adjust our tariffs to account for inflation, our operating results could still suffer if we are unable to increase our tariffs sufficiently to offset inflation. Doing so may become more difficult as we attract more price-sensitive and low income subscribers.

### **Risks Relating to the Legal and Regulatory Environment in the Russian Federation**

#### ***Weaknesses relating to the Russian legal system and Russian law create an uncertain environment for investment and for business activity***

The Russian Federation is still developing the legal framework required by a market economy. Our business is subject to the rules of federal laws and decrees, orders and regulations issued by the President, the Government, the federal ministries and regulatory authorities, which are, in turn, complemented by regional and local rules and regulations. These legal norms at times overlap or contradict one another. Several fundamental Russian laws have only become effective within the past five to ten years, and many have recently been amended. The recent nature of much of Russian law and the rapid evolution of the Russian legal system place the enforceability and underlying constitutionality of laws in doubt and result in ambiguities, inconsistencies and anomalies. Many new laws remain untested. In addition, Russian law sometimes leaves substantial gaps in regulatory infrastructure. Among the risks of the current Russian legal system, to varying degrees, are:

- inconsistencies among federal laws, among decrees, orders and regulations issued by the President, the Government, federal ministries and regulatory authorities and among regional and local laws, rules and regulations;
- limited judicial and administrative guidance on interpreting Russian law;
- the possibility of undue influence on or manipulation of judges and the judicial system;
- substantial gaps in the regulatory structure due to delay or absence of implementing legislation;
- a high degree of discretion on the part of Governmental authorities; and
- bankruptcy procedures that can be subject to abuse.

All of these weaknesses could affect our ability to enforce our rights under contracts, or to defend against claims by others under Russian jurisdiction, which in turn could have a material adverse effect on our business.

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<sup>6</sup> Source: CBR.



***Unlawful or arbitrary Government action may have an adverse effect on our business***

Governmental authorities have a high degree of discretion in the Russian Federation and have in the past exercised their discretion arbitrarily, without due process or prior notice, and sometimes in a manner contrary to law. Moreover, the Government also has the power, in certain circumstances, by regulation or Governmental act, to interfere with the performance of, nullify or possibly terminate contracts. Unlawful or arbitrary Governmental actions have reportedly included withdrawal of licences, sudden and unexpected tax audits, criminal prosecutions and civil actions. Federal and local Governmental entities have also used common defects in share issuances and registration as pretexts for court claims and other demands to invalidate such issuances and registrations and/or to void transactions, often for political purposes. Unlawful or arbitrary Governmental action, if directed at us, could have a material adverse effect on our business, and on the value of the Securities.

***The judiciary's relative inexperience and lack of independence, as well as the difficulty of enforcing court decisions and Governmental discretion in instigating, joining and enforcing claims, could prevent us or investors in the Securities from obtaining effective redress in a court proceeding, including redress for expropriation or nationalisation***

The independence of the judicial system and its immunity from economic, political and nationalistic influences in the Russian Federation remain largely untested. Many judges and courts are inexperienced in the area of business and corporate law. The Russian Federation is a civil law jurisdiction and, as such, as a general rule, judicial precedents have no binding effect on subsequent decisions. In addition, most court decisions are not readily available to the public. All of these factors make judicial decisions in the Russian Federation difficult to predict and effective redress uncertain. Additionally, parties often advance court claims in furtherance of political aims. We may be subject to such claims and may not receive a fair trial. In addition, law enforcement agencies do not always enforce court judgments effectively, so we may not be able to recover amounts awarded to us.

There are also legal uncertainties relating to property rights. During its transformation from a centrally planned economy to a market economy, the Russian Federation enacted laws to protect private property against expropriation and nationalisation. However, it is possible that due to lack of experience in enforcing these provisions or to political pressure, Russian courts would not enforce these laws in the event of an attempted expropriation, nationalisation, or re-organisation. Such expropriation, nationalisation or re-organisation could potentially bring little or no compensation and could have a material adverse effect on our operations and revenues.

***The Russian Federation'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 "Limitation on Enforcement of Civil Liabilities".

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. However, there is a risk that these rules and Russian law may be interpreted by a Russian court so as to deny such recognition and enforcement, or that the 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. Consequently, our business, financial condition and results of operations may be adversely affected.



### ***Laws restricting foreign investment could materially adversely affect our business***

We could be materially adversely affected by the adoption of new laws or regulations restricting foreign participation in Russian companies or unfavourable interpretation of existing regulations on the matter by courts and competent authorities. There have been examples in the recent past, and there is one ongoing example, of attempts to interpret such laws unfavourably in relation to foreign shareholders of Russian telecommunications companies. On 7 May 2008, Federal Law No. 57-FZ, “On the Procedure for Making Foreign Investments in Business Enterprises Having Strategic Importance to Secure Defence and Security of the State” dated 29 April 2008 (the “**Foreign Strategic Investments Law**”), came into force. The Foreign Strategic Investments Law restricts the level of foreign investment in certain sectors of the Russian economy considered to be strategic. We qualify as a “strategic company”, since we were classified by FAS as a company “holding a dominant position” in the market of mobile communication services in the territory of the Russian Federation, with a market share of over 25% as well as because we offer services involving the use of cryptographic technologies. Acquisition of direct or indirect control over a company that falls under the definition of the “strategic company” by a foreign investor or an entity controlling, controlled or under the common control with a foreign investor would require preliminary approval by the special commission under the Russian Government. See “Regulation of the Russian Telecommunications Industry—Foreign Strategic Investments Law”. The above-mentioned restriction, as well as any limitations on foreign investment which may be imposed in the future and unfavourable interpretation of respective legal requirements by courts and competent authorities may limit our ability to raise equity financing in foreign capital markets or consummate strategic transactions in the future and, therefore, may have a material adverse effect on our business and results of operations. For the avoidance of doubt, the Foreign Strategic Investment Law will not impact this Offering.

### ***Shareholder liability provisions of Russian law could expose us to liability for our subsidiaries’ obligations***

Although our major operating subsidiaries have been merged into OJSC MegaFon, we still have several Russian subsidiaries, including the companies which operate under the “NetByNet” brand, and the VAS Media group of companies. Under Russian law, we may be jointly and severally liable for the obligations of a subsidiary. This liability exists if:

- we have a right to give binding instructions to a subsidiary under the subsidiary’s charter or under a contract concluded with the subsidiary;
- we give compulsory instructions to a subsidiary; and
- the subsidiary’s obligation arises from actions that the subsidiary takes pursuant to such compulsory instructions.

Furthermore, we may also bear contingent liability for the obligations of a subsidiary that becomes insolvent or bankrupt if this is shown to be our company’s fault.

In either of these circumstances, if we knew that the action taken pursuant to our instructions would result in losses, then the subsidiary’s shareholders would be able to seek compensation from us for such losses. Although we currently own 100% of each of our operating subsidiaries (except for Synterra-Media and our operating subsidiaries outside the Russian Federation, namely TT-Mobile, Ostelecom and Aquafon), in any case where, now or in the future, we were to become less than a 100% owner, these shareholder liability provisions of Russian law could result in significant liabilities for us and adversely affect our business.

### ***Our creditors may demand early performance of our obligations or compensation of damages as a result of the Share Redemption***

Under Russian law, a company must notify the competent authority within three business days of the approval by the general shareholders’ meeting of a decrease of share capital. The company must then publish two notifications on the decrease of the share capital in specifically designated mass media once per month in successive months. One method by which a company can decrease its share capital is by way of a share redemption. Our General Shareholders’ Meeting approved the Share Redemption on 11 May 2012. We duly published the first notification on 30 May 2012 and the second on 4 July 2012.

The Joint-Stock Companies Law provides that creditors whose rights arose prior to publication of a notification on a decrease of share capital may demand, within 30 days following the last such notification: (i) early performance of the company’s obligations, or, if such early performance is impossible; (ii) early termination of their contractual relations with the company and recovery of the related damages. The statute of limitations for

such demands is six months from the latest notification on decrease of the share capital. A creditor's claim may be dismissed by the court if the company can prove that (i) the creditors' rights are not infringed as a result of the decrease of the share capital and (ii) security granted for due performance of the respective obligation is sufficient.

The relationship between the period for presenting claims and the statute of limitations under the above provision of the Joint-Stock Companies Law is not clear. In particular, the law does not specify whether in order to be able to apply to court, a creditor is still required to make a claim within the specified 30 days period and whether a creditor who fails to make such demand loses its right to apply to court.

We have not received any claims from our creditors within 30 days of the last notification on the decrease of our share capital that we published as a result of the Share Redemption. However, we cannot exclude the possibility that a creditor may file a claim with a court seeking early performance of our obligations within six months from the last notification even if such creditor has not submitted a respective demand directly to us during the abovementioned 30 days period.

If the amount of a respective creditor's claims is significant and such claims are sustained by the court, this may have a material adverse effect on our business, financial condition and results of operation.

***Shareholder rights provisions of Russian law may impose additional costs on us, which could cause our financial results to suffer***

Under Russian law, shareholders that vote against or abstain from voting on some decisions have "appraisal rights", or the right to sell their shares back to the company at market value. The decisions that trigger such "appraisal rights" include:

- a re-organisation;
- the approval by the shareholders of a major transaction, the value of which comprises over 50% of the company's assets calculated in accordance with RAS as at the last reporting date, regardless of whether the transaction is actually consummated or not; and
- amendments to our Charter in a manner that limits shareholder rights.

In these circumstances, the obligation for the company to buy back shares is limited to an amount of shares with an aggregate value of up to 10% of the company's net assets, calculated according to RAS at the time the relevant decision is taken.

If these circumstances were to occur in relation to us (or, as the case may be, in relation to any of our Russian subsidiaries that we do not wholly own (a "**Relevant Russian Subsidiary**")), then our (or our Relevant Russian Subsidiary's) obligation to buy back an amount of shares equal to up to 10% of our (or our Relevant Russian Subsidiary's) net assets (calculated in accordance with RAS at the time that the matter at issue is voted on) could have a material adverse effect on its results of operations and financial condition.

In addition, shareholders who vote against or abstain from voting on a decision to place shares or convertible securities through a closed subscription, as well as all shareholders in case of share issuance through an open subscription, have a pre-emptive right to acquire additional shares or convertible securities at the same price, *pro rata*, to the number of shares they own. This requirement may lead to delays in us completing equity and convertible offerings and may lead to uncertainty with respect to sales of newly-issued shares to strategic investors.

***The Russian Federation's developing securities laws and regulations may limit our ability to attract future investment and could subject us to fines or other enforcement measures despite our best efforts at compliance, which could cause our financial results to suffer and harm our business***

The regulation and supervision of the securities market, financial intermediaries and issuers are considerably less developed in the Russian Federation than in the West. Disclosure and reporting requirements, anti-fraud safeguards, insider trading restrictions and duties of the directors to the company are relatively new concepts in the Russian Federation and are unfamiliar to many Russian companies and managers.

In addition, Russian securities rules and regulations can change rapidly, which may adversely affect our ability to conduct securities-related transactions. While some important transactions are subject to little or no oversight in

the Russian Federation, other transactions are subject to requirements not found in other jurisdictions, resulting in delays in conducting securities offerings and accessing the capital markets. It is often unclear whether certain regulations, decisions and letters issued by the various regulatory authorities apply to us. Violation of reporting and other securities regulation requirements can result in the imposition of fines or difficulties in registering subsequent share issuances. We may be subject to fines or other enforcement measures despite our best efforts at compliance, which could cause our financial condition to suffer.

***Corporate governance standards in the Russian Federation are not of the same standard as those in Western Europe and the United States.***

Corporate governance standards in the Russian Federation are not of the same standard as those in Western Europe and the United States. In particular, we are not required to comply with the U.K. Corporate Governance Code. Accordingly, there are fewer protections for investors than would otherwise be the case were we required to comply with the U.K. Corporate Governance Code principles on corporate governance or similar standards of other European Union member states or the United States.

***If we or any of our existing or future subsidiaries is recognised as an operator occupying a “substantial position” or a natural monopoly, we might be subject to price regulations and this may adversely affect our business, financial condition and results of operations***

Aside from Governmental control over persons “holding a dominant position”, the Telecommunications Law provides for special control over fixed-line telecommunications operators occupying a “substantial position”, i.e., operators which, together with their affiliates, have not less than 25% of installed capacity or are able to carry out transmission of not less than 25% of traffic in a geographically defined numeration zone or over the whole territory of the Russian Federation. Under this law, key terms of such operators’ interconnection agreements, including the interconnection tariffs, are subject to Governmental regulation. In addition, such operators are required to develop standard interconnection agreements and publish them as a public offer made to all operators who intend to interconnect to their networks.

Neither we, nor our subsidiaries, except for Pskovskaya GTS, are classified as telecommunications operators occupying a “substantial position”. While at present the foregoing provisions of law apply only to Russian fixed-line operators, amendments to the Telecommunications Law were proposed in 2008 that would have extended application of the law to mobile operators if those had been adopted. Although this draft law was withdrawn by its originator in June 2011, if these or similar amendments are successfully adopted in the future and we or any of our existing or future Russian subsidiaries are recognised as an operator occupying a “substantial position”, regulators may reduce our interconnection tariffs which, in turn, may have a material adverse effect on our business, financial condition and results of operations.

In addition, Pskovskaya GTS, is also recognised by the Federal Tariff Service as a natural monopoly in the Pskov micro-region telecommunications market. As a result, Pskovskaya GTS is subject to price regulation imposed by the Federal Tariff Service and to other obligations and restrictions. If we or any of our other existing or future Russian subsidiaries is recognised as a natural monopoly, we will also be subject to special state regulation which may adversely affect our business, financial condition and results of operations.

***Russian legal entities may be forced into liquidation 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 formal non-compliance with certain requirements during formation, re-organisation or operation. There have been cases in the past in which formal deficiencies in the establishment process of a Russian legal entity or non-compliance with provisions of Russian law have been used by Russian courts as a basis for the liquidation of that entity. Some Russian courts, in deciding whether to order the liquidation of a company, have looked beyond the fact that the company failed to comply fully with all applicable legal requirements and have taken into account other factors, such as the financial standing of the company and its ability to meet its tax obligations, as well as the economic and social consequences of its liquidation. Nonetheless, creditors have the right to accelerate claims, including damages claims, and Governmental or local authorities may seek the liquidation of a company with negative net assets. Courts have, on rare occasions, ordered the involuntary liquidation of a company for having net assets amounting to less than the minimum charter capital required by law, even if the company had continued to fulfil its obligations and had net assets in excess of the minimum charter capital at the time of liquidation.

For example, under Russian corporate law, negative net assets calculated on the basis of RAS as of the end of the second or any subsequent year of a company's operations can serve as a basis for a court to order the liquidation of the company upon a claim by Governmental authorities. Many Russian companies have negative net assets due to very low historical asset values reflected on their RAS balance sheets; however, their solvency, i.e., their ability to pay debts as they come due, is not otherwise adversely affected by such negative net assets. Although neither we nor any of our material subsidiaries currently has or has had net negative assets in the past, should any entity fail to maintain positive net assets in the future, it may result in its involuntary liquidation, which may have a material adverse effect on our business, results of operations, financial condition and prospects.

### ***Restrictive currency regulations may adversely affect our business and financial condition***

Notwithstanding significant recent liberalisation of the Russian currency control regime and the abolition of certain restrictions from 1 January 2007, the Federal Law No. 173-FZ "On Currency Regulation and Currency Control" of 10 December 2003, as amended (the "**Currency Law**"), and current regulations still contain a number of limitations on foreign currency operations. In particular, Russian companies must notify the Russian tax authorities upon opening, closing or making amendments to details of bank accounts denominated in any currency with banks located outside of the Russian Federation. Moreover, certain currency control restrictions were not repealed and these include a general prohibition of foreign currency operations between Russian companies (except for the operations specifically listed in the Currency Law and the operations between the authorised banks specifically listed in the CBR regulations) and the requirement to repatriate, subject to certain exemptions, export-related earnings to the Russian Federation. Restrictions on our ability to conduct some of these transactions could increase our costs, or prevent us from continuing necessary business operations, or from successfully implementing our business strategy, which could have a material adverse effect on our business, results of operations, financial condition and prospects.

As a result of the current state of the banking sector, considerable delays may occur in the transfer of funds within, and the remittance of funds out of, the Russian Federation. Any delay or other difficulty in transferring or remitting funds could limit our ability to meet payment and debt obligations as they become due, which could result in the acceleration of debt obligations and cross-defaults, and, in turn, have a material adverse effect on our business, revenues, financial condition, results of operations and prospects.

### **Risks Relating to Taxation in the Russian Federation**

#### ***The Russian taxation system is relatively underdeveloped***

The Russian Government is constantly reforming the tax system by redrafting parts of the Tax Code of the Russian Federation (the "**Russian Tax Code**"). As of 1 January 2009 the corporate profits tax rate was reduced to 20%. For individuals who are tax residents in the Russian Federation the current personal income tax rate is 13%. The general rate of VAT is 18%. As of 1 January 2010, the Unified Social Tax has been replaced by social security charges payable to the Russian pension, social security and medical insurance funds. Since 1 January 2012 the total security charge generally equals 30%. Since 1 January 2012 the new Russian transfer pricing legislation is in force.

Russian tax laws, regulations and court practice are subject to frequent change, varying interpretations and inconsistent and selective enforcement. In accordance with the Constitution of the Russian Federation, laws that introduce new taxes or worsen a taxpayer's position cannot be applied retroactively. Nonetheless, there have been several instances when such laws have been introduced and applied retroactively.

Despite steps taken by the Russian Government to reduce the overall tax burden in recent years, there is a possibility that the Russian Federation would impose arbitrary or onerous taxes and penalties in the future, which could have a material adverse effect on our business, financial condition, results of operations and prospects.

In addition to the actual tax burden imposed on Russian taxpayers, these conditions complicate tax planning and related business decisions. These uncertainties could possibly expose us to significant fines and penalties and potentially severe enforcement measures and could result in a greater than expected tax burden and could have a material adverse effect on our business, results of operations and financial condition or prospects.

Generally, taxpayers are subject to tax audits for a period of three calendar years immediately preceding the year in which the audit commences. The tax authorities are generally prohibited from carrying out a subsequent on-site tax audit in respect of the same taxes for the same, already audited tax period. 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 last date of the tax period during which the tax offence was committed (depending on the nature of the tax offence). Nevertheless, based on current judicial interpretation, the statute of limitations for tax offences may be extended beyond three years in certain circumstances.

Tax audits or inspections may result in additional costs to us, in particular if the relevant tax authorities conclude that we did not satisfy our tax obligations in any given year. Such audits or inspections may also impose additional burdens on us by diverting management resources. The outcome of these audits or inspections could have a material adverse effect on our business, financial condition, results of operations and prospects.

In October 2006, the Plenum of the Supreme Arbitration Court of the Russian Federation 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. 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. However, 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 this trend is anticipated to continue in the future. Although the intention of this ruling was to combat tax law abuses, in practice there can be no assurance that the tax authorities will not seek to apply this concept in a broader sense than may have been intended by the Supreme Arbitration Court.

Recently, the Government of the Russian Federation approved a new Model Treaty to be entered into between the Russian Federation and foreign countries for the avoidance of double taxation and the prevention of tax evasion on income and property (the “**Russian Model Treaty**”). This Russian Model Treaty was adopted as the basis for negotiating new treaties with the competent authorities of foreign countries. The most substantial changes that have been introduced by the Russian Model Treaty are the following:

A competent authority may refuse to grant concessions established by a treaty, *inter alia*, if: (a) more than 50% of the equity interests in the foreign company belong, directly or indirectly, to parties that are not resident in the state in which the company operates (however, this provision does not apply if the owner of the equity interests engages in significant business activity in the country in which the foreign company is located, save where such business solely consists of the mere ownership of assets and/or the performance of auxiliary operations); or (b) if the receipt of a concession applicable to the payment of dividends, interest or royalties is one of the main reasons for seeking to apply the treaty;

- (1) The Russian Government has effectively incorporated the right to apply the thin capitalisation rules in accordance with the requirements of Russian tax legislation to interest income payable abroad with respect to “controlled debt” (see “—The Russian thin capitalisation rules allow for different interpretations, which may affect our business, results of operations, financial condition or prospects”).
- (2) The above changes to the Russian Model Treaty evidence the Russian tax authorities’ desire to challenge the availability of the tax relief provided by double tax treaties and to insist on the application of the Russian thin capitalisation rules to interest payments.

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. Further, these risks and uncertainties complicate our tax planning and related business decisions, potentially exposing us to significant fines, penalties and enforcement measures, and could materially adversely affect our business, results of operations and financial condition.

Furthermore, Russian tax legislation is becoming increasingly technical and complex. 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 for 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 could be deducted by the Russian subsidiaries of OJSC MegaFon for corporate income tax purposes on “controlled” debts. A controlled debt is defined as a loan or other indebtedness (i) obtained by a Russian company from a foreign entity (foreign parent) which owns, directly or indirectly, more than 20% of such Russian company’s share capital; (ii) obtained by a Russian company from another Russian company affiliated to such foreign parent; or (iii) that is guaranteed or otherwise secured by such foreign parent or its Russian affiliates (each 20% direct or indirect shareholder or affiliate a “**Related Party**”). The deductibility of interest is restricted to the extent that the foreign controlled debt of a Russian company exceeds its 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 subsidiaries 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 share capital, or loans from Russian affiliated companies of such foreign shareholder, or loans from any other party, if such a loan is guaranteed by such foreign shareholder of a Russian entity or by the Russian entity that 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, in particular, regarding guarantees issued with respect to loans provided by third parties. The court practice on this matter is also controversial, but recent court precedents indicate that the Russian tax authorities are seeking to apply thin capitalisation rules to cases that are not formally subject to such restrictions through application of the substance over form principle.

***New Russian transfer pricing rules may subject our transfer prices to challenge by the Russian tax authorities***

On 1 January 2012, new transfer pricing legislation was introduced in the Russian Federation.

In particular, the new transfer pricing legislation has expanded the methods for monitoring the prices of controlled transactions, and the list of controlled transactions have been expanded to include:

- cross-border transactions with certain types of commodities where the amount of income attributable to one counterparty exceeds 60 million rubles;
- Russian domestic transactions between related entities if the total annual turnover of such transactions exceeds 1,000 million rubles (3,000 million rubles for 2012 and 2,000 million rubles for 2013);
- transactions with residents of offshore jurisdictions included in the list established by the Russian Ministry of Finance where the amount of income attributable to one counterparty exceeds 60 million rubles; and
- transactions between Russian legal entities and related foreign legal entities.

The amended transfer pricing law requires taxpayers to notify the Russian tax authorities as of controlled transactions (for 2012 and 2013 the notification is required where the income attributable to one counterparty exceeds 100 million rubles per annum and 80 million rubles per annum, respectively). Taxpayers are required to present to the Russian tax authorities transfer pricing documentation upon their request.

The amended transfer pricing rules may have a potential impact on our tax costs arising from the pricing mechanisms used in controlled transactions and, in particular, transactions with related parties (regardless of whether they are located in the Russian Federation or not) in and outside of the Russian Federation. The Russian tax authorities will be entitled to accrue additional tax liabilities if prices for the controlled transactions differ from those which independent counterparties in similar conditions would have applied. As yet, it is still unclear what effect the new transfer pricing rules may have on taxpayers, including us.

As a result, due to the uncertainties in the interpretations of transfer pricing legislation, no assurance can be given that the tax authorities will not challenge the prices applied by us and make adjustments, which could affect our tax position. Unless such tax adjustments are successfully contested in court, we could become liable for increases in our tax payables. The amended Russian transfer pricing law, including the possible tax adjustments outlined above, could have a material adverse effect on our business, results of operations and financial condition.



*Our tax burden may become greater than the estimated amount that has been paid or accrued on our balance sheet, as Russian tax authorities have often been arbitrary and aggressive in their interpretation of Russian tax laws which are often highly unclear, contradictory and subject to varying interpretation by different tax authorities*

Starting in 2007, the Russian MegaFon companies applied an accelerated (double) tax depreciation on various types of telecommunication equipment. The Russian tax authorities have recently started challenging the application of this accelerated tax depreciation by telecommunications operators, including the Russian MegaFon companies. Certain Russian MegaFon companies are currently in the process of defending their tax position in the courts. See “Business—Litigation—Synterra Tax Case” for further details. On 11 May 2012, one of the Russian MegaFon companies successfully defended its position in the court of cassation, and we expect that these disputes will be resolved in a positive manner. However, as the litigation process is not complete and court rulings have not been consistent to date, the outcome of the litigation remains uncertain. Were application of accelerated tax depreciation to be successfully challenged by the tax authorities in courts, we do not believe that any additional amount of tax payable would be materially adverse to our financial position.

In addition, in accordance with the draft version of the Main Directions of Russian Tax Policy for 2013 and planned for 2014-2015, our ability to apply such accelerated tax depreciation could be narrowed or excluded. No assurance can currently be 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 the Russian MegaFon companies. We cannot give any assurances that as a result of the introduction of any such potential changes, the Russian MegaFon companies would not be required to make substantially larger tax payments in future, which may affect our financial results.

#### **Risks Relating to the Securities and the Trading Market**

*An investment in the Securities carries a high degree of risk and many factors could have a material adverse effect on the value of the Securities, and an active and liquid market for the Securities may not develop*

An investment in the Securities is speculative and carries a high degree of risk. Potential investors must be prepared to bear the risk of a total loss of their investment. A material adverse effect on the value of the Securities could arise from many factors, including:

- variations in our operating results and those of other Russian companies including our competitors;
- securities analysts’ or investors’ expectations that such operating results will not be met by us;
- actual or anticipated announcements of significant acquisitions, strategic partnerships, joint ventures, capital commitments, technical innovations or new products or services by us or our competitors;
- variations in national and industry growth rates;
- changes in Governmental legislation or regulation;
- regulatory actions that affect our business;
- depth and liquidity of the market for the Securities;
- general economic conditions within the business sector where we operate or in the Russian Federation; or
- extreme price and volume fluctuations on the Russian or other emerging market stock exchanges.

The market value of our Securities may also vary considerably from its underlying net asset value. Moreover, the market price of the Securities may decline below their Offer Price, which will be determined based on the results of the bookbuilding exercise conducted by the Joint Bookrunners.

In addition, the Russian stock market where the underlying ordinary shares will be listed has from time to time experienced extreme price and volume volatility. For example, during the recent economic downturn, in the second half of 2008, price and volume volatility resulted in a suspension of trading on certain Russian stock exchanges, in some cases for several days. This has negatively affected the market for securities listed in the Russian Federation. Such conditions, if they were to reoccur, could significantly adversely affect the liquidity and market price for the Securities. Furthermore, future sales of the Securities may affect the market price of the Securities. Sales, or the possibility of sales, of substantial numbers of Securities in the public markets—including, in the case of the Offer Shares, the Russian stock market—following the Offering could have an adverse effect on the trading prices of the Securities and could affect our ability to obtain further capital through

an offering of equity securities. Further, subsequent equity offerings may reduce the percentage ownership of our existing shareholders. Moreover, newly issued preferred shares may have rights, preferences or privileges senior to those of the ordinary shares.

Furthermore, before the Offering, there has been no public trading market for the Securities. Although the GDRs are expected to be admitted to trading on the London Stock Exchange and our ordinary shares were listed on MICEX on 27 September 2012, an active, liquid trading market may not develop or be sustained after this Offering. Active, liquid trading markets generally result in lower price volatility and more efficient execution of buy and sell orders for investors. If an actual liquid trading market for the Securities does not develop, the price of the Securities may be more volatile and it may be difficult to complete a buy or sell order for the Securities.

***Enforcement of the Sberbank Pledge and subsequent sale of the subject ordinary shares or GDRs could adversely affect our ordinary share and/or GDR price***

Approximately 33.8% of our outstanding ordinary shares are subject to the Sberbank Pledge (as defined in “Principal and Selling Shareholders”). Sberbank will not be subject to the lock-up in respect of such ordinary shares (see “Plan of Distribution”) and accordingly will be free to sell all or a portion of those ordinary shares in connection with enforcement of the Sberbank Pledge. Sales, or the possibility of future sales, of a substantial number of ordinary shares or GDRs in the market following enforcement of the Sberbank Pledge could have a substantial adverse effect on the market price of our ordinary shares and GDRs.

***We may decide not to pay dividends in the future, and holders of GDRs may be subject, in any event, to limitations or delays in repatriating their earnings from distributions made on the GDRs***

Although we have recently paid dividends to our shareholders, and on 8 June 2012 OJSC MegaFon’s Board of Directors adopted a dividend policy (see “Dividend Policy”), we may be unable or elect not to declare dividends in the future. The payment of dividends, if any, by us to holders of the Securities will depend on (in addition to applicable regulatory requirements), among other things, our future profits, financial position and capital requirements, the sufficiency of our distributable reserves, credit terms, general economic conditions and other factors that the directors and/or shareholders deem to be important from time to time. Should we decide against declaring dividends in the future, the price of the Securities may be adversely affected.

We anticipate that any dividends that we may pay in the future in respect of the ordinary shares held by the Depositary or its nominee on behalf of GDR holders will be declared and paid to the Depositary in rubles and will be converted into U.S. dollars by the Depositary and distributed to holders of the GDRs, net of all fees, taxes, duties, charges, cost and expenses which may become or have become payable under the the deposit agreement entered into between us and the Depositary dated 24 August 2012 (the “**Deposit Agreement**”) or under applicable law in respect of such GDRs. Accordingly, the value of dividends received by holders of the GDRs will be subject to fluctuations in the exchange rate between the ruble and the U.S. dollar. Such fluctuations could have an adverse effect on the price of the GDRs.

Furthermore, even though current Russian legislation permits distributions in rubles to be converted into U.S. dollars by the Depositary without restriction, the ability to convert rubles into U.S. dollars is subject to the availability of U.S. dollars in Russian currency markets. Although there is an existing, albeit limited, market within the Russian Federation for the conversion of rubles into U.S. dollars, including the interbank currency exchange and over-the-counter and currency futures markets, further development of this market is uncertain. At present, there is no market for the conversion of rubles into foreign currencies outside of the Russian Federation and no viable market in which to hedge ruble and ruble-denominated investments.

In addition, dividends that we may distribute to the Depositary will be subject to applicable Russian withholding taxes. See “—Payments of dividends (if any) on the Securities may be subject to Russian withholding tax” below.

***Under applicable Russian law, the Depositary may be deemed the beneficial owner of the ordinary shares underlying the GDRs, and a Russian court could order the seizure of such ordinary shares in legal proceedings against the Depositary***

Many jurisdictions, such as the United Kingdom and the United States, distinguish between legal owners of securities, such as a depositary, and the beneficial owners of securities, such as holders of GDRs. In these jurisdictions, shares held by the depositary on behalf of the GDR holders would not be subject to seizure in connection with legal proceedings against the depositary that are unconnected with the shares.

Current Russian law may not, however, recognise a distinction between legal and beneficial ownership of securities. Russian law generally treats a depository as the owner of shares underlying GDRs and, accordingly, may not recognise GDR holders' beneficial ownership in such shares.

Thus, in proceedings brought against a Depository, whether or not related to the ordinary shares underlying the GDRs, Russian courts may treat those underlying ordinary shares as the assets of such Depository, open to seizure or arrest.

In the past, lawsuits were filed against depositaries seeking the seizure of various Russian companies' shares represented by GDRs issued by that depository. However, the cases were dismissed. In the event that a lawsuit seeking the seizure or arrest of the ordinary shares underlying the GDRs were to be successful in the future against the Depository, and the ordinary shares underlying the GDRs were to be seized or arrested, the holders of the GDRs involved would lose their rights to such underlying ordinary shares and all or part of the money invested in them.

From 1 January 2013, amendments to the Federal Law of 22 April 1996, No. 39-FZ "On the Securities Market", as amended (the "**Securities Market Law**") adopted by Federal Law No. 415-FZ of 7 December 2011 (the "**Amendments on DR Programmes**") will preclude certain enforcement measures on ordinary shares underlying the GDRs in proceedings against the Depository in the Russian Federation. Once the Amendments on DR Programmes enter into force and the underlying ordinary shares are re-recorded on the so-called "depo" account of a depository programme in the name of the Depository, such ordinary shares may not be seized to enforce the obligations of the Depository. See "—The Amendments on DR Programmes, once in force, may complicate the exercise of rights to, and the ability to derive benefits from, the underlying ordinary shares and could expose investors to a risk of suspension of our GDRs programme", below.

***Following the Offering, holders of the Offer Shares may not be able to deposit the Offer Shares in the GDR programme in order to receive GDRs, and changes in Russian regulatory policy with respect to the placement and circulation of shares outside the Russian Federation in the form of GDRs or otherwise may negatively affect the market for the Securities being offered***

Whenever the Depository believes that the ordinary shares deposited with it against issuance of GDRs represent (or, upon accepting any additional shares for deposit, would represent) a percentage exceeding any limit established by any applicable law, directive, regulation or permit, or trigger any condition for the making of any filing, application, notification or registration or for obtaining any approval, licence or permit under any applicable law, directive or regulation, or for taking any other action, the Depository may (i) close its books to deposits of additional shares to prevent such thresholds or limits being exceeded or conditions being satisfied or (ii) take such steps as are, in its opinion, necessary or desirable to remedy the consequences of such thresholds or limits being exceeded or conditions being satisfied and to comply with any such law, directive or regulation, including, without limitation, causing *pro rata* cancellation of GDRs and withdrawal of the underlying ordinary shares from the depository receipt programmes to the extent necessary or desirable to so comply.

Russian securities regulations provide that no more than 25% of any class of a Russian company's issued shares may be circulated abroad through depository receipt programmes or otherwise. Although it was announced in 2011 that the Russian President had instructed the Russian Government to abolish existing restrictions on foreign placement and circulation of securities of Russian issuers, those restrictions have not been so abolished as of the date hereof. On 27 September 2012, we received permission from the FSFM for 123,380,000 of our ordinary shares (but in any event not more than 20% of our outstanding ordinary shares at any time) to be circulated abroad through GDRs (the "**GDR Permit**"). Upon the completion of the Offering, the GDR programme is expected to account for approximately [●]% of our share capital. There can be no assurance that we will be able to obtain approval for a deposit of a greater number of our shares with the Depository under the GDR programme than we currently have approval for, and any remaining capacity may be used by our other existing shareholders. As a result, once these thresholds have been reached, it may not be possible to deposit ordinary shares with the Depository under the GDR programme to receive GDRs and under certain circumstances you may be required to withdraw shares from the GDR programme, which may in either case affect the liquidity and the value of the Securities.

In addition, under Russian corporate law, a person that has acquired more than 30%, 50% or 75% of an open joint stock company's ordinary shares and voting preferred shares (including, for such purposes, the shares already owned by such person and its affiliates) will, except in certain limited circumstances, be required to make, within 35 days of acquiring such shares, a public tender offer for other shares of the same class and for

securities convertible into such shares. From the moment of the relevant acquisition until the date the offer is sent to the company, the person making the offer and its affiliates will be able to register for quorum purposes and vote only 30%, 50% or 75%, as the case may be, of the company's ordinary shares and voting preferred shares (regardless of the size of their actual holdings). See "Description of Share Capital and Certain Requirements of Russian Law—Certain requirements of Russian legislation—Change of Control and Anti-takeover Protection". Under Russian law in effect on the date hereof, the Depositary may be considered the owner of the shares underlying the GDRs, and as such may be subject to the mandatory public tender offer rules together with any of its affiliates acquiring our shares. See "—Under applicable Russian law, the Depositary may be deemed the beneficial owner of the ordinary shares underlying the GDRs, and a Russian court could order the seizure of such ordinary shares in legal proceedings against the Depositary" above. In addition, in a private clarification letter to one of the depositaries, the FSFM took the general position that the mandatory public tender offer rules do apply to a depositary bank and accordingly such position may currently apply to The Bank of New York Mellon (Luxembourg) S.A., as Depositary for the GDR programme, and its affiliates. Accordingly, at present, the mandatory tender offer rules result in a *de facto* cap on the aggregate holding of The Bank of New York Mellon (Luxembourg) S.A., as Depositary for the GDR programme, and its affiliates of our ordinary shares of 29.99% (subject to other regulatory requirements and limits from time to time applicable to the GDR programme).

In addition, under Russian anti-monopoly legislation, transactions over a certain amount involving companies with combined assets value or combined revenues exceeding certain thresholds, or companies registered as having more than a 35% share of a certain commodity market and resulting in a shareholder (or a group of affiliated shareholders) holding more than 25%, 50% or 75% of the voting capital stock of such company, or in an acquisition of such company's assets the value of which exceeds a certain amount, must be approved in advance by FAS. See "Regulation of the Russian Telecommunications Industry—Fair Competition Provisions—Antitrust Regulation". In a private general interpretive guidance, FAS clarified that the depositary need not obtain the approval referred to above in connection with depositary receipt programmes such as the GDR programme. If, however, FAS were to rescind or disregard its above mentioned interpretation, the aggregate holding of The Bank of New York Mellon (Luxembourg) S.A., as Depositary for the GDR programme, and its group (as defined under Russian law) of our ordinary shares may be subject to a *de facto* cap of 25% of the ordinary shares (subject to other regulatory requirements and limits from time to time applicable to the GDR programme), unless the Depositary was able to obtain FAS approval for a higher percentage.

Furthermore, should the 25% limit established by Russian securities regulations with respect to depositary receipts programmes, such as the GDR programme, be increased or eliminated in the future, the aforementioned restrictions (provided that they remain in force and are applicable to the depositary banks and the GDR programmes under the legislation in force at that time) may result in relevant *de facto* caps to the GDR programme (subject to other regulatory requirements and limits from time to time applicable to the GDR programme), thus preventing the Depositary and the GDR holders from taking advantage of such increase or elimination.

In addition, the statutory and FSFM regulations relating to the GDRs are not entirely clear in a number of respects, including the extent to which existing permissions are grandfathered following changes in regulations and the applicability of domestic offering requirements and limits on the percentage of ordinary shares that can be sold in the form of GDRs pursuant to follow-on offerings. Any adverse interpretation and/or application of these regulations may further limit the ability to deposit ordinary shares into the GDR facilities.

The aforementioned restrictions have been changed in the past and may be subject to changes at any time in the future by the Russian regulatory authorities, and there can be no assurance that changes by the authorities will not adversely affect the legality and/or size of our GDR programme, which could adversely affect the price of the Securities.

However, some of these risks may cease to apply on or after 1 January 2013, once the ordinary shares underlying the GDRs are re-recorded at a "depo" account of a depositary programme in the Depositary's name in accordance with the Amendments on DR Programmes. See "—Under applicable Russian law, the Depositary may be deemed the beneficial owner of the ordinary shares underlying the GDRs, and a Russian court could order the seizure of such ordinary shares in legal proceedings against the Depositary".

Any additional issuance of our ordinary shares will be registered by the FSFM and will be assigned a provisional state registration number, containing a suffix distinguishing it from the previous issuance of ordinary shares of the same class. Following completion of the issuance, the provisional suffix will be cancelled. The FSFM permission for our GDR programme expressly permits the deposit of shares having specific registration numbers.



Ordinary shares having a different registration number, whether currently in issue or to be issued in the future, may not be deposited in our GDR programme. As a result, the Depositary may be entitled to refuse a deposit of shares having a different registration number than those set out in the FSFM permission for the GDR programme.

***Voting rights with respect to the ordinary shares represented by the GDRs are limited by the terms of the Deposit Agreement and the relevant requirements of Russian law***

The holders of the GDRs will have no direct voting rights with respect to the ordinary shares represented by the GDRs. They will be able to exercise voting rights with respect to the ordinary shares represented by the GDRs only in accordance with the provisions of the Terms and Conditions of the GDRs as set out in the Deposit Agreement and the relevant requirements of Russian law. There are, therefore, practical limitations upon the ability of the holders of the GDRs to exercise their voting rights due to the additional procedural steps involved in communicating with them. For example, OJSC MegaFon is required under its Charter, in compliance with the Joint Stock Companies Law, to notify shareholders at least 20 days in advance of any General Shareholders' Meeting (with the exception of certain limited circumstances, for which a notice period of at least 30 days is required) and at least 70 days in advance of an Extraordinary General Shareholders' Meeting to elect directors or a General Shareholders' Meeting, whether annual or extraordinary, to pass upon certain other matters. OJSC MegaFon's shareholders will receive notice directly from OJSC MegaFon, and they will be able to exercise their voting rights by either attending the meeting in person or voting by power of attorney. See "Management and Corporate Governance—Governance Bodies—General Shareholders' Meeting".

The holders of the GDRs, by comparison, will not receive notice directly from OJSC MegaFon. Rather, in accordance with the Deposit Agreement, OJSC MegaFon will provide that notice to the Depositary. The Depositary has undertaken, in turn, as soon as practicable thereafter, if requested by OJSC MegaFon in writing in a timely manner and at OJSC MegaFon's expense, and provided there are no U.S., U.K. or Russian legal prohibitions (including, without limitation, the rules of the London Stock Exchange or the rules of MICEX) to distribute to the holders of the GDRs notice of the meeting, copies of voting materials (if and as received by the Depositary from OJSC MegaFon) and a statement as to the manner in which instructions may be given by holders of the GDRs. To exercise their voting rights, the holders of the GDRs must then instruct the Depositary how to vote the ordinary shares represented by the GDRs they hold. Because of this additional procedural step involving the Depositary, the process for exercising voting rights may take longer for holders of the GDRs than for holders of the ordinary shares, and OJSC MegaFon cannot assure the holders of the GDRs that they will receive voting materials in time to enable them to return voting instructions to the Depositary in a timely manner. The GDRs for which the Depositary does not receive timely voting instructions will not be voted.

In addition, although Russian securities regulations expressly permit the Depositary to split the votes with respect to the ordinary shares underlying the GDRs in accordance with instructions from GDR holders, there is little court or regulatory guidance on the application of such regulations, and the Depositary may choose to refrain from voting at all unless it receives instructions from all of the holders of the GDRs to vote the ordinary shares in the same manner. The holders of the GDRs may thus have significant difficulty in exercising voting rights with respect to the ordinary shares underlying the GDRs. There can be no assurance that holders and beneficial owners of GDRs will (i) receive notice of General Shareholders' Meetings to enable the timely return of voting instructions to the Depositary, (ii) receive notice to enable the timely cancellation of GDRs with respect to shareholder actions (as discussed below) or (iii) be given the benefit of dissenting or minority shareholders' rights with respect to an event or action in which the holder or beneficial owner has voted against, abstained from voting or not given voting instructions. The Depositary is only required to execute the voting instructions of the holders of GDRs insofar as practicable and as permitted under applicable law. In practice, holders of GDRs may not be able to instruct the Depositary to (i) vote the ordinary shares represented by their GDRs on a cumulative basis if such votes are split and split votes are rejected by OJSC MegaFon or the Custodian or held invalid by the Russian courts; (ii) introduce proposals for the agenda of shareholders' meetings or request that a shareholders' meeting be called; or (iii) nominate candidates for the Board of Directors or certain other of our governance bodies. If holders of GDRs wish to take such actions, they should timely request that their GDRs be cancelled and take delivery of the ordinary shares and thus become the owners of the ordinary shares on OJSC MegaFon's share register.

From 1 January 2013, Russian law will impose additional conditions for the exercise of voting rights in respect of the ordinary shares underlying the GDRs. See "—The Amendments on DR Programmes, once in force, may complicate the exercise of rights to, and the ability to derive benefits from the underlying ordinary shares and could expose investors to a risk of suspension of our GDRs programme" below.



***The Amendments on DR Programmes, once in force, may complicate the exercise of rights to, and the ability to derive benefits from, the underlying ordinary shares and could expose investors to a risk of suspension of our GDRs programme***

The Amendments on DR Programmes will enter into force on 1 January 2013 (except for certain provisions that take effect on 1 July 2012), and they will considerably change the regulatory regime of both future and already established depositary share programmes of Russian issuers. However, due to a lack of official interpretive guidance regarding the Amendments on DR Programmes, and pending the adoption of relevant regulations by the FSFM, the effect of such changes on OJSC MegaFon, the Depositary and prospective GDRs holders remains unclear.

The Amendments on DR Programmes will change the existing system of recording the Depositary's rights to the ordinary shares underlying the GDRs. From 1 January 2013, the underlying ordinary shares will no longer be recorded at the Depositary's "owner's" account, with the custodian holding a "depo" account of a nominee in OJSC MegaFon's shareholder register. Instead, the underlying ordinary shares will need to be re-recorded at the "depo" account of a depositary programme, opened with a qualified Russian custodian who, in turn, holds a "depo" account of a nominee with the central depositary. On 6 November 2012, the FSFM granted National Settlement Depositary (Non-banking Credit Organisation, CJSC) ("NSD") the status of central depositary. OJSC MegaFon cannot offer any assurance to prospective investors that the process of re-recording the underlying ordinary shares, as required by the Amendments on DR Programmes, will not result in technical disruptions to operations with the GDRs, including the deposit and withdrawal of the underlying ordinary shares, at or around the time of such re-recording.

Because under the Amendments on DR Programmes the Depositary will no longer be treated for the purposes of the Joint Stock Companies Law as a holder of title to the underlying ordinary shares, the Depositary will lose its status as an ordinary shareholder of OJSC MegaFon. As a result, the Depositary may no longer be able to exercise rights normally enjoyed by ordinary shareholders (other than voting and dividend rights, which are granted to the Depositary pursuant to the Amendments on DR Programmes). For example, the Depositary may not benefit on behalf of the GDRs holders from a pre-emptive right in cases set by the Joint Stock Companies Law for the benefit of ordinary shareholders and/or a right to participate in share buybacks conducted by OJSC MegaFon.

The Amendments on DR Programmes will also impose disclosure and reporting requirements on the Depositary and "depository receipts owners" ("владельцы") (the scope of this term, as used in the Amendments on DR Programmes, is not entirely clear) as a condition to receiving dividends and exercising voting rights in respect of the ordinary shares underlying the GDRs.

From 1 January 2013, the Depositary will be able to vote at the General Shareholders' Meeting only on instructions from depository receipts owners for which information has been provided to OJSC MegaFon (including the corresponding number of the underlying ordinary shares) and will only be able to receive dividends for the benefit of such depository receipts owners. See "Description of Share Capital and Certain Requirements of Russian Law—Description of Share Capital—Dividends".

In addition, since 1 July 2012, the Amendments on DR Programmes oblige OJSC MegaFon to prepare quarterly a list of the depository receipts owners (including the number of the GDRs held by each depository receipts owner), and the depository receipts owners must provide all necessary information for such list (which is expected to be done through the Depositary). Further, OJSC MegaFon will be obliged to provide these lists to the FSFM, courts, certain investigative authorities and divisions of the Ministry of Internal Affairs upon demand.

Currently, pending the adoption of relevant regulations by the FSFM, it is not clear whether the term "depository receipts owner" means a holder registered on the records of the Depositary, a securities intermediary or a beneficial owner of a GDR for the purposes of the Amendments on DR Programmes. As a result, the scope of the above reporting obligations, which may affect the rights of the GDRs holders, also remains uncertain. OJSC MegaFon cannot offer assurance to prospective investors that the Amendments on DR Programmes and the pending regulations by the FSFM will be compatible with the previously customary infrastructure for depository receipts programmes (such as *pro rata* exercise of voting and dividends rights to the underlying ordinary shares by depository receipts holders via securities intermediaries and the Depositary) or foreign confidentiality regulations, or that the new requirements will not impose additional burdens upon the Depositary, prospective investors or their respective securities intermediaries such that they would make investments in the GDRs less attractive. It also remains unclear how the authorities will use their new powers to require information on the depository receipts owners.

In addition, effective 1 July 2012, the FSFM has the power to require the Depositary to cure any infringement of the Amendments on DR Programmes (including, potentially, a reporting violation by any GDRs holder). A failure to cure can lead to the suspension or limitation by the FSFM of all or part of the operations with the “depo” account of a depositary programme for up to six months. It is unclear how the FSFM will use these new regulatory powers.

***Holders of the Securities may not be able to exercise their pre-emptive rights***

Generally, existing holders of shares of Russian open joint stock companies are in certain circumstances entitled to statutory pre-emptive rights with respect to newly issued shares, pursuant to Russian law and a company’s charter (see “Description of Share Capital and Certain Requirements of Russian Law—Description of Share Capital—Pre-emptive Rights”). Holders of the Securities in certain jurisdictions may face restrictions under relevant local law on their ability to exercise statutory pre-emptive rights with respect to any new equity issuances by OJSC MegaFon. In particular, holders of Securities located in an EEA Member State may not be able to exercise their statutory pre-emptive rights, unless a prospectus pursuant to the Prospectus Directive is effective with respect to those rights, or an exemption under the Prospectus Directive from the requirement to produce such a prospectus is available. OJSC MegaFon does not currently expect to produce such a prospectus or take steps to receive an exemption from the requirement to produce such a prospectus. Furthermore, U.S. holders of Securities may not be able to exercise such statutory pre-emptive rights, unless a registration statement under the Securities Act is effective with respect to those rights, or an exemption from the registration requirement under the Securities Act is available. OJSC MegaFon does not currently expect to file any such registration statement, and no assurance can be given that an exemption from the registration requirements of the Securities Act would be available to enable such U.S. holders to exercise such statutory pre-emptive rights and, if such exemption were available, OJSC MegaFon may not take the steps necessary to enable U.S. holders of Securities to rely on it.

***Our ordinary shares may be de-listed from MICEX, the FSFM permission for the GDR programme may be revoked and the GDR facilities may have to be terminated***

In order to maintain its “V” listing on MICEX, OJSC MegaFon is required to comply with listing requirements, including, among others, compliance with Russian securities laws and FSFM regulations, and with certain minimum corporate governance requirements as well as maintaining minimum trading volumes. A material failure to comply with these listing requirements may constitute grounds for de-listing of OJSC MegaFon’s ordinary shares, which may in turn result in the revocation of FSFM’s permission for the GDR programme, since the listing of our ordinary shares on a Russian stock exchange is one of the pre-requisites for obtaining and maintaining FSFM’s permission in relation to the GDR programme. See “Description of Share Capital and Certain Requirements of Russian Law—Corporate Governance” for certain details of such requirements, and “Management and Corporate Governance—Russian Corporate Governance Requirements” for a discussion of our compliance with the requirements of a “V” listing.

There can be no assurance that a failure to comply with corporate governance requirements will not result in a de-listing of OJSC MegaFon’s shares. A Russian stock exchange de-listing and/or a revocation of the FSFM permission for the GDR programme would have a material adverse effect on the price of the Securities.

The current lack of a central and rigorously regulated share registration system in the Russian Federation may result in improper record ownership of our ordinary shares

Ownership of shares in Russian joint stock companies (or, if the shares are held through a nominee or custodian, then the holding of such nominee or custodian) is determined by entries in a share register and is evidenced by extracts from that register. Currently, there is no operating central registration system in the Russian Federation. Share registers are maintained by the companies themselves or, if a company has more than 50 shareholders or so elects, by licensed registrars located throughout the Russian Federation. Regulations have been issued regarding the licensing conditions for such registrars as well as the procedures to be followed both by companies maintaining their own registers and licensed registrars when performing the functions of registrar. In practice, however, these regulations have not been strictly enforced, and registrars generally have relatively low levels of capitalisation and inadequate insurance coverage. Moreover, registrars are not necessarily subject to effective Governmental supervision. Due to the current lack of a central and rigorously regulated share registration system in the Russian Federation, transactions in respect of a company’s shares could be improperly or inaccurately recorded, and share registration could be lost through fraud, negligence or oversight by a registrar incapable of compensating shareholders for its misconduct.

In general, if transactions involving our ordinary shares were to be improperly or inaccurately recorded by our registrar, or registration of our ordinary shares were to be lost by such registrar, the beneficial holders of such ordinary shares, including GDR holders, could lose all or part of the money invested in them. See “Description of Share Capital and Certain Requirements of Russian Law—Description of Share Capital—Registration and transfer of shares” for more discussion of the share registration system and registrars in the Russian Federation.

However, Federal Law No. 414-FZ “On the Central Depository” (the “**Central Depository Law**”), which generally came into force on 1 January 2012, set out a legal framework for establishment and operational conditions of the central depository. This law is aimed at improving effectiveness and competitiveness of the Russian stock market, including expediting and facilitating securities trade settlements and mitigating the risks associated therewith. Pursuant to this law, the central depository is a depository which is a non-bank credit organisation assigned with the special status of central depository. Only a joint-stock company registered in the Russian Federation can be assigned with such a status. Pursuant to the Central Depository Law, the central depository, within one year from the date of having been granted with such a status, shall take all necessary steps to open its nominal holder accounts, in, among others, all the securities registers of the issuers which are obliged to disclose information in accordance with the Securities Market Law. Also, the Central Depository Law prohibits persons maintaining securities registers from opening, and depositing securities to (save for limited exceptions), other nominal holder accounts from the date of opening a nominal holder account with the central depository. On 6 November 2012, the FSFM granted NSD the status of central depository.

***Investors may have limited recourse against OJSC MegaFon, members of its Board of Directors and its management board because OJSC MegaFon generally conducts its operations outside the United Kingdom and U.S. and all of its current members of the Board of Directors and management board reside outside the United Kingdom and the U.S.***

Judgments rendered by a court in any jurisdiction outside the Russian Federation will generally be recognised by courts in the Russian Federation only if an international treaty providing for recognition and enforcement of judgments in civil or commercial cases exists between the Russian Federation and the country where the judgment is rendered, or if a federal law is adopted in the Russian Federation providing for the recognition and enforcement of foreign court judgments. See “Limitation on Enforcement of Civil Liabilities”.

As at the date hereof, there is no treaty between the United States or the United Kingdom and the Russian Federation providing for reciprocal recognition and enforcement of court judgments in civil and commercial matters, and no relevant federal law on enforcement of foreign court judgments has been adopted in the Russian Federation. 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. These limitations may deprive investors of effective legal recourse for claims related to their investment in the Securities. OJSC MegaFon’s presence outside the United Kingdom and the United States may limit the legal recourse of the investors against OJSC MegaFon, its directors and management board. OJSC MegaFon is incorporated under Russian laws. All of the members of its Board of Directors and management board reside outside the United Kingdom and the United States. As a result, investors may not be able to effect service of process within the United Kingdom and the United States upon OJSC MegaFon, members of its Board of Directors and management board. Furthermore, all of OJSC MegaFon’s assets are located outside the United Kingdom and the United States, principally in the Russian Federation; the Company further believes that the majority of the assets of the members of its Board of Directors and management board are located outside the United Kingdom and the United States. As a result, investors may not be able to enforce United Kingdom and United States court judgments obtained against OJSC MegaFon or the members of its Board of Directors or management board in jurisdictions outside the United Kingdom and the United States. In addition, it may be difficult for investors to enforce, in original actions brought in courts in jurisdictions outside the United Kingdom and the United States, liabilities obtained in accordance with U.K. and U.S. securities laws.

***Payments of dividends (if any) on the Securities may be subject to Russian withholding tax***

Payments of dividends by a Russian entity to a Russian resident investor who is an individual or a legal entity or organisation resident in the Russian Federation for tax purposes should generally be subject to Russian withholding income tax and such tax should not exceed 9% of the gross dividend amount payable to such Russian resident investor.

With respect to dividends payable in respect of the ordinary shares represented by GDRs, there is a risk that investors that are Russian corporate tax residents may be required to pay additional Russian corporate income tax on such dividend amount received at the rate of 9% or 20% (the higher rate applies if the income received is not recognised as dividends for Russian profits tax purposes). Similarly, Russian individual tax resident investors may be required to pay additional personal income tax from the dividends received under the GDRs at the rate of 9% or 13% (the higher rate applies if the income received is not recognised as dividends for Russian personal income tax purposes). There is also no established procedure providing for the refund or credit of tax withheld from dividends payable through the Depository to the Russian resident investors holding the GDRs.

In general, payments of dividends by a Russian entity to non-resident legal persons, organisations and non-resident individuals are subject to Russian withholding tax at a rate of 15%. Such Russian withholding tax may generally be subject to reduction pursuant to the terms of an applicable double tax treaty between the Russian Federation and the country of tax residence of non-resident investors to the extent that such non-resident investors are entitled to benefit from this double tax treaty, provided the Russian tax documentation requirements are satisfied.

However, Russian tax rules applicable to non-resident investors that hold GDRs are characterised by significant uncertainty and, until recently, an absence of interpretative guidance. The Ministry of Finance of the Russian Federation has expressed its opinion that non-resident investors in depositary receipts should be treated as the beneficial owners of the dividends paid on the underlying shares for the purposes of double tax treaty provisions applicable to Russian withholding tax on dividend income from the underlying shares, provided that the respective tax residence of such investors is duly confirmed. However, the Russian tax authorities have not provided official guidance addressing how an investor that holds depositary receipts should demonstrate its beneficial ownership of the dividend income payable under the underlying shares. In the absence of any specific provisions in the tax legislation with respect to the concept of beneficial ownership and the taxation of the income of beneficial owners, it is unclear how the Russian tax authorities will ultimately treat investors that hold GDRs in this regard. In such circumstances, there can be no assurance that a non-resident investor that holds GDRs will be in a position to benefit from a reduced Russian withholding tax rate on dividend income from the underlying ordinary shares provided by an applicable double tax treaty.

Consequently, in the absence of any interpretative tax guidance on the beneficial ownership concept in the Russian Federation and due to the fact that the Depository (and not the investors that hold GDRs) is the legal owner of the ordinary shares underlying the GDRs under Russian law, we are likely to withhold tax from the dividends payable on the GDRs at a rate of 15% even when it is subject either to possible reduction pursuant to the terms of any applicable double tax treaty with respect to dividends payable to non-resident holders which are not individuals, or to possible reduction under the provisions of Russian domestic tax law with respect to dividends payable to Russian resident holders who are individuals or legal entities resident in the Russian Federation (including legal entities or organisations, in each case not organised under Russian law, that hold the GDRs through an office in the Russian Federation), or to possible non-withholding of income tax with respect to dividends payable to legal entities or organisations, in each case not organised under Russian law, that hold the GDRs through an office in the Russian Federation. However, no assurance can be given that such reduction of the Russian withholding tax rate or non-withholding of income tax at source will be available for the holders with respect to the dividends payable under the GDRs.

Moreover, procedures for advance treaty clearance are not certain enough in the current Russian legislation with respect to non-resident individual investors. Therefore, it is very likely that for non-resident individual investors a reduction of withholding income tax provided by a respective double tax treaty between the Russian Federation and the country of the tax residence of such non-resident individual investors could not be obtained before a dividend is paid. If non-resident individual investors do not obtain double tax treaty relief at the time the dividend income related to the Offer Shares or the GDRs is paid to such non-resident individual investors and income tax is withheld by a Russian income payer, such non-resident individual investors may apply for a refund within one year from the end of the tax period in which the tax was withheld. The documentation requirements to obtain such a refund would include an official confirmation of a non-resident individual investor's tax residence



in a country having an effective double tax treaty with the Russian Federation which provides for a respective reduction of withholding income tax. However, there can be no assurance that such double tax treaty relief (or refund of any taxes withheld) will be available for such non-resident individual investor.

Furthermore, if tax authorities view dividends payable on the Offer Shares or the GDRs as Russian-source income, there is a theoretical risk that this income attributed to non-resident individual holders of GDRs may be subject to tax in the Russian Federation twice, resulting in a combined gross tax rate of up to 45% (i.e., 15% income tax withheld by us from dividend payments plus 30% Russian personal income tax payable by a non-resident individual on a self-assessed basis from the subsequent payment made by the Depositary to such individual GDR holders, should such income be treated as a distribution of ordinary Russian-source income to non-resident individuals rather than a dividend distribution).

The imposition or risk of the imposition of the above tax liabilities in the Russian Federation could adversely affect the value of the Securities. See “Taxation”.

***Capital gains from the sale of the Securities may be subject to Russian income tax***

Based on the assumption that less than 50% of our gross assets consist of (i) immovable property located in the Russian Federation; and (ii) financial instruments derived from shareholdings in Russian companies or organisations, which companies or organisations have more than 50% of their gross assets comprised of immovable property located in the Russian Federation, then the gross proceeds or capital gains from the disposal of the Offer Shares received by non-resident investors that are a legal entity or an organisation should not be subject to withholding tax in the Russian Federation, provided that such Offer Shares are disposed of other than through an office in the Russian Federation. The Russian Tax Code does not specify which document(s) evidence the satisfaction of the above assumption.

If the above assumption as to the portion of the Russian immovable property and related financial instruments in our assets is incorrect, the gross proceeds from a disposal of the Offer Shares by a non-resident investor that is a legal entity or an organisation (disposing of the Offer Shares other than through an office in the Russian Federation) are subject to withholding tax in the Russian Federation at a rate of 20%, providing that the proceeds from such disposal are deemed to be received from a Russian source. Alternatively, the capital gains from the sale are subject to a 20% withholding tax. Capital gain means the difference between the sale price and the sum of the acquisition and disposal costs (which need to be evidenced by proper supporting documents) of the Offer Shares.

In accordance with recent amendments to the Russian Tax Code, which came into force in 2011, if a non-resident holder that is a legal entity or organisation disposes of securities and such securities are recognised as marketable securities under the Russian Tax Code, the proceeds from such disposal (effected other than through an office in the Russian Federation) should not be subject to profits tax in the Russian Federation. Consequently, no Russian withholding income tax should be imposed on the proceeds from disposal of the Offer Shares to be received by a non-resident holder to the extent the Offer Shares would be recognised as marketable securities under the requirements of the Russian Tax Code. A non-resident holder that is a legal entity or an organisation should generally not be subject to Russian withholding tax in respect of disposal of the GDRs if such disposal is conducted on a foreign stock exchange and the GDRs are recognised as circulating on such foreign stock exchange (providing such disposal is conducted other than through an office of such entity or organisation in the Russian Federation).

If a non-resident holder that is a legal entity or organisation disposes of the GDRs over-the-counter (other than through an office in the Russian Federation) and the proceeds from such disposal are deemed to be received from a Russian source, the gross proceeds of such disposal may be subject to withholding tax in the Russian Federation at a rate of 20%. Alternatively, the capital gains from the sale may be subject to a 20% withholding tax. The capital gain is the excess, if any, of the sales price over the sum of the acquisition and disposal costs (which need to be evidenced by proper supporting documents) of the GDRs. Russian withholding tax would apply if more than 50% of our assets consist of immovable property located in the Russian Federation.

Where the proceeds from a disposal of the Securities are received from a source within the Russian Federation by a non-resident investor that is an individual, there is a risk that Russian withholding tax would be charged at a rate of 30% on the gross proceeds from such disposal less any available cost deduction.



A resident investor that is a legal entity or an organisation should generally be subject to Russian profits tax at a rate of 20% of the capital gain. A resident investor who is an individual should generally be subject to income tax at a rate of 13% on the gross proceeds from a disposal of the Securities less any available cost deduction.

The imposition or risk of the imposition of the above tax liabilities in the Russian Federation could adversely affect the value of the Securities. See “Taxation”.

## **Other Risks**

*Information regarding our competitors and official data from Russian Government agencies were not independently verified by us; certain future market trends discussed in the Prospectus are based on many assumptions that may turn out to be inaccurate*

Some of the information contained in this Prospectus has been derived from the official data of Russian Government agencies and third-party independent agencies, such as AC&M Consulting. The official data published by Russian federal, regional and local Governments are 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 must, therefore, be subject to uncertainty due to concerns about the completeness or reliability of available official and public information.

Statistical data, including official data, published in the Russian Federation are substantially less complete and reliable and may be produced on a different basis than those published in countries with more developed market economies. Due to the unavailability of alternative reliable sources of country-specific data, Russian companies necessarily rely to some extent on this statistical data in their business planning. As a result, assumptions made by Russian companies in their business plans may prove to be incorrect.

The lack of accurate statistical data may contribute to the overall volatility of the Russian economy and may adversely affect our business planning capacity, which in turn could have a material adverse effect on our business, financial condition, results of operations and prospects.

In addition, because no standard methodology for calculating the number of subscribers, the monthly average revenue per user (“**ARPU**”), minutes of usage (“**MOU**”) and churn exists in the telecommunications industry, reported numbers may vary from those which would result from the use of a uniform methodology. Therefore, comparisons of certain operating data between different telecommunications operators may be difficult to draw.

Furthermore, this Prospectus contains estimates of future market trends in the telecommunications sector which are inherently uncertain. The process of estimating market trends is complex. It requires interpretations of available technical data and many assumptions to be made, including assumptions relating to current and future economic conditions and customers’ preferences. In addition, historical data that can be used as a frame of reference in preparing these estimates are limited. We cannot give any assurance that such estimates will prove to be accurate.

## THE OFFERING

### The Company

Open Joint Stock Company MegaFon, a company incorporated under the laws of the Russian Federation and registered in the Unified State Register of Legal Entities under number 1027809169585. Its registered office is at 30 Kadashevskaya Embankment, Moscow, 115035, Russian Federation, and its telephone number is +7 499 755 2155.

### The Selling Shareholders

Sonera Holding B.V., a company organised and existing under the laws of the Netherlands, which is a wholly owned subsidiary of TeliaSonera AB, a major Swedish and Finnish telecommunications provider with world-wide operations whose shares are listed on the Stockholm and Helsinki stock exchanges; and MegaFon Investments (Cyprus) Limited, a company organised and existing under the laws of Cyprus, which is a wholly owned subsidiary of OJSC MegaFon. See “Principal and Selling Shareholders”.

### The Offering

The Selling Shareholders are offering an aggregate of up to [●] of our ordinary shares, consisting of [●] Offer Shares and [●] GDRs, with one GDR representing an interest in one ordinary share.

The Offering comprises (i) an offering of Offer Shares in the Russian Federation and (ii) an offering of Offer Shares and GDRs outside of the Russian Federation. The Offer Shares and GDRs are being offered outside the United States in reliance on Regulation S and within the United States to certain QIBs, as defined in, and in reliance on, Rule 144A of the Securities Act.

Under the GDR Permit the Selling Shareholders are allowed to sell 123,380,000 of our ordinary shares through the GDR program (but in any event not more than 20% of our outstanding ordinary shares at any time).

### Offer Price

The offer price is U.S.\$[●] per Offer Share / GDR.

### Share Capital

Immediately prior to the Offering, OJSC MegaFon’s issued share capital consisted of 620,000,000 ordinary shares, each with nominal value of 0.1 rubles, which are fully paid and issued.

Our ordinary shares are subject to applicable provisions of Russian law and our Charter, and have the rights described under “Description of Share Capital and Certain Requirements of Russian Law”.

### Over-allotment Option

The Selling Shareholders have, *pro rata* to the number of Offer Shares and GDRs being sold by each of them, granted an Over-Allotment Option to the Joint Global Coordinators on behalf of the Joint Bookrunners to acquire up to [●] additional ordinary shares in the form of ordinary shares and GDRs at the Offer Price for the purpose of covering over-allotments and other short positions, if any, in connection with the Offering. The Over-Allotment Option is exercisable upon written notice to the Selling Shareholders at any time up to and including the thirtieth day following the announcement of the Offer Price. If the Joint Global Coordinators on behalf of the Joint Bookrunners exercise the Over-Allotment Option, the Selling Shareholders will be obligated to sell and each Joint Bookrunner will be severally obligated, subject to the conditions contained in the Underwriting Agreement, to purchase, a number of additional ordinary shares in the form of ordinary shares and GDRs proportionate to that Joint Bookrunner’s initial amount indicated in

the table in “Plan of Distribution”. The Over Allotment Option is granted to the Joint Bookrunners as part of the Underwriting Agreement for no additional consideration to the Selling Shareholders from the Joint Bookrunners. See “Plan of Distribution—Underwriting Agreement and Over-Allotment Option”.

#### **The GDRs**

One GDRs will represent one ordinary share on deposit with Sberbank of Russia (the “**Custodian**”), as custodian for the Depositary. The GDRs will be issued by the Depositary pursuant to the Deposit Agreement. The Regulation S GDRs will be evidenced initially by a Regulation S Master GDR (the “**Regulation S Master GDR**”) and the Rule 144A GDRs will be evidenced initially by a Rule 144A Master GDR (the “**Rule 144A Master GDR**” and, together with the Regulation S Master GDR the “**Master GDRs**”), each to be issued pursuant to the Deposit Agreement. Pursuant to the Deposit Agreement, the ordinary shares represented by the GDRs will be held by the Custodian, for the account of the Depositary, which in turn holds for the benefit of the holders of the GDRs.

From time to time the Depositary may deduct per-GDR fees and other fees and expenses from dividend distributions and may otherwise assess other per-GDR fees and other fees and expenses to the GDR holders. See “Terms and Conditions of the Global Depositary Receipts”.

Except in the limited circumstances described herein, definitive GDR certificates will not be issued to holders in exchange for interests in the GDRs represented by the Master GDRs. Subject to the terms of the Deposit Agreement, interests in the Regulation S Master GDR may be exchanged for interests in the corresponding number of GDRs represented by the Rule 144A Master GDR, and vice versa. See “Terms and Conditions of the Global Depositary Receipts” and “Settlement and Delivery—Global Clearance and Settlement Procedures”.

#### **Closing Date—GDRs**

The GDRs are expected to be issued, and payment for them to be made, on or about [●] 2012.

#### **Closing Date—Offer Shares**

The Offer Shares are expected to be sold from [●] 2012, and payment for them is expected to be made to the Selling Shareholders on or about [●] 2012.

#### **Use of Proceeds**

The net proceeds of the Offering received by us will be used as follows:

- approximately U.S.\$ [●] will be used to repay and/or refinance existing debt; and
- the remainder will be used for general corporate purposes, including the continuing development and expansion of MegaFon’s network.

We will not receive any proceeds from the sale of Securities by Sonera.

See “Use of Proceeds”.

#### **Depositary**

The Bank of New York Mellon (Luxembourg) S.A.

#### **Lock-up**

Each of OJSC MegaFon, the Selling Shareholders, TeliaSonera AB, Garsdale, Telecominvest Holdings Limited and CJSC Telecominvest has agreed not to, without the consent of the Joint Global Coordinators on behalf of the Joint Bookrunners (except in limited

circumstances), issue, offer, sell or otherwise transfer any of our ordinary shares or securities convertible or exchangeable into or exercisable therefor for a period of 180 days after the later of the Closing Date. See “Plan of Distribution—Lock-up Provisions”.

## **Voting**

Each GDR carries the right to vote one ordinary share, subject to the provisions of the Deposit Agreement and applicable Russian law. Each ordinary share carries one vote. See “Terms and Conditions of the Global Depositary Receipts” and “Description of Share Capital and Certain Requirements of Russian Law—Description of Share Capital—Rights Attaching to Ordinary Shares”.

The Depositary will endeavour to exercise, on behalf of holders of GDRs, at any meeting of holders of our ordinary shares of which the Depositary receives timely notice, the voting rights relating to the ordinary shares underlying the GDRs in accordance with instructions it receives from holders of GDRs. We will notify the Depositary of any resolution(s) to be proposed at any general meeting. The Deposit Agreement does not allow for the voting of fractional entitlements. See “Terms and Conditions of the Global Depositary Receipts—Voting Rights” and “Description of Share Capital and Certain Requirements of Russian Law—Description of Share Capital—Rights Attaching to Ordinary Shares”.

## **Dividend Policy**

OJSC MegaFon had not paid any cash dividends on its share capital prior to 24 April 2012, when it paid a dividend of 151,863 million rubles. This amounted to 245 rubles per ordinary share. This dividend was a paid as part of a broader re-organisation of the shareholders of OJSC MegaFon (see “Principal and Selling Shareholders—Changes in Shareholding Structure and Ultimate Beneficial Owners—April and May 2012 Shareholding Changes” for further details).

Pursuant to the Voting Agreement, our board of directors adopted a dividend policy on 8 June 2012 (the “**Dividend Policy**”).

According to the Dividend Policy, the possibility to distribute dividends should be preliminarily considered by the Finance Committee of the Board of Directors, on the proposal of OJSC MegaFon’s General Director. The decision to pay a dividend must be approved by the General Shareholders’ Meeting on a recommendation by the Board of Directors.

In making the decision on the amount of the dividend the following factors (the “**Relevant Factors**”) shall be taken into account:

- the amount of consolidated net profit of OJSC MegaFon for the first quarter, first six months or first 9 months of the current financial year or the results of the full financial year;
- our Group’s need for financial resources for business development and strategy implementation purposes;
- the ability of our Group to meet its obligations as they fall due;
- other factors that in the judgement of the Board of Directors should have an impact on the amount of the dividend, including, without limitation, factors that may lead to OJSC MegaFon losing its investment grade rating assigned by the international credit rating agencies Moody’s, S&P or Fitch.

When determining the amount of the dividends (calculated on a per share basis) to be recommended for a distribution to the General

Shareholders' Meeting of OJSC MegaFon and the relevant portion of OJSC MegaFon's net profit to be used for payments of dividends, the Board of Directors of OJSC MegaFon shall proceed from the assumption that the total funds to be allocated to a payment of dividends as a general rule shall be equal to (subject to the restrictions established by the legislation of the Russian Federation (Article 43 of the Joint Stock Companies Law) and subject always to the Relevant Factors) the aggregate (meaning for the avoidance of doubt the sum of values that appear in paragraphs (a) plus (b) below) of:

- (a) the higher of:
  - 1) 70% of the value that is determined as the amount of Net Profit plus amortisation and depreciation minus Investments for the last financial year, and
  - 2) 50% of Net Profit for the last financial year; and
- (b) a value (which may be negative) corresponding to the Net Debt capacity of OJSC MegaFon within the bounds of the Optimal Capital Structure.

For the purposes of the Dividend Policy, the following definitions apply:

**“Net Profit”** means, for the 12 months ended December 31 of the last financial year, the amount of net profit exclusive of the effect of non-cash items based on data of the annual consolidated profit and loss statement of OJSC MegaFon prepared in accordance with U.S. GAAP or IFRS, as applicable.

**“Investments”** means the amount of capital expenditures on fixed assets and intangible assets excluding expenditures on acquisition of companies (M&A) based on the consolidated financial statements of OJSC MegaFon for the 12 months ended December 31 of the last financial year.

**“Optimal Capital Structure”** means the level of Net Debt that would result in a ratio of Net Debt to Adjusted OIBDA as recommended by the Board of Directors of the Company in the range of 1.2-1.5 as of and for the 12 months ended December 31 of the last financial year based on the consolidated financial statements of OJSC MegaFon as at and for the 12 months ended December 31 of the last financial year.

**“Net Debt”** at any time means the aggregate amount of financial indebtedness calculated according to the nominal, principal or other amount in which financial indebtedness should be reflected in the consolidated balance sheet as at December 31 of the last financial year of the Company less cash and cash equivalents (after giving effect to the dividend which is proposed to be paid). The Company expects also to deduct short-term investments and long-term deposits in the calculation of Net Debt for these purposes.

**“Adjusted OIBDA”** for the relevant financial year means the amount of Net Profit adding back depreciation and amortisation.

See further “Dividend Policy”.

## **Taxation**

For a discussion of certain U.S., U.K. and Russian tax consequences of purchasing and holding the Securities, see “Taxation”.

## **Transfer Restrictions**

The Securities will be subject to certain restrictions on transfer as described under “Selling and Transfer Restrictions”.



## **Listing and Trading**

Our ordinary shares have been listed on quotation list “V” of MICEX since 27 September 2012 under the symbol MFON. Trading in our ordinary shares on MICEX is expected to commence on or about [●] 2012. Prior to the Offering, there has been no public market for the Securities. Prices for the Offer Shares traded on MICEX may not reflect the value of the GDRs.

Application has been made to (1) the UKLA for a listing of up to [●] GDRs, consisting of (i) [●] GDRs in issue as at the date of Admission, consisting of [●] GDRs to be issued on the Closing Date, (ii) up to [●] additional GDRs to be issued in connection with the Over-allotment Option, and (iii) up to [●] additional GDRs to be issued from time to time against the deposit of ordinary shares (to the extent permitted by law) with a custodian on behalf of the Depositary, to be admitted to the Official List, and (2) the London Stock Exchange for such GDRs to be admitted to trading on the London Stock Exchange’s regulated market through its IOB. Admission to the Official List and to unconditional trading through the IOB is expected to take place on or about [●] 2012. Conditional trading in the GDRs on the London Stock Exchange through the IOB is expected to commence on an if-and-when-issued basis on or about [●] 2012. All dealings in the GDRs prior to the commencement of unconditional dealings will be of no effect if Admission does not take place and will be at the sole risk of the parties concerned. OJSC MegaFon’s GDRs are expected to be traded on the Regulated Market under the symbol “MFON”.

## **Settlement Procedures—GDRs**

Payment for the GDRs is expected to be made in U.S. dollars in same-day funds through the facilities of DTC, Euroclear and Clearstream on or about the Closing Date. OJSC MegaFon has applied to DTC to have the Rule 144A GDRs accepted for clearance through DTC and to Euroclear and Clearstream to have the Regulation S GDRs, accepted for clearance through the systems of Euroclear and Clearstream. Upon acceptance by DTC, a single Rule 144A Master GDR will be issued and deposited with the Bank of New York Mellon in New York as custodian for DTC and registered in the name of Cede & Co., as nominee for DTC. The Regulation S Master GDR will be registered in the name of The Bank of New York Depository (Nominees) Limited, as nominee for The Bank of New York Mellon, London Branch, as common depositary for Euroclear and Clearstream. Except in limited circumstances described herein, investors may hold beneficial interests in the GDRs evidenced by the corresponding Master GDRs only through DTC, Euroclear or Clearstream, as applicable.

Transfers within DTC, Euroclear and Clearstream will be in accordance with the usual rules and operating procedures of the relevant system. See “Settlement and Delivery—Global Clearance and Settlement Procedures”.

The security identification numbers for the GDRs offered hereby are as follows:

Regulation S GDRs: CUSIP: 58517T209  
ISIN: US58517T2096  
Common Code: 084894044  
CFI Code: ESVTFA  
SEDOL: B8PQQ77

Rule 144A GDRs: CUSIP: 58517T100  
ISIN: US58517T1007  
Common Code: 084894150  
CFI Code: ESVTFA  
SEDOL: B832YZ1

London Stock Exchange GDR trading symbol: MFON

**Settlement Procedures—Offer Shares**

Each investor in the Offer Shares is required to pay for any Shares in U.S. dollars or rubles, as the case may be. In order to take delivery of the Offer Shares, an investor should either have a direct account with CJSC “Computershare Registrar”, our share registrar, or a deposit account with NSD or any other depositary that has an account with NSD or a direct account with our share registrar. However, Offer Shares held directly or through a depositary having a direct account with our share registrar are ineligible for trading on MICEX. Only if the Offer Shares are deposited with NSD (or through another depositary having an account at NSD), can they be traded on MICEX.

Ordinary Shares ISIN: RU000A0JS942

Ordinary Shares CFI Code: ESVXXR

Ordinary Shares SEDOL: B8PR8P2

MICEX Ordinary Shares trading symbol: MFON

**Risk Factors**

Prospective investors should consider carefully certain risks discussed under “Risk Factors”.

## USE OF PROCEEDS

The gross proceeds of the Offering will be approximately U.S.\$ [●]. The net proceeds that we will receive from the Offering by virtue of the Securities sold by our subsidiary, MICL, (assuming no exercise of the Over-allotment Option) and after deduction of underwriting commissions, fees and expenses incurred in connection with the Offering of approximately U.S.\$ [●], will be approximately U.S.\$ [●]. We will not receive any proceeds from the sale of Securities by Sonera.

The net proceeds of the Offering received by us will be used as follows:

- approximately U.S.\$ [●] will be used to repay and/or refinance existing debt; and
- the remainder will be used for general corporate purposes, including the continuing development and expansion of MegaFon's network.

## DIVIDEND POLICY

OJSC MegaFon had not paid any cash dividends on its share capital prior to 24 April 2012, when it paid a dividend of 151,863 million rubles (equivalent to approximately U.S.\$5,150 million at the CBR exchange rate as of 24 April 2012). This amounted to 245 rubles per ordinary share. This dividend was a paid as part of a broader re-organisation of the shareholders of OJSC MegaFon. See “Principal and Selling Shareholders—Changes in Shareholding Structure and Ultimate Beneficial Owners—April and May 2012 Shareholding Changes”.

Pursuant to the Voting Agreement, our Board of Directors adopted a dividend policy (the “**Dividend Policy**”) on 8 June 2012.

According to the Dividend Policy, the possibility to distribute dividends should be preliminarily considered by the Finance Committee of the Board of Directors, on the proposal of OJSC MegaFon’s General Director. The decision to pay a dividend must be approved by the General Shareholders’ Meeting on a recommendation by the Board of Directors.

In determining the amount of the dividend the following factors (the “**Relevant Factors**”) shall be taken into account:

- the amount of consolidated net profit of OJSC MegaFon for the first quarter, first six months or first 9 months of the current financial year or the results of the full financial year;
- our Group’s need for financial resources for business development and strategy implementation purposes;
- the ability of our Group to meet its obligations as they fall due;
- other factors that in the judgement of the Board of Directors should have an impact on the amount of the dividend, including, without limitation, factors that may lead to OJSC MegaFon losing its investment grade rating assigned by the international credit rating agencies Moody’s, S&P or Fitch.

When determining the amount of the dividends (calculated on a per share basis) to be recommended for a distribution to the General Shareholders’ Meeting of OJSC MegaFon and the relevant portion of OJSC MegaFon’s net profit to be used for payments of dividends, the Board of Directors of OJSC MegaFon shall proceed from the assumption that the total funds to be allocated to a payment of dividends as a general rule shall be equal to (subject to the restrictions established by the legislation of the Russian Federation (Article 43 of the Joint Stock Companies Law) and subject always to the Relevant Factors) the aggregate (meaning for the avoidance of doubt the sum of values that appear in paragraphs (a) plus (b) below) of:

- (a) the higher of:
  - 1) 70% of the value that is determined as the amount of Net Profit plus amortisation and depreciation minus Investments for the last financial year, and
  - 2) 50% of Net Profit for the last financial year; and
- (b) a value (which may be negative) corresponding to the Net Debt capacity of OJSC MegaFon within the bounds of the Optimal Capital Structure.

To the extent that dividends are declared and paid by OJSC MegaFon in the future, holders of the GDRs on the relevant record date will be entitled to receive dividends payable in respect of ordinary shares underlying the GDRs subject to the terms of the Deposit Agreement.

For further details see “Description of Share Capital and Certain Requirements of Russian Law—Description of Share Capital—Dividends”, “Management and Corporate Governance—Board of Directors—Meetings: Voting and Quorum” and “Management and Corporate Governance—General Shareholders’ Meetings—Powers of the General Shareholders’ Meeting”.

For the purposes of the Dividend Policy, the following definitions apply:

“**Net Profit**” means, for the 12 months ended December 31 of the last financial year, the amount of net profit exclusive of the effect of non-cash items based on data of the annual consolidated profit and loss statement of OJSC MegaFon prepared in accordance with U.S. GAAP or IFRS, as applicable.

“**Investments**” means the amount of capital expenditures on fixed assets and intangible assets excluding expenditures on acquisition of companies (M&A) based on the consolidated financial statements of OJSC MegaFon for the 12 months ended December 31 of the last financial year.

“**Optimal Capital Structure**” means the level of Net Debt that would result in a ratio of Net Debt to Adjusted OIBDA as recommended by the Board of Directors of the Company in the range of 1.2-1.5 as of and for the 12 months ended December 31 of the last financial year based on the consolidated financial statements of OJSC MegaFon as at and for the 12 months ended December 31 of the last financial year.

“**Net Debt**” at any time means the aggregate amount of financial indebtedness calculated according to the nominal, principal or other amount in which financial indebtedness should be reflected in the consolidated balance sheet as at December 31 of the last financial year of the Company less cash and cash equivalents (after giving effect to the dividend which is proposed to be paid). The Company expects also to deduct short-term investments and long-term deposits in the calculation of Net Debt for these purposes.

“**Adjusted OIBDA**” for the relevant financial year means the amount of Net Profit adding back depreciation and amortisation.



## CAPITALISATION AND INDEBTEDNESS

The following table shows our consolidated cash and cash equivalents and capitalisation, comprised of total non-current debt and total equity, as of 30 September 2012. For further information regarding our financial condition, see “Selected Consolidated Financial Information”, “Management’s Discussion and Analysis of Financial Condition and Results of Operations” and our Consolidated Financial Statements included elsewhere in this Prospectus.

	As of 30 September 2012
	(unaudited) (in millions of rubles)
<b>Cash and cash equivalents<sup>(1)</sup></b> .....	<b>17,012</b>
<b>Current debt</b>	
Short-term loans and current portion of long term debt .....	28,494
<b>Total current debt</b> .....	<b>28,494</b>
<b>Non-current debt</b>	
Debt, less current portion <sup>(2)</sup> .....	130,620
<b>Total non-current debt</b> .....	<b>130,620</b>
<b>Total debt</b> .....	<b>159,114</b>
<b>OJSC MegaFon Shareholders’ equity</b>	
Ordinary shares (par value of 0.1 rubles, 620,000,000 shares issued; 530,720,500 shares outstanding) .....	581
Treasury shares (89,279,500 ordinary shares at cost) .....	(63,883)
Reserve fund .....	17
Additional paid-in capital .....	13,852
Retained earnings .....	135,987
Accumulated other comprehensive loss .....	(557)
<b>Total OJSC MegaFon shareholders’ equity</b> .....	<b>85,997</b>
Noncontrolling interests .....	630
<b>Total equity</b> .....	<b>86,627</b>
<b>Total capitalisation<sup>(3)</sup></b> .....	<b>217,247</b>

(1) Does not reflect the estimated net cash proceeds that will be received by MICL, our wholly owned subsidiary, from the Offering of [●] million rubles. See “Use of Proceeds”.

(2) Subsequent to 30 September 2012, we issued 10,000 million ruble bonds in October 2012, the proceeds of which were applied in prepayment in part of a loan from VTB Bank OJSC in the amount of 10,000 million rubles. This has not resulted in any net change in our non-current debt since 30 September 2012. See “Management’s Discussion and Analysis of Financial Condition and Results of Operations—Liquidity and Capital Resources—Indebtedness”.

(3) Total capitalisation is the sum of non-current debt and total equity.

Except as described in the footnotes to the table above, as at the date hereof, there has been no material change in our capitalisation since 30 September 2012.

## SELECTED CONSOLIDATED FINANCIAL INFORMATION

The financial data set forth below as of 31 December 2009, 2010 and 2011 and for the years then ended have been extracted without material adjustment from our Audited Consolidated Financial Statements. The financial data set forth below for the nine-month periods ended 30 September 2012 and 2011, have been extracted without material adjustment from our Unaudited Interim Condensed Consolidated Financial Statements. Our Consolidated Financial Statements are prepared in accordance with U.S. GAAP. Our functional and reporting currency is the ruble. The Unaudited Interim Condensed Consolidated Financial Statements reflect all normal and recurring adjustments that are necessary for a fair presentation of the financial position and results of operations for the interim periods presented. Results of operations for the nine month period ended 30 September 2012, are not necessarily indicative of results for the full year ending 31 December 2012, for any other interim period or for any future fiscal year.

The financial data set forth below should be read in conjunction with, and are qualified in their entirety by reference to, our consolidated financial statements and related notes included elsewhere in this Prospectus and “Management’s Discussion and Analysis of Financial Condition and Results of Operations”.

	Years Ended 31 December			Nine Months Ended 30 September	
	2011	2010	2009	2012	2011
<b>Consolidated Results of Operations</b>	(in millions of rubles)				
<b>Revenues</b>					
Wireless revenues . . . . .	218,994	202,837	178,824	178,608	161,054
Wireline revenues . . . . .	15,194	7,496	674	13,394	10,555
Sales of handsets and accessories . . . . .	8,420	5,182	2,385	9,096	5,537
<b>Total revenues . . . . .</b>	<b>242,608</b>	<b>215,515</b>	<b>181,883</b>	<b>201,098</b>	<b>177,146</b>
<b>Cost of revenues</b>					
Cost of services . . . . .	47,644	41,648	33,128	41,437	34,025
Cost of handsets and accessories sold . . . . .	11,252	6,775	4,076	8,708	8,241
<b>Total cost of revenues . . . . .</b>	<b>58,896</b>	<b>48,423</b>	<b>37,204</b>	<b>50,145</b>	<b>42,266</b>
Sales and marketing expenses . . . . .	21,841	19,471	17,361	15,727	15,230
Operating expenses . . . . .	61,049	49,847	39,126	49,288	44,060
Depreciation . . . . .	42,377	35,035	28,269	35,489	31,253
Amortisation . . . . .	5,299	3,839	3,075	4,594	3,728
<b>Operating income . . . . .</b>	<b>53,146</b>	<b>58,900</b>	<b>56,848</b>	<b>45,855</b>	<b>40,609</b>
<b>Other income/(expense)</b>					
Interest expense . . . . .	(706)	(837)	(1,657)	(4,549)	(726)
Interest income . . . . .	3,591	4,008	3,255	1,047	2,606
Other gain/(loss), net . . . . .	30	18	(89)	(9)	83
Loss on derivatives, net . . . . .	(51)	(203)	(300)	—	(27)
Foreign currency exchange loss, net . . . . .	(105)	(700)	(2,192)	(8,758)	(406)
<b>Total other income/(expense), net . . . . .</b>	<b>2,759</b>	<b>2,286</b>	<b>(983)</b>	<b>(12,269)</b>	<b>1,530</b>
<b>Income before income taxes and noncontrolling interest . . . . .</b>	<b>55,905</b>	<b>61,186</b>	<b>55,865</b>	<b>33,586</b>	<b>42,139</b>
Provision for income taxes . . . . .	12,320	11,962	10,565	7,593	8,276
<b>Net Income . . . . .</b>	<b>43,585</b>	<b>49,224</b>	<b>45,300</b>	<b>25,993</b>	<b>33,863</b>
Net (gain)/loss attributable to noncontrolling interest . . . . .	(6)	(52)	(11)	(93)	46
<b>Net income attributable to MegaFon . . . . .</b>	<b>43,579</b>	<b>49,172</b>	<b>45,289</b>	<b>25,900</b>	<b>33,909</b>

	Years Ended 31 December			Nine Months Ended 30 September	
	2011	2010	2009	2012	2011

(in millions of rubles)

### Consolidated Cash Flows Data

Net cash provided by operating activities	97,295	86,613	79,350	82,170	74,510
Net cash provided by/(used in) investing activities	(102,656)	(88,821)	(60,303)	37,647	(77,940)
of which cash paid for capital expenditures <sup>(1)</sup>	(73,332)	(63,860)	(46,036)	(33,589)	(50,419)
Net cash provided by/(used in) financing activities	5,945	(7,161)	(10,583)	(104,608)	7,343

	As of 31 December			As of 30 September	
	2011	2010	2009	2012	2011

(in millions of rubles)

### Consolidated Balance Sheet Data

Cash and cash equivalents	2,887	2,667	12,550	17,012	6,232
Short-term investments	84,509	63,554	49,114	2,213	84,878
Property, plant and equipment, net	223,718	194,872	147,231	213,824	208,882
Total debt <sup>(2)</sup>	43,709	32,921	27,146	159,114	44,270
Net debt <sup>(3)</sup>	(45,689)	(33,605)	(34,518)	139,887	(49,924)
Working capital <sup>(4)</sup>	70,320	48,299	45,515	(24,290)	72,211
Total equity	276,632	233,126	183,914	86,627	267,118

	As of 31 December			As of 30 September	
	2011	2010	2009	2012	2011

(in millions, unless stated otherwise)

### Key Industry Data, Russian Federation only

Estimated mobile Subscribers (end of period) <sup>(5)</sup>	227.6	219.2	207.9	229.8	225.2
Mobile penetration (end of period) <sup>(5),(6)</sup>	156.8%	151.0%	143.2%	160.9%	155.1%

### MegaFon Operating Data, Russian Federation only

Wireless Subscriber base (end of period) <sup>(7)</sup>	61.6	56.6	50.2	62.8	59.7
Share of total Subscribers (end of period) <sup>(8)</sup>	27.1%	25.8%	24.2%	27.3%	26.5%
MOU (in minutes per month) <sup>(9)</sup>	288	285	275	294	286
ARPU (rubles) <sup>(10)</sup>	311	312	322	316	308
Churn rate <sup>(11)</sup>	48.3%	49.8%	45.8%	36.7%	36.1%
Data Services User Base (end of period) <sup>(12)</sup>	19.1	16.2	12.6	20.0	17.2
DSU (in megabytes per month) <sup>(13)</sup>	628	256	47	1,006	564
ARPDU (rubles) <sup>(14)</sup>	133	113	86	144	132
APPMb (rubles) <sup>(15)</sup>	0.21	0.44	1.83	0.14	0.23

### Key Financial Data

Total revenues (rubles)	242,608	215,515	181,883	201,098	177,146
Gross profit <sup>(16)</sup> (rubles)	183,712	167,092	144,679	150,953	134,880
Gross margin <sup>(17)</sup>	75.7%	77.5%	79.5%	75.1%	76.1%
OIBDA <sup>(18)</sup> (rubles)	100,822	97,774	88,192	85,938	75,590
OIBDA margin <sup>(19)</sup>	41.6%	45.4%	48.5%	42.7%	42.7%
Total debt/OIBDA <sup>(20)</sup>	0.43	0.34	0.31	1.39	0.44
Net debt <sup>(3)</sup> /OIBDA <sup>(20)</sup>	(0.45)	(0.34)	(0.39)	1.22	(0.50)
OIBDA/interest expense	143	117	53	19	104

(1) This represents the actual cash paid for capital expenditures, which may relate to capital expenditures accrued in other periods.

(2) Total debt includes short term loans, long-term debt and current portion of long-term debt.

(3) Net debt is total debt minus cash, cash equivalents, short-term investments and long-term deposits.

(4) Working capital is total current assets less total current liabilities.

(5) Source: AC&M Consulting.

(6) Source: AC&M Consulting. AC&M Consulting calculates mobile penetration based on official population data reported by state statistics institutions of relevant countries. Starting from the second quarter of 2012, AC&M has calculated penetration using an updated population figure for the Russian Federation based on the 2012 population census results. This explains why a higher penetration rate is given as of 30 September 2012 compared to as of 31 December 2011, despite the estimated number of Subscribers being the same.

(7) We define "Subscriber" as each SIM card that is connected to the network and is "active", that is, that has had at least one chargeable traffic event (that is, use of voice, Value-Added Services ("VAS") or data transfer services) within the preceding three months, whether chargeable to the Subscriber or to a third party (for example, interconnection charges

payable by other operators). Where an individual person holds more than one SIM card, each SIM card is included as a separate Subscriber.

- (8) MegaFon's share of total Russian Subscribers is the total number of MegaFon's Russian Subscribers at the end of a period divided by the total number of Russian mobile Subscribers at the end of such period.
- (9) We calculate MOU by dividing the total number of minutes of usage (including both outgoing and incoming calls) during a given period by the average number of our Subscribers during such period and dividing the result by the number of months in such period.
- (10) We calculate ARPU for a given period by dividing the aggregate of our wireless revenues from local subscribers, revenues from data transfer services and revenues from VAS, revenues from interconnection charges and revenues from roaming charges to other operators for the same period by the average number of our Subscribers during that period, and further dividing the result by the number of months in that period.
- (11) We calculate churn rate as the number of Subscribers who cease to be Subscribers within a given period divided by the average number of Subscribers during that period. Churn rate for the nine months ended 30 September 2011 and 2012 is not presented on an annualised basis.
- (12) We define a "Data Services User" as a Subscriber who has used any of our data transfer services within the preceding three months.
- (13) We calculate DSU by dividing the total number of megabytes transferred by our network during a given period by the average number of data services users during such period and dividing the result by the number of months in such period.
- (14) We calculate our ARPDU for a given period by dividing our data services revenues for a given period by the average number of our data services users during that period, and further dividing the result by the number of months in that period.
- (15) We calculate our APPMb by taking ARPDU for a given period, and dividing by DSU in that period.
- (16) Gross profit is calculated as the difference between cost of revenues for a given period and total revenues for such period. Because this measure is based on the exclusion or inclusion of specific items, it may not be comparable to measures used by other companies which adopt similar measures.
- (17) Gross margin is calculated as gross profit for a given period divided by total revenues for such period.
- (18) OIBDA is a non-U.S. GAAP financial measure. OIBDA is defined as, in relation to any relevant period, the consolidated operating income for such period plus depreciation and amortisation. The reconciliation of OIBDA to operating income, the most directly comparable U.S. GAAP financial measure, is as follows:

	Years Ended 31 December			Nine Months Ended 30 September	
	2011	2010	2009	2012	2011
	(in millions of rubles)				
Operating income	53,146	58,900	56,848	45,855	40,609
<i>Add:</i>					
Depreciation and amortisation	47,676	38,874	31,344	40,083	34,981
<b>OIBDA</b>	<b><u>100,822</u></b>	<b><u>97,774</u></b>	<b><u>88,192</u></b>	<b><u>85,938</u></b>	<b><u>75,590</u></b>

We believe that OIBDA provides useful information and is an important supplemental indicator of the strength and performance of our business operations, including our ability to finance capital expenditures, acquisitions 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 the non-cash current period allocation of costs associated with long-lived assets acquired or constructed in prior periods. OIBDA calculations are commonly used as bases for some analysts, investors, credit rating agencies and other parties to compare the periodic and future operating performance and value of companies within our industry. OIBDA has limitations as an analytical tool, and should not be considered in isolation as an alternative to net income attributable to MegaFon, operating income or any other measure of performance under U.S. GAAP.

- (19) OIBDA margin is calculated as OIBDA for a given period divided by total revenue for such period.
- (20) The nine months data is presented on an annualised basis (the nine months data multiplied by 4/3).

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

*The following discussion and analysis should be read in conjunction with the section captioned "Selected Consolidated Financial Information" and our Consolidated Financial Statements included elsewhere in this Prospectus. In addition to historical information, the following discussion contains forward-looking statements based on current expectations that involve risks and uncertainties. Our actual results could differ materially from those anticipated in the forward-looking statements as a result of numerous factors, including the risks discussed in the section of this Prospectus entitled "Risk Factors" and elsewhere in this Prospectus.*

### Overview

We are a leading universal telecommunications provider with approximately 63 million Subscribers in the Russian Federation as of 30 September 2012. We offer a broad range of voice, data and other mobile and fixed-line telecommunications services to retail customers, businesses, Government clients and other telecommunications services providers. Among the Russian mobile operators, we are ranked first in terms of data revenues and second in terms of overall mobile revenues for the six months ended 30 June 2012<sup>7</sup>, and second in terms of Subscribers as of 30 June 2012<sup>8</sup>. Our total revenues increased by 13.5%, to 201,098 million rubles for the nine months ended 30 September 2012 as compared to the same period in 2011.

We have been awarded licences to provide 2G and 3G services in each of the 83 micro-regions of the Russian Federation and, as of 30 September 2012, our 2G and 3G networks covered approximately 92% and 72%, respectively, of the Russian population. As of 31 March 2012 we operated the largest 3G network in the Russian Federation based on the number of 3G base stations<sup>9</sup>. This has allowed us to become the leader in mobile data services, generating 38.8% of the revenues in this market segment among the Big Three in the first six months of 2012<sup>10</sup>. This segment of the telecommunication market has recently demonstrated high growth rates and we believe it holds the greatest potential for future growth. We also operate a backhaul and backbone fibre-optic network spanning over 130,000 kilometres, as of 30 September 2012. We believe that our mobile assets coupled with our fixed-line assets will enable us to develop and provide fixed-mobile convergent telecommunications solutions to our clients by taking advantage of cross-selling opportunities.

We are also closely observing the developments in the next generation of wireless technology, known variously as long term evolution ("LTE") standard or fourth generation ("4G"), for deployment on our networks. We have already conducted tests of the LTE/4G technology and we are planning to employ it during the 2014 Winter Olympic and Paralympic Games to be held in Sochi, for which we are the official mobile provider. Furthermore, on 25 July 2012, we were issued an LTE/4G licence covering the entire territory of the Russian Federation. While we believe we are well-positioned to create our own LTE/4G network in the near future (possibly in cooperation with other operators), in February 2012 we also entered into an MVNO agreement with Yota that has allowed us to provide LTE/4G services to our customers in fourteen major Russian cities as at the date of this Prospectus (Novosibirsk, Moscow, Sochi, Krasnodar, Samara, Vladivostok, Ufa, Kazan, St. Petersburg, Kostroma, Tula, Vladimir, Yoshkar-Ola and Khabarovsk) with expected coverage of more than 40 cities by the end of 2012. Yota has been a related party of MegaFon since July 2012. See "Transactions with Related Parties".

Our integrated telecommunication services are generally provided under the "MegaFon" brand, although some services carry the brand names of businesses that we have acquired. In addition to our operations in the Russian Federation, we provide mobile services through our subsidiaries in Tajikistan, Abkhazia and South Ossetia. The operations of these subsidiaries are not significant to our overall operations and financial results and, accordingly, are not discussed in detail herein.

Our total revenues were 242,608 million rubles, 215,515 million rubles and 181,883 million rubles for the years ended 31 December 2011, 2010 and 2009, respectively, increasing by 27,093 million rubles, or 12.6%, from 2010 to 2011, and by 33,632 million rubles, or 18.5%, from 2009 to 2010. Our total revenues increased by 23,952 million rubles, or 13.5%, to 201,098 million rubles for the nine months ended 30 September 2012 from 177,146 million rubles for the nine months ended 30 September 2011. Our revenues increased primarily due to growth in our total Subscriber base, as well as a significant increase in revenues from data transfer services from our existing and new Subscribers.

<sup>7</sup> As derived from the publicly available financial information of our competitors.

<sup>8</sup> Source: AC&M Consulting.

<sup>9</sup> Source: Respective operator's websites.

<sup>10</sup> Source: AC&M Consulting.



## Key Factors Affecting our Results of Operations

### Overview

Our performance and results of operations have been and will continue to be affected by a number of factors, including external factors. Certain of these key factors that have had, or may have, an effect on our results are set forth below. For further discussion of the factors affecting our results of operations, see “Risk Factors”.

The key component of our revenues is wireless revenues, which contributed 90.2% and 88.8% of our total revenues for the year ended 31 December 2011 and the nine months ended 30 September 2012, respectively. Our wireless revenues are principally driven by the number of wireless Subscribers on our network (our Subscriber base), traffic volumes (voice in terms of MOU, data services usage in terms of megabytes transferred (“DSU”) and SMS in terms of number of outgoing messages), our Subscribers’ usage of VAS and the resulting monthly ARPU. Development of our Subscriber base is driven by a number of factors, including market dynamics (including population, demographics (as certain of our offerings are targeted at different demographic groups), technological innovation, evolving customer behaviour and availability of new products and services, including VAS), our ability to attract new Subscribers and our churn rate (the percentage of Subscriber disconnections during a given period). A significant factor that has driven the growth of our wireless revenues is the increasing use of data, internet access and related services (in each case, mobile data), which are currently the major drivers of growth in the telecommunications industry.

Our revenues are also driven by overall market penetration, acquisitions and strategic partnerships, the level of competition for obtaining new Subscribers and retaining existing ones and general economic conditions.

Almost all of our revenues in the periods presented are generated by us in the Russian Federation, with approximately 1% of our revenues generated by our subsidiaries outside the Russian Federation. Accordingly, we do not present a geographical breakdown of our financial information as it is not material.

### Key Performance Indicators

Within the following discussion and analysis we provide certain key performance indicators (based on our Russian operations only), which we believe are useful for evaluating our business and results of operations and form part of the information routinely reviewed by our management to evaluate our performance.

#### Wireless Subscriber Base

The following table sets forth the Subscriber base for our wireless business as at the dates and for the periods indicated, respectively. These statistics are based on our operations in the Russian Federation only and exclude data from our operations in Tajikistan, Abkhazia and South Ossetia.

	As of 31 December			As of 30 September	
	2011	2010	2009	2012	2011
	(in thousands)				
Wireless Subscriber Base <sup>(1)</sup> . . . . .	61,631	56,607	50,222	62,805	59,740
of which Data Services User Base <sup>(2)</sup> . . . . .	19,086	16,160	12,611	19,972	17,218

(1) We define “Subscriber” as each SIM card that is connected to the network and is “active”, that is, that has had at least one chargeable traffic event (that is, use of voice, VAS or data transfer services) within the preceding three months, whether chargeable to the Subscriber or to a third party (for example, interconnection charges payable by other operators). Where an individual person holds more than one SIM card, each SIM card is included as a separate Subscriber.

(2) We define “Data services user” as a Subscriber who has used any of our data transfer services within the preceding three months.

Our wireless Subscriber base increased by 12.7% from 31 December 2009 to 31 December 2010, by 8.9% from 31 December 2010 to 31 December 2011 and by 1.9% from 31 December 2011 to 30 September 2012. Our Subscriber base increased as a result of an increase in our data services user base, as well as due to our competitive tariff offerings, decreases in our roaming charges and expansion of our distribution network. The smaller increase in our wireless Subscriber base from 31 December 2011 to 30 September 2012 resulted mainly from the increasing saturation of the market, as well as our increased focus on improving the quality of our client base and reducing churn.

We offer both pre-paid and post-paid services to our wireless Subscribers. 95.2% of our wireless Subscribers as at 30 September 2012 pre-paid for our services and 88.5% of our wireless revenues were from pre-paid services for the nine months ended 30 September 2012.

Our wireless data services user base (which forms part of our Subscriber base) increased by 28.1% from 31 December 2009 to 31 December 2010, by 18.1% from 31 December 2010 to 31 December 2011 and by 4.6% from 31 December 2011 to 30 September 2012. Wireless data services users accounted for 31.0% and 31.8% of our total Subscriber base as at 31 December 2011 and 30 September 2012, respectively. The increase in our wireless data services user base was mainly due to improvements made to the quality of our network and the expansion of our network coverage and transport infrastructure (our 3G network covers all macro-regions in the Russian Federation), through investment in network infrastructure as well as through acquisitions, including the acquisition of Synterra. In addition, there is a generally proportionately higher use of wireless data services in the Russian Federation than in many other countries due to the fact that in certain areas of the Russian Federation there is no access to a fixed-line network, or it is more expensive to access a fixed-line network than to access wireless data services. In the Russian Federation, the fixed-line broadband penetration rate was approximately 40% as of 30 September 2012,<sup>12</sup> as compared to mobile (SIM-based) penetration of 160.9% as of the same date.<sup>13</sup> A further contributing factor to the increase in data services user base was our effort to increase sales of USB modems, which are used to access data services. We currently operate the largest 3G network in the Russian Federation in terms of population and territory coverage, which allowed us to become the leader in mobile data services, generating 38.8% of the revenues in this market segment among the Big Three in the first six months of 2012<sup>14</sup>. Over the medium-term, the wireless data services user base in Russia is expected to expand and mobile internet penetration is expected to increase further, though we may not maintain our *pro rata* market share of that growth.

In 2011 and for the nine months ended 30 September 2012, our marketing strategy focused on increasing our existing clients' use of our network as well as optimising tariffs. As part of our marketing strategy, we therefore tailored our nationwide plans (including integrated product packages that bundle voice and data services) aimed at increasing the penetration rates in specific regions, by tailoring the tariffs for such product packages on a regional basis to target local Subscribers. These local tariff plans were designed to be more in line with local Subscribers' needs and so, we believe, were more attractive to such Subscribers than nationwide tariffs, which may not meet the needs of such Subscribers. We believe that the launch of these local tariff plans contributed to an increase in our Subscriber base in the regions, and encouraged their increased use of our services, particularly our wireless data services.

#### Wireless Traffic

MOU measures the average monthly minutes of voice services used per wireless Subscriber, while DSU measures the average monthly data traffic per user for our wireless data services. The following table sets forth MOU data, DSU data and SMS traffic volumes for our wireless business for the periods indicated. These statistics are based on our operations in the Russian Federation only and exclude data from our operations in Tajikistan, Abkhazia and South Ossetia.

	For the Year Ended 31 December			For the Nine Months ended 30 September	
	2011	2010	2009	2012	2011
MOU <sup>(1)</sup> (in minutes per month) . . . . .	288	285	275	294	286
Voice traffic <sup>(2)</sup> (billions of minutes) . . . . .	202	185	153	165	148
DSU <sup>(3)</sup> (in megabytes per month) . . . . .	628	256	47	1,006	564
Data traffic <sup>(4)</sup> (in petabytes) . . . . .	117	39	5	163	77
SMS <sup>(5)</sup> (billions) . . . . .	18.1	16.8	14.0	14.6	13.1

- (1) We calculate MOU by dividing the total number of minutes of usage (including both outgoing and incoming calls) during a given period by the average number of our Subscribers during such period and dividing the result by the number of months in such period.
- (2) Number of minutes of incoming and outgoing voice services during such period, including visitors' minutes.
- (3) We calculate DSU by dividing the total number of megabytes transferred by our network during a given period by the average number of data services users during such period and dividing the result by the number of months in such period.
- (4) Number of petabytes transferred by our network during such period.
- (5) Number of outgoing SMS during such period.

<sup>12</sup> Source: AC&M Consulting.

<sup>13</sup> Source: AC&M Consulting.

<sup>14</sup> Source: AC&M Consulting.

MOU per Subscriber in 2009 reflected depressed demand for voice services as a result of the economic crisis in the Russian Federation that continued into early 2009, although this was partially offset by a recovery in demand for voice services in the second half of 2009. The increase in demand in 2010 was due in part to tariff initiatives that we created to mitigate the negative effect of the economic crisis, and also from the gradually improving economic conditions. MOU further increased in 2011 as compared to 2010. MOU per Subscriber increased in the first nine months of 2012, compared to the first nine months of 2011, mainly due to the launch of regional tariffs aimed at stimulating traffic between users on our network, including intercity calls.

DSU increased by 209 megabytes per month, or 444.7%, from 2009 to 2010, and further increased by 372 megabytes per month, or 145.3%, from 2010 to 2011. For the nine months ended 30 September 2012, DSU increased by 78.4% to 1,006 megabytes per month from 564 megabytes per month for the nine months ended 30 September 2011. The increase in demand for data services was mainly due to the continuing expansion in capacity and coverage of our 3G network nationwide, accelerating sales of USB modems and tariff initiatives designed to stimulate demand for data transfer services. These factors were also the basis for the considerable growth of our data services user base, which also contributed to the growth in data traffic. During the nine months ended 30 September 2012, approximately two thirds of data traffic throughput in our network was accounted for by USB modem usage by our Subscribers.

Outgoing SMS traffic increased by 2.8 billion SMS, or 20.0%, from 2009 to 2010, and further increased by 1.3 billion SMS, or 7.7%, from 2010 to 2011. Outgoing SMS increased by 1.5 billion, or 11.5%, to 14.6 billion for the nine months ended 30 September 2012, from 13.1 billion for the nine months ended 30 September 2011. The increase in SMS during these periods was mainly as a result of an increase in our Subscriber base and changes in our tariffs as well as, in the case of the increase from 2009 to 2010, recovery in demand following the economic crisis in the Russian Federation.

#### *Wireless ARPU and APPM*

The following table sets forth the ARPU, average monthly revenues per data services user (“**ARPDU**”), average price per minute (“**APPM**”) and average price per megabyte (“**APPMb**”) for our wireless business for the periods indicated. These statistics are based on our operations in the Russian Federation only and exclude data from our operations in Tajikistan, Abkhazia and South Ossetia.

	Year ended 31 December			Nine Months ended 30 September	
	2011	2010	2009	2012	2011
	(in rubles)				
ARPU <sup>(1)</sup> .....	311	312	322	316	308
of which ARPDU <sup>(2)</sup> .....	133	113	86	144	132
APPM <sup>(3)</sup> .....	1.08	1.09	1.17	1.07	1.08
APPMb <sup>(4)</sup> .....	0.21	0.44	1.83	0.14	0.23

(1) We calculate our ARPU for a given period by dividing the aggregate of our wireless revenues from local subscribers, revenues from data transfer services and revenues from VAS, revenues from interconnection charges and revenues from roaming charges to other operators for the same period by the average number of our Subscribers during that period, and further dividing the result by the number of months in that period.

(2) We calculate our ARPDU for a given period by dividing our data services revenues for a given period by the average number of our data services users during that period, and further dividing the result by the number of months in that period.

(3) We calculate our APPM by taking ARPU for a given period, and dividing by MOU in that period.

(4) We calculate our APPMb by taking ARPDU for a given period, and dividing by DSU in that period.

ARPU is driven primarily by changes in our tariffs and pricing plans, as well as by traffic. Even with improved economic conditions, our ARPU fell from 2009 to 2011, due to lower tariffs (as reflected by the decrease in APPM from 1.17 rubles per minute in 2009 to 1.08 rubles per minute in 2011), offset in part by increased usage. These changes in ARPU also reflected changes in the composition of our Subscriber base, as new Subscribers joining our network from other operators are likely to move to benefit from our cheaper tariffs.

ARPU increased by 2.6%, or 8 rubles per month, from the nine months ended 30 September 2011 to the nine months ended 30 September 2012 due to increased use of VAS and data traffic by our Subscribers.

Although ARPU declined overall, ARPDU increased by 17.7% from 113 rubles per month for the year ended 31 December 2010 to 133 rubles per month for the year ended 31 December 2011 as a result of more than a

two-fold increase in the DSU from 256 megabytes per month during the year ended 31 December 2010 to 628 megabytes per month during the year ended 31 December 2011, which was partially offset by a 52.3% decrease in the APPMb from 0.44 rubles per megabyte for the year ended 31 December 2010 to 0.21 rubles per megabyte for the year ended 31 December 2011. ARPDU increased by 9.1%, or 12 rubles per month, from 132 rubles per month for the nine months ended 30 September 2011 to 144 rubles per month for the nine months ended 30 September 2012, predominantly due to an increase in data traffic as a result of our tariff initiatives. In general, data transmission volumes and the share of revenues from data transfer services in the total revenues of all Russian mobile operators, including us, remain relatively low compared to worldwide standards. See “The Russian Telecommunications Industry”. We expect there to be further decreases in APPMb, but notwithstanding these decreases, we expect our revenues from data transfer services as a proportion of total revenues to continue to grow, primarily due to increased usage.

Although ARPDU represents an increasing proportion of ARPU, voice remains the main contributor to our ARPU. While the share of revenues from voice services (represented by wireless revenues from local subscribers) in wireless revenues has been declining, it is still the most significant generator of wireless revenues and in fact MOU per Subscriber has continued to increase from 2009 to 2011. Voice is one of the most competitive sectors in the industry, and rapid development of new Voice over IP technology, as well as intense competition to attract new Subscribers and maintain the loyalty of existing ones, has placed increasing pressure on prices for voice services. As a result, we expect APPM to continue to decline, which would be expected to result in a decrease in the voice component of ARPU.

#### *Wireless Churn rate*

“Churn” refers to the percentage of wireless Subscribers that disconnect from the network during a given period. The table below sets forth our churn rate for the periods indicated. These statistics are based on our operations in the Russian Federation only and exclude data from our operations in Tajikistan, Abkhazia and South Ossetia.

	Year Ended 31 December			Nine Months ended 30 September	
	2011	2010	2009	2012	2011
Churn rate <sup>(1)</sup> . . . . .	48.3%	49.8%	45.8%	36.7%	36.1%

(1) Churn rate is the number of Subscribers who cease to be Subscribers within a given period divided by average number of Subscribers during that period. Churn rate for the nine months ended 30 September 2011 and 2012 is not presented on an annualised basis.

Our churn rate for our wireless operations increased from 45.8% for the year ended 31 December 2009 to 49.8% for the year ended 31 December 2010, before decreasing to 48.3% for the year ended 31 December 2011. Our churn rate for the nine months ended 30 September 2012 was 36.7%, representing a percentage point increase of 0.6 on our churn rate of 36.1% for the nine months ended 30 September 2011. The increase in churn rate from 2009 to 2010 resulted mainly from increase in competitive pressure, while a number of factors contributed to the decrease from 2010 to 2011, including further enhancement to the quality of our network, the launch of several new tariff plans and bundled offerings, the accelerated expansion of our own retail network and the launch of a nationwide advertising campaign aimed at maintaining subscriber loyalty. Churn rates for operators in the Russian Federation, particularly in Moscow, are high compared to worldwide standards because Subscribers are not subject to fixed-term contracts, which allows them freedom to migrate between operators. As our Subscribers are not subject to fixed-term contracts, like other major Russian mobile operators, we do not generally subsidise our Subscribers’ purchase of handsets. This means that we have relatively low subscriber acquisition costs, which mitigates our high churn rates.

#### *Acquisitions and Strategic Partnerships*

##### *Historic Acquisitions*

We have developed our business through organic growth, building our Subscriber base and increasing revenues through expansion of our products and services with effective marketing. In recent years we have also pursued growth opportunities through selective acquisitions that we believe will allow us to expand our geographical reach, add to our product and service offerings and improve our market share.

We have primarily sought to acquire businesses to establish a greater presence in non-core areas, including our fixed-line broadband segment, as well as to invest in new technologies and services. The strengthening of our position in the fixed line and broadband market through the completion of a number of strategically important

acquisitions of companies that operate primarily in the fixed-line business in 2010 and 2011 has resulted in an increase in our wireline customer base and in our wireline revenues.

The following table sets forth our acquisitions during 2009, 2010 and 2011 and the nine months ended 30 September 2012.

<u>Company</u>	<u>Location</u>	<u>Activity</u>	<u>Date of Acquisition</u>	<u>Ownership Interest</u>	<u>Purchase Price (in millions of Rubles)</u>
<b>2009</b>					
Debt Investments Limited, including: . . . . .	Cyprus	Holding company	March 2009	100%	932
51% of CJSC Aquafon GSM and 51% of CJSC Ostelecom . . . . .	Abkhazia and South Ossetia	Mobile communications services			
Additional 24% of CJSC Ostelecom . . . . .	South Ossetia	Mobile communications services	December 2009		30
<b>Aggregate purchase price of acquisitions in 2009</b>					<b>962</b>
<b>2010</b>					
CJSC Synterra and several subsidiaries of CJSC Synterra, including CJSC PeterStar . . . . .	Russian Federation	Integrated fixed-line communications services	June 2010	100%	12,433
CJSC Metrocom . . . . .	Russian Federation	Fixed-line communications services	October 2010	100%	2,000
<b>Aggregate purchase price of acquisitions in 2010</b>					<b>14,433</b>
<b>2011</b>					
Fairlie Holding and Finance Limited (NetByNet brand) and subsidiaries . . . . .	Russian Federation	Fixed-line broadband, IP telephony, digital TV, multimedia services	June 2011	100%	8,731
CJSC Web Plus . . . . .	Russian Federation	Fixed-line communication services	June 2011	100%	54
LLC Nakhodka Telecom . . . . .	Russian Federation	Fixed-line communication services	November 2011	100%	196
LLC Internet Tsentr and LLC Svyazinform . . . . .	Russian Federation	Fixed-line broadband telephony services	November 2011	100%	610
LLC Luchshe.Net . . . . .	Russian Federation	Fixed-line broadband telephony services	December 2011	100%	318
OJSC Yugratel . . . . .	Russian Federation	Fixed-line broadband, IP telephony, digital TV services	December 2011	100%	2,421
<b>Aggregate purchase price of acquisitions in 2011</b>					<b>12,330</b>
<b>Nine months ended 30 September 2012</b>					
Felebior Holdings Limited, which is the holding company for the VAS Media group of companies . . . . .	Russian Federation	VAS services.	September 2012	100%	8,679
<b>Aggregate purchase price of acquisitions in nine months ended 30 September 2012</b>					<b>8,679</b>

In 2010, we completed the acquisition of 100% of the issued share capital of Synterra, an integrated telecommunications services provider in the Russian Federation, with a fibre-optic network spanning approximately 30,000 kilometres in the Russian Federation. Synterra provides fixed-line, wireline broadband and satellite communications services primarily to governmental and high-end corporate clients. The acquisition was



for a total consideration of U.S.\$745 million (equivalent to 23,147 million rubles at the exchange rate as at 2 June 2010), which was comprised of cash consideration of approximately U.S.\$298 million (equivalent to 9,259 million rubles at the exchange rate as at 2 June 2010), deferred and contingent consideration in the notional amount of up to U.S.\$110 million (equivalent to 3,418 million rubles at the exchange rate as at 2 June 2010) and estimated net debt of Synterra in the amount of U.S.\$337 million (equivalent to 10,470 million rubles at the exchange rate as at 2 June 2010)). The deferred and contingent consideration consisted of an unconditional deferred payment amount of U.S.\$43 million (equivalent to 1,336 million rubles at 2 June 2010 exchange rate) and several contingent payments in an aggregate amount of up to U.S.\$67 million (equivalent to 2,082 million rubles at 2 June 2010 exchange rate) payable on or before June 2013. In 2010, we repaid the debt of Synterra assumed in the transaction in full. We financed the acquisition and refinanced the debt of Synterra mainly from cash provided by our operating activities. As at 30 September 2012, our remaining liability for deferred and contingent consideration outstanding in respect of the Synterra acquisition, including certain related accrued interest, was U.S.\$92 million (equivalent to 2,844 million rubles at the exchange rate as at 30 September 2012), of which U.S.\$44.8 million (equivalent to 1,385 million rubles at the exchange rate as at 30 September 2012) is unconditional and payable on or prior to the third anniversary of the closing of the acquisition, while the remaining balance is subject to satisfaction of certain conditions and possible retentions as set out in the acquisition documents. U.S.\$74 million of the deferred and contingent consideration bears interest at the rate of 2.75% per annum, while the remaining U.S.\$18 million of the deferred and contingent consideration is interest free. Although no formal action has been initiated, there is disagreement among the parties as to the actual amount of the contingent consideration to be paid by us. See “Business—Litigation—Potential Litigation in Relation to the Synterra Purchase”.

While the lower margin wireline services business of Synterra reduced our operating margin in the short term, we have benefited, and expect in the longer term to continue to benefit, from a number of synergies as a result of the acquisition of Synterra that have increased our profitability. We have successfully integrated Synterra into our operations resulting in increased capacity and reach of our fibre-optic network, which enables us to improve the quality of our communications services and achieve higher data transfer rates. The acquisition has also provided us with direct access to government clients and high-end corporate customers for our developing fixed-line business, and further allows us to offer fixed-mobile convergent telecommunications solutions to our clients. See “Business—The Company—History”.

In 2011, one of the main drivers of increases in our wireline revenues was the strengthening of our position in the fixed-line and broadband market through the completion of a number of strategically important acquisitions of companies that operate primarily in the fixed-line business and that also provided us with access to new corporate and governmental clients. Our wireline revenues have increased significantly by 2,154.3%, or 14,520 million rubles, from 674 million rubles for the year ended 31 December 2009 to 15,194 million rubles for the year ended 31 December 2011. Nonetheless, our wireline revenues remain a relatively small proportion of our total revenues (6.3% and 6.7% for the year ended 31 December 2011 and for the nine months ended 30 September 2012, respectively).

In particular, the acquisition of NetByNet provided us with access to fixed-line broadband, digital TV and IP telephony businesses in a number of regions, including Moscow, where NetByNet is a significant fixed-line broadband services provider. We acquired NetByNet in June 2011 for total consideration having a fair value of 8,731 million rubles as at the date of acquisition, consisting of cash consideration of 7,507 million rubles and contingent consideration of 1,224 million rubles. The beneficiary of one of the companies that acted as sellers in the NetByNet acquisition was Mr Ivan Tavrín, our current CEO. Mr Tavrín was not employed by us or any of our related parties when we acquired NetByNet in June 2011. In June 2012, we paid U.S.\$43.6 million (equivalent to 1,431 million rubles at the exchange rates as of the payment dates) in full and final settlement of all contingent consideration liability for the NetByNet acquisition. Following the acquisition of NetByNet in June 2011, only the results of operations of NetByNet from June 2011 to September 2011 were consolidated in our financial statements for the nine months ended 30 September 2011, whereas, for the nine months ended 30 September 2012, the results of operations of NetByNet were consolidated for the full nine month period.

In September 2012, we completed the acquisition of a 100% interest in Felebior Holdings Limited, which is the holding company for the VAS Media group of companies. VAS Media is involved in the development of a wide range of VAS services, and before the acquisition partnered with MegaLabs on a variety of projects, such as Mobile TV Solution. We expect the synergies between VAS Media and MegaLabs to provide opportunities within the VAS services market. The acquisition was for a total cash payment of U.S.\$290.2 million (equivalent to approximately 9,207 million rubles at the exchange rate as of 11 September 2012), of which U.S.\$16.6 million (equivalent to approximately 528 million rubles at the exchange rate as of 11 September 2012) was applied

towards settlement of trade payables owed to VAS Media in respect of services provided by VAS Media prior to the date of the acquisition. See “Transactions with Related Parties”. The results of operations of VAS Media were consolidated in our financial statements from 1 September 2012.

For more information regarding our acquisitions, see Notes 3, 11 and 14 to the Audited Consolidated Financial Statements as of and for the years ended 31 December 2011, 2010 and 2009 and Note 3 to the Unaudited Condensed Consolidated Financial Statements for the three and nine months ended 30 September 2012 and 2011 included in this Prospectus.

### *Euroset*

On 28 September 2012, Lefbord Investments Limited (“**Lefbord**”) entered into an agreement (the “**Euroset SPA**”) with Alpazo Limited (the “**Seller**”) to acquire a 50% stake in Euroset, the biggest wireless equipment retailer in the Russian Federation (the “**Euroset Acquisition**”). The remaining 50% of Euroset will be owned by VimpelCom, one of our competitors.

Lefbord is currently wholly-owned by Garsdale, our controlling shareholder. Before the completion of this acquisition by Lefbord, we expect to enter into agreements with Lefbord pursuant to which we will subscribe for ordinary and redeemable preference shares in Lefbord resulting in us owning 50% of its share capital. The consideration for our subscription will be approximately U.S.\$535 million (the “**MegaFon Contribution**”). At the same time, Garsdale will subscribe for further ordinary and redeemable preference shares in Lefbord resulting in Garsdale owning the remaining 50% interest in Lefbord. The consideration for Garsdale’s subscription will be 50% of the share capital of Internet Media Partnership Limited, a debt in an amount of U.S.\$3 million owed to Garsdale by Primordial Soup Limited and promissory notes pursuant to which Garsdale promises to pay Lefbord (or its assignees) in aggregate U.S.\$395 million (together, the “**Garsdale Contribution**”). Immediately following these contributions by MegaFon and Garsdale, Lefbord will, pursuant to the Euroset SPA, acquire a 50% stake in Euroset from the Seller in consideration for the MegaFon Contribution and the Garsdale Contribution. The Garsdale Contribution has not been independently valued but has been valued by the Seller at U.S.\$535 million in aggregate. We, together with Garsdale and MICL, are currently in the process of negotiating a shareholders’ agreement as to the governance of Lefbord (the “**Lefbord Governance Agreement**”). The Lefbord Governance Agreement is expected to provide for an undertaking by Garsdale to indemnify Lefbord in relation to any claim that might arise in the future in connection with the part of the Euroset consideration that relates to the Garsdale Contribution and other potential liabilities related to Garsdale’s participation in the Euroset Acquisition. However, no assurance can be given that such indemnity will ultimately be provided for in the Lefbord Governance Agreement, or, if included, that it will be drafted in a form that provides us with adequate protection. See “Risk Factors—Risks related to our Business and Industry—The return on, and benefit from, our recent investment in Euroset might be affected by disagreements among Euroset shareholders”.

The consideration described above implies a valuation of Euroset of approximately U.S.\$2.14 billion (excluding net debt and any deferred and contingent consideration) and of approximately U.S.\$2.30 billion (including net debt, which, for the purposes of these calculations, is estimated at U.S.\$160 million as of 28 September 2012, and excluding any deferred and contingent consideration). We expect to make a further subscription for shares in Lefbord for up to U.S.\$50 million to fund deferred and contingent consideration payable by Lefbord to the Seller if certain targets are met by Euroset by 30 June 2013. If these targets are met, we expect that Garsdale will be required to make an equivalent subscription for shares in Lefbord thereby maintaining (and not increasing) our 50% stake.

Pursuant to the Lefbord Governance Agreement, we expect to be required to purchase, one year from the closing date of the Euroset Acquisition (with the possibility for this obligation to be deferred for up to two further years upon agreement of the parties), Garsdale’s interest in Lefbord for U.S.\$535 million, plus interest at a rate of 8% per annum, plus any earn-out related payments made by Garsdale to Lefbord, increased by any additional contributions made to Lefbord by Garsdale and reduced by any payments received by Garsdale from Lefbord (the “**Lefbord Consideration**”). Our purchase obligation is not reflected in our financial statements included in this Prospectus, but is expected to be included and treated as a short-term or long-term liability (depending on our assessment of whether the purchase obligation shall be performed before or after one year from the closing date of the Euroset Acquisition) upon execution of the transaction. We expect our indirect interest in Euroset (both before and after the purchase of Garsdale’s remaining interest in Lefbord) to be accounted for using the equity method. We expect to have the option to pay the Lefbord Consideration in cash or in ordinary shares in OJSC MegaFon held by us or our subsidiary MICL. Such ordinary shares are expected to be valued at the weighted average market price for OJSC MegaFon GDRs for the six-month period prior to our purchase of Garsdale’s remaining interest in Lefbord.

We are currently negotiating an agreement to be entered into by us, Euroset Holding N.V., VimpelCom, Garsdale and Lefbord with respect to the governance of Euroset (the “**Euroset Governance Agreement**” and together with the Lefbord Governance Agreement and other ancillary documents, the “**Euroset Transaction Documents**”, and the transactions contemplated therein, together with the Euroset Acquisition, the “**Euroset Transaction**”).

The details of the Euroset Transaction have not yet been finally agreed and they could depart, potentially materially and adversely to us, from the description set out above. The execution of the Euroset Transaction Documents is subject to the satisfaction of a number of conditions, including obtaining FAS approval for the transaction. The Euroset Transaction was approved by our shareholders on 6 November 2012 in accordance with the approval requirements under the Russian interested party transaction regime. See “Description of Share Capital and Certain Requirements of Russian Law—Certain Requirements of Russian Legislation—Interested Party Transactions”. For risks relating to the Euroset Transaction, see “Risk Factors—Risks Relating to our Business and Industry—The return on, and benefits from, our recent investment in Euroset might be affected by disagreements among Euroset shareholders”.

We expect that if this acquisition is completed, it will allow our products to be more prominently marketed in Euroset’s outlets and we believe it may help reduce our churn rate. We further believe that we may be able to benefit from synergies related to the sale of handsets, for which Euroset is a leading market participant in the Russian Federation. Moreover, the purchase of handsets on a joint basis with Euroset could lower our costs of handsets and accessories sold. Furthermore, the entry into a new dealership agreement with Euroset based on our new revenue sharing model is a condition to the completion of the Euroset acquisition. We believe that this new agreement may allow us to reduce our SAC. See “Business—Sales and Distribution—Third-Party Dealer Network (Multi-brand Telecommunications Retailers and Other Points of Sale)”.

#### *Yota MVNO Agreement*

In addition to our own planned LTE/4G network development, in February 2012, we entered into a MVNO agreement with Yota for the use of their LTE/4G networks in the Russian Federation. The MVNO agreement is intended to enable us to be among the first to provide LTE/4G services to our customers using the LTE/4G network and frequencies of Yota and also to reduce our own upfront investment. It enables Yota to use our network infrastructure to provide 2G and 3G voice and data services to its customers. This partnership has already allowed us to start offering LTE/4G services to customers in fourteen major Russian cities as of the date hereof (Novosibirsk, Moscow, Sochi, Krasnodar, Samara, Vladivostok, Ufa, Kazan, St. Petersburg, Kostroma, Tula, Vladimir, Yoshkar-Ola and Khabarovsk. See “Business—Certain Contracts and Projects Relating to the Operation of our Business—Yota MVNO Agreement”. In the future, we expect the MVNO arrangement with Yota may result in increased demand for our voice and data services.

In March and April 2012, we made prepayments to Yota in an aggregate amount of U.S.\$50 million (equivalent to 1,546 million rubles at the exchange rate as of 30 September 2012) for the provision of future interconnection services under the terms of the agreement.

See Note 14 to the Unaudited Condensed Consolidated Financial Statements for the three and nine months ended 30 September 2012 and 2011 included in this Prospectus.

#### *Competition*

We compete with other telecommunications operators in the Russian Federation for customers on the basis of tariffs, network quality, customer service and the range of products and services offered. Our two major competitors are MTS and VimpelCom. However, as a result of our geographical expansion and our increasing capacity in the fixed-line sector, we are increasingly facing competition from regional service providers, such as Tele2 Russia, and from other fixed-line operators, such as OJSC Rostelecom. See “The Russian Telecommunications Industry—Our MegaFon Competitors”. Competition with all of these operators is intense, and may result in declining prices for some of our services, which could have an impact on our margins, dilute our earnings and increase our churn rate as a result of our Subscribers switching to other operators. Our subscriber acquisition costs may also increase as a result of competition for new Subscribers in the markets in which we operate. See “Risk Factors—Risks Relating to our Business and Industry—We face intense competition”.

### ***General economic conditions***

The Russian Federation, like many other countries, has experienced economic instability as a result of the ongoing global economic and financial crisis. Since the Russian Federation produces and exports large amounts of oil, gas and metals, its economy is particularly vulnerable to prices of energy and commodities in the world market.

We operate in the telecommunications sector where underlying demand has proven to be less sensitive than other sectors in the course of the global financial and economic crisis. Mobile (SIM-based) penetration in the Russian Federation grew from 143.2% as of 31 December 2009 to 151.0% as of 31 December 2010, to 156.8% as of 31 December 2011 and to 160.9% as of 30 September 2012,<sup>15</sup> one of the highest rates globally. However, recessionary conditions typically adversely impact consumer spending, including telecommunications products and services, which in turn impacts our Subscriber base and revenues. Consumers may spend less on an incremental basis, such as by placing fewer calls or migrating to cheaper price plans. Consumers may also delay the replacement of their existing handsets. Recessionary conditions may impair growth in penetration of new VAS, traffic, ARPU and number of Subscribers.

### ***Tax, currency and customs legislation***

The taxation system in the Russian Federation continues to evolve and is characterised by frequent changes in legislation, official pronouncements and court decisions, which are sometimes contradictory and subject to varying interpretation by different tax authorities. In particular, in July 2010, the Customs Code of the Russian Federation was effectively replaced with a new Customs Code of the Customs Union of the Russian Federation, the Republic of Belarus and the Kazakhstan Republic. To date, the new Customs Code has been in force for a relatively short period, and its implementation is often unclear or inconsistent, resulting in inconsistent enforcement and delays in customs clearance of imported goods.

Taxes are subject to review and investigation by a number of authorities, which have the authority to impose severe fines, penalties and interest charges. Generally, taxpayers are subject to tax audits for a period of three calendar years immediately preceding the year in which the tax audit commences. The tax authorities are generally prohibited from carrying out a subsequent on-site tax audit in respect of the same taxes for the same, already audited, tax period. 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 the last date of the tax period during which the tax offence was committed (depending on the nature of the tax offence). Nevertheless, based on current judicial interpretation, the statute of limitations for tax offences may be extended beyond three years in certain circumstances.

Recent events within the Russian Federation suggest that the tax authorities are taking a more assertive and substance-based position in their interpretation and enforcement of tax legislation. These circumstances may 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. Management believes that it has provided adequately for tax liabilities based on its interpretations of applicable Russian tax legislation, official pronouncements and court decisions. However, the interpretations of the relevant authorities could differ and the effect on our results of operations, if the authorities were successful in enforcing their interpretations, could be significant.

We believe that our interpretation of the relevant legislation is appropriate and is in accordance with the current industry practice and that our tax, currency and customs positions will be sustained. However, the interpretations of the relevant authorities could differ. Our estimate as of 8 November 2012, the date on which our Unaudited Condensed Consolidated Financial Statements for the three and nine months ended 30 September 2012 and 2011 were issued, of the possible effect of additional income taxes, before fines and interest, if any, on our results of operations, if the authorities were successful in enforcing different interpretations, was in the amount of up to approximately 950 million rubles.

### ***Seasonality***

Generally, our revenues are higher during the second half of the year. We see an increase in the third quarter primarily due to increased mobile phone use by Subscribers who travel during the summer from urban areas to country homes, or dachas, where fixed line penetration is relatively low, as well as following the summer vacation period as people return to work. The first quarter is usually our weakest period as we see a decline in

<sup>15</sup> Source: AC&M Consulting. Total revenue estimates exclude sales of handsets and accessories.



demand during the long winter holidays in the Russian Federation and the short month of February. Demand accelerates during the second quarter, but revenues in the first half are still lower than in the second half of the year. However, several factors, including sales promotions, can influence quarterly trends, which may not be consistent from year to year.

## **Shareholder Transactions**

### *Special Dividend and Purchase of Shares*

OJSC MegaFon has recently undergone changes in its shareholding structure. See “Principal and Selling Shareholders—Changes in Shareholding Structure and Ultimate Beneficial Owners”. These changes included the purchase by MICL, a wholly owned subsidiary of OJSC MegaFon, from Allaction Limited, a company in the Alfa Group, of 14.4% of the share capital in OJSC MegaFon for consideration of 63,883 million rubles, including transaction costs, on 24 April 2012. Contemporaneously with these changes in shareholding structure, we also paid a special dividend to our shareholders of 151,863 million rubles. See “—Liquidity and Capital Resources—Distributions to Shareholders”.

### *New Financings*

To fund the purchase of ordinary shares by MICL and the special dividend, in April 2012 we entered into a number of financing arrangements, pursuant to which we incurred additional borrowings (net of repayments) in an aggregate principal amount of approximately 142,400 million rubles. See “—Liquidity and Capital Resources—Indebtedness”. For a discussion of certain issues relating to the increase in our level of indebtedness, see “Risk Factors—Risks Relating to our Financial Condition—Our dividend and share buyback have increased our indebtedness and substantially depleted our working capital”.

### *Effects of Shareholder Transactions*

As a result of the dividend payment and the re-purchase of 14.4% of our ordinary shares, and the additional new borrowings, see “—Liquidity and Capital Resources—Indebtedness”, we have substantially depleted our working capital, including available cash and short-term investments. However, we believe we will continue to be able to generate significant operating cash flows and, as at 8 November 2012, have access to undrawn lines of credit of approximately 79,000 million rubles that can be used to cover capital and operating expenditures. Additionally, we can defer capital expenditures if necessary to meet short-term liquidity requirements.

## **Key income statement line items**

### **Revenues**

Our principal sources of revenues consisted of:

#### *Wireless revenues*

Our wireless revenues include wireless revenues from local subscribers, data transfer and VAS services, revenues from interconnection charges, roaming charges to other operators and other revenues.

#### *Wireless Revenues from Local Subscribers*

Our wireless revenues from local subscribers are primarily derived from voice services used by our Subscribers. They include revenues from monthly fees, airtime revenues and revenues from our own Subscribers roaming on other operators’ networks.

#### *Revenues from Data Transfer Services*

Data transfer services, including general packet radio service (“GPRS”), are provided both to our pre-paid and post-paid Subscribers. In the fourth quarter of 2011, we launched a single tariff for all portable electronic devices, MegaFon Online.

#### *Revenues from VAS Services*

VAS include voicemail, itemised billing, SMS, multimedia messaging service (“MMS”), ring back tone, content and media, mobile finance and others. See “Business—Operations—Our Services—Value-Added Services”. We may include VAS in a certain tariff plan or Subscribers may purchase VAS separately, either on a monthly, daily or per-use basis.



We recognise revenues related to usage charges and VAS in the period when the services are provided and account for them in our revenues. The market for VAS services is expected to provide potential opportunities for growth in the future, and we expect revenues from VAS to represent an increasing proportion of our revenues in the near future.

#### *Revenues from Interconnection Charges*

Revenues from interconnection charges include revenues from wireless and wireline operators that are earned from the services rendered for termination charges levied on other operators for terminating calls on our wireless networks and use of our networks. We have local interconnection agreements with fixed line operators, including local public switched telephone network operators. We also have interconnection agreements with our mobile competitors to allow their Subscribers to place calls to and receive calls from our Subscribers and vice versa, and with domestic and international operators for long distance traffic.

#### *Roaming Charges to other Operators*

Revenues from roaming charges to other operators are generated from other operators whose subscribers use our network. Roaming allows our Subscribers and guest roamers to receive and make international, long distance and local calls while travelling outside of their home network. As of 30 September 2012, we had bilateral roaming agreements with companies from 205 countries operating 584 networks.

Roaming agreements regulate the relationship and billing procedures between operators. Typically, the host operator sends the subscriber's home operator a bill for the roaming services provided to the subscriber. The subscriber's home operator pays the host operator directly for the roaming services and then charges the subscriber for the services.

We charge roaming fees to other mobile operators for their subscribers on a per-minute basis for "guest" roamers utilising our network while travelling in our service area. We recognise revenues from roaming fees in the period when the services are provided. Growth or declines in roaming fees tend to mirror growth or declines in mobile user travel, which in turn is generally affected by the prevailing economic conditions.

#### *Other Revenues*

We have other sources of revenues, including, but not limited to, fees for additional services to our corporate clients.

#### *Wireline Revenues*

Our wireline revenues, which include revenues from wireline broadband services, are derived from usage of our fixed-line network, which includes payments from individual, corporate and government customers for local and long-distance telecommunications and data transfer services. Wireline revenues also include interconnection charges from wireless and wireline operators for terminating calls on our wireline networks.

#### *Sales of Handsets and Accessories*

Revenues from sales of handsets and accessories include revenues from sales of handsets (including phones and smartphones), modems, MMS photo frames, security cameras with built-in SIM cards that transmit images to mobile phones, "social phones" with bigger keys and an emergency call button, computers with built-in modems and pre-installed SIM cards, tablets and other accessories.

#### ***Cost of Revenues***

Our cost of revenues includes cost of services (which includes interconnection charges, cost of VAS and roaming expenses) and costs of handsets and accessories sold (which includes cost of SIM cards).

#### *Cost of Services*

##### *Interconnection charges*

Interconnection charges include charges payable to other operators for termination of calls of our wireline and wireless subscribers to other network and line rental charges. Mobile operators must interconnect with other local, long distance and international telephone operators to gain access to their networks and sometimes, via these operators, to the networks of other operators around the world. We do not expect the base tariffs in respect of interconnection charges to change significantly in 2012. As our interconnection charges are related to the

number of our Subscribers, any increase in the number of our Subscribers (including as a result of an increase in the number of our Subscribers using federal numbers) would be expected to result in a corresponding increase in absolute terms in our interconnection charges.

Line rental charges include the costs associated with renting dedicated circuits from one point to another point. We also rent fibre-optic capacity from third parties to connect some of our main switches, to connect some inter-city traffic between base stations and as part of our backbone network.

#### *Cost of VAS*

Our cost of VAS is primarily related to charges to content providers recorded when we are the primary obligor in an arrangement for the sale of content to our customers. The revenues from sale of content services are presented net of related costs when we act as an agent of the relevant content provider.

#### *Roaming Expenses*

Other mobile operators that allow our Subscribers to roam on their networks charge us for providing such services. Roaming expenses represent the amounts we must pay to other mobile operators pursuant to agreements that we have concluded with them. We expense roaming expenses in the period during which the mobile operators provide roaming services to our Subscribers. Roaming expenses are not passed on directly to Subscribers, but rather, we pay the charges directly and then bill our Subscribers separately for roaming services. Generally, we expect roaming expenses to increase in absolute terms as we expand our operations and increase our Subscriber base and as a result of increased demand from our Subscribers in light of lower roaming charges. See “—Wireless Revenues—Roaming Charges to other Operators”.

#### *Cost of Handsets and Accessories Sold*

Our cost of handsets and accessories sold includes the cost of handsets and accessories and the cost of SIM cards provided to our customers.

#### *Sales and Marketing Expenses*

Our sales and marketing expenses consist of:

- Advertising, including promotional expenses;
- Commissions to dealers for connection of new Subscribers; and
- Commissions to dealers for cash collections from Subscribers.

We have an extensive distribution network. In the nine months of 2012, we enrolled 28.1% of our new Subscribers through our owned-and-operated stores, 17.1% through our monobrand outlets operated by third parties, 46.7% through third party dealers, 7.4% through direct sales and 0.7% through our online shop. Our network of owned-and-operated stores has increased significantly over the period under review, from 448 as of 31 December 2009 to 1,841 as of 30 September 2012. We intend to continue reducing our reliance on third-party dealers and further increase the number of our owned-and-operated stores, which we believe offer higher quality customer service and boost customer loyalty.

Generally, we compensate dealers on the basis of revenue sharing arrangements, which we introduced in early 2012 as part of an initiative to reduce churn and SAC. Under our revenue sharing model, we compensate dealers with a specified share of revenues generated by each new customer signed up through the dealer. In certain circumstances, there may be a revenue threshold that must be reached in relation to a specific customer before dealers become eligible for a share in those revenues. Generally, such share of revenues is calculated based on the amount spent by each new customer in the first six months (or occasionally longer or shorter periods) of the new contract.

However, with certain dealers, such as the Russian Post Office and Euroset, we still operate on the basis of a fixed commission for each customer connected, generally subject to a minimum commission. We expect to acquire an indirect 25% stake in Euroset and, if this acquisition is successfully completed, we expect to implement our revenue sharing model with Euroset. See “—Key Factors Affecting Results of Operations—Acquisitions and Strategic Partnerships—Euroset”.

We face continuing competition from major Russian mobile operators and expect our sales and marketing costs to increase as we further compete for the Russian customer base. This may be partially offset by the increase in number of our owned-and-operated stores which we expect to have a positive impact on our sales and marketing costs.

### ***Operating Expenses***

Our operating expenses include:

- Salaries and social charges;
- Rent and utilities;
- Operating taxes;
- Network repair and maintenance;
- Radio frequency fees;
- Office maintenance;
- Bad debt expense;
- Professional services;
- Vehicle costs;
- Materials and supplies;
- Insurance; and
- Other expenses.

Generally, we expect our operating expenses to increase in absolute terms, including as a result of increases in salaries and social charges in connection with increases in personnel, increases in network repair and maintenance expenses and increases in rent and utilities expenses, in each case, in connection with the expansion of our network.

### ***Depreciation***

We depreciate the capitalised costs of our tangible assets, which consist mainly of buildings, telecommunications and other equipment owned by us. We expect depreciation expenses to grow in absolute terms as we continue to expand our network.

### ***Amortisation***

We amortise our intangible assets, which consist primarily of telecommunications licences and frequencies, software, marketing related licences, customer base, numbering capacity and other intangible assets. We expect amortisation expenses to grow in absolute terms as we continue to expand out our network and continue to pursue growth opportunities through selective acquisitions. We also expect an increase in amortisation expenses due to the method of amortisation that we use for marketing related licences. We believe this reflects the pattern in which the economic benefits of these intangible assets are used. See “—Liquidity and Capital Resources—Contractual Obligations”.

### ***Other Income and Expenses***

Our other income and expense include:

#### ***Interest expense***

We incur interest expense on our vendor financing agreements, loans from banks and other borrowings. Our interest bearing liabilities carry both fixed and floating interest rates. On our borrowings with a floating interest rate, the interest rate is linked to LIBOR, EURIBOR or MosPrime. Our interest expense depends on a combination of prevailing interest rates, our credit rating and the amount of our outstanding interest bearing liabilities. We would expect an increase in our borrowings to result in an increase in our interest expense.

#### ***Interest income***

We receive interest income on ruble and foreign currency denominated bank deposits.

### *Gain/(loss) on derivatives, net*

We incur gains and/or losses on derivatives because we have chosen not to designate both our fixed to fixed rate cross-currency swaps and our dual-currency deposits as hedging instruments and, therefore, report all gains and losses from the change in fair value of these derivative financial instruments directly in earnings; also, we incur gains and/or losses from the change in fair value of derivative financial instruments embedded in our dual currency deposits with various banks. All our fixed to fixed rate cross-currency swaps and dual-currency deposits accounted for in our consolidated statements of comprehensive income were settled in 2011 and 2010, respectively. In 2011 and the nine months ended 30 September 2012 we entered into the interest rate swaps which are designated as cash flow hedges for accounting purposes, however, the amount reclassified as earnings during the nine months ended 30 September 2012 was immaterial.

### *Foreign currency gain/(loss), net*

We incur foreign currency gains and/or losses on foreign currency denominated monetary assets and liabilities, including foreign currency denominated cash, bank deposits, short-term investments and debt. We experienced a significant increase in foreign currency exchange loss during the second quarter of 2012, mainly as a result of a significant increase in our borrowings, and a revaluation of our U.S. dollar-denominated obligations as a result of the significant depreciation of the ruble against the U.S. dollar during the second quarter of 2012. However this loss was partially offset as a result of appreciation of the ruble against the U.S. dollar during the third quarter of 2012. See “—Results of Operations—Nine Months Ended 30 September 2012 compared to Nine Months Ended 30 September 2011—Foreign Currency Exchange Loss”.

### *Provision for Income Taxes*

Provision for income taxes includes both current and deferred tax expense. The statutory income tax rate in the Russian Federation in 2011, 2010 and 2009 was 20.0%. Our effective income tax rates in 2009 and 2010 were lower than the statutory tax rate due to certain income tax preferences and certain tax positions taken with respect to prior years. Our 2011 tax rate exceeded the statutory income tax rate mainly due to the increase in the amount of non-deductible expenses for income tax purposes and de-recognition of certain tax benefits which increased the effective income tax rate. Our tax rate for the nine months ended 30 September 2012 was 22.6%, which exceeded the statutory income tax rate, mainly due to an increase in our non-deductible expenses and taxable gains from intragroup borrowings.

## **RESULTS OF OPERATIONS**

The financial information set forth below has been prepared in accordance with U.S. GAAP and presented in millions of rubles, unless otherwise indicated.

### **Nine Months Ended 30 September 2012 compared to Nine Months Ended 30 September 2011**

The following table sets forth certain financial information regarding our consolidated results of operations for the nine months ended 30 September 2012 and 2011:

	Nine Months Ended 30 September		Ruble Change	%	% of Revenues Nine Months Ended 30 September	
	2012	2011			2012	2011
	(in millions of rubles)				(%)	
<b>Revenues</b> .....	<b>201,098</b>	<b>177,146</b>	<b>23,952</b>	<b>13.5</b>	<b>100.0</b>	<b>100.0</b>
Cost of revenues .....	50,145	42,266	7,879	18.6	24.9	23.9
Sales and marketing expenses .....	15,727	15,230	497	3.3	7.8	8.6
Operating expenses .....	49,288	44,060	5,228	11.9	24.5	24.9
Depreciation .....	35,489	31,253	4,236	13.6	17.7	17.6
Amortisation .....	4,594	3,728	866	23.2	2.3	2.1
<b>Operating income</b> .....	<b>45,855</b>	<b>40,609</b>	<b>5,246</b>	<b>12.9</b>	<b>22.8</b>	<b>22.9</b>
Other income/(expense), net .....	(12,269)	1,530	(13,799)	(901.9)	(6.1)	0.9
<b>Income before taxes and noncontrolling interest</b> .....	<b>33,586</b>	<b>42,139</b>	<b>(8,553)</b>	<b>(20.3)</b>	<b>16.7</b>	<b>23.8</b>
Provision for income taxes .....	7,593	8,276	(683)	(8.3)	3.8	4.7
<b>Net income</b> .....	<b>25,993</b>	<b>33,863</b>	<b>(7,870)</b>	<b>(23.2)</b>	<b>12.9</b>	<b>19.1</b>
Net (gain)/loss attributable to noncontrolling interests .....	(93)	46	(139)	(302.2)	0.0	0.0
Net income attributable to MegaFon .....	25,900	33,909	(8,009)	(23.6)	12.9	19.1

## Revenues

Our total revenues increased by 23,952 million rubles, or 13.5%, to 201,098 million rubles for the nine months ended 30 September 2012 from 177,146 million rubles for the nine months ended 30 September 2011. We attribute this increase to the growth in our Subscriber base due to improvement in the overall economic situation in the Russian Federation, our continuing investment in acquiring new Subscribers, our value-for-money tariff offerings and our expansion in the fixed-line and broadband market.

The following table sets forth details of our revenues by segment for the nine months ended 30 September 2012 and 2011:

	Nine Months Ended 30 September		Ruble Change	%	Nine Months Ended 30 September	
	2012	2011			2012	2011
	(in millions of rubles)				(% )	
Wireless revenues	178,608	161,054	17,554	10.9	88.8	90.9
Wireline revenues	13,394	10,555	2,839	26.9	6.7	6.0
Sale of handsets and accessories	9,096	5,537	3,559	64.3	4.5	3.1
<b>Total revenues</b>	<b>201,098</b>	<b>177,146</b>	<b>23,952</b>	<b>13.5</b>	<b>100.0</b>	<b>100.0</b>

### Wireless revenues

Our wireless revenues increased by 17,554 million rubles, or 10.9%, to 178,608 million rubles, or 88.8% of total revenues for the nine months ended 30 September 2012 compared to 161,054 million rubles, or 90.9% of total revenues for the nine months ended 30 September 2011.

The following table sets forth the breakdown of our wireless revenues for the nine months ended 30 September 2012 and 2011:

	Nine Months Ended 30 September		Ruble Change	%	% of Revenues Nine Months Ended 30 September	
	2012	2011			2012	2011
	(in millions of rubles)				(% )	
Wireless revenues from local subscribers	98,752	93,951	4,801	5.1	49.1	53.0
<i>of which Russian revenues</i>	97,353	92,984	4,369	4.7	48.4	52.5
Revenues from data transfer services	25,214	19,364	5,850	30.2	12.6	10.9
<i>of which Russian revenues</i>	25,036	19,290	5,746	29.8	12.5	10.9
Revenues from VAS	26,434	21,621	4,813	22.3	13.1	12.2
<i>of which Russian revenues</i>	26,150	21,378	4,772	22.3	13.0	12.1
Revenues from interconnection charges	27,010	24,402	2,608	10.7	13.4	13.8
<i>of which Russian revenues</i>	26,794	24,296	2,498	10.3	13.3	13.7
Roaming charges to other operators	810	1,208	(398)	(32.9)	0.4	0.7
<i>of which Russian revenues</i>	783	1,185	(402)	(33.9)	0.4	0.7
Other revenues	388	508	(120)	(23.6)	0.2	0.3
<i>of which Russian revenues</i>	372	431	(59)	(13.7)	0.2	0.2
<b>Total wireless revenues</b>	<b>178,608</b>	<b>161,054</b>	<b>17,554</b>	<b>10.9</b>	<b>88.8</b>	<b>90.9</b>
<i>of which Russian revenues</i>	<i>176,488</i>	<i>159,564</i>	<i>16,924</i>	<i>10.6</i>	<i>87.8</i>	<i>90.1</i>

### Wireless Revenues from Local Subscribers

Wireless revenues from local subscribers increased by 4,801 million rubles, or 5.1%, to 98,752 million rubles for the nine months ended 30 September 2012 from 93,951 million rubles for the nine months ended 30 September 2011. The increase was primarily due to an increase in our Subscriber base. Our Subscriber base in the Russian Federation grew by 3.1 million, or 5.1% to 62.8 million as of 30 September 2012 from 59.7 million as of 30 September 2011.

As a proportion of wireless revenues, wireless revenues from local subscribers decreased to 55.3% for the nine months ended 30 September 2012 from 58.3% for the nine months ended 30 September 2011, as a result of proportionately higher growth of other types of revenues, in particular, revenues from data transfer services and VAS.



#### *Revenues from Data Transfer Services*

During the nine months ended 30 September 2012, revenues from data transfer services continued to be a significant source of growth for wireless revenues, comprising 14.1% of wireless revenues for the nine months ended 30 September 2012, as compared to 12.0% for the nine months ended 30 September 2011. Revenues from data transfer services increased by 5,850 million rubles, or 30.2%, to 25,214 million rubles for the nine months ended 30 September 2012 from 19,364 million rubles for the nine months ended 30 September 2011. This increase was primarily due to an increase in DSU (as well as the overall Subscriber base), which more than offset a decrease in APPMb.

#### *Revenues from VAS*

Revenues from VAS increased by 4,813 million rubles, or 22.3%, to 26,434 million rubles, or 14.8% of wireless revenues, for the nine months ended 30 September 2012 from 21,621 million rubles, or 13.4% of wireless revenues for the nine months ended 30 September 2011. The increase was primarily due to increased usage of content services, as well as increases in revenues from SMS, although revenues from SMS decreased as a percentage of revenues from VAS to approximately 36.4% for the nine months ended 30 September 2012 as compared to approximately 39.4% for the corresponding period in 2011.

#### *Revenues from Interconnection Charges*

Revenues from interconnection charges increased by 2,608 million rubles, or 10.7%, to 27,010 million rubles, or 15.1% of wireless revenues, for the nine months ended 30 September 2012 from 24,402 million rubles, or 15.2% of wireless revenues, for the nine months ended 30 September 2011. The increase was primarily due to growth in our Subscriber base, which resulted in an increase in incoming traffic to Subscribers on our network and a corresponding increase in number of terminations on our network.

#### *Roaming Charges to other Operators*

Revenues from roaming charges to other operators decreased by 398 million rubles, or 32.9%, to 810 million rubles, or 0.5% of wireless revenues, for the nine months ended 30 September 2012 from 1,208 million rubles, or 0.8% of wireless revenues, for the nine months ended 30 September 2011.

Following an initiative of the Russian government aimed at lowering roaming charges, we were the first among our principal competitors to renegotiate roaming contracts with a number of operators in Europe with a view to reducing tariffs and increasing roaming traffic. As a result, starting from 15 December 2011, we significantly reduced prices for our roaming services in 44 European countries, including the European part of the CIS and Turkey. The decrease in our revenues from roaming charges to other operators in the nine months ended 30 September 2012 was primarily due to this decrease in pricing for our roaming services, which was offset in part by higher demand for roaming services.

#### *Wireline Revenues*

Wireline revenues increased by 26.9%, or 2,839 million rubles, to 13,394 million rubles for the nine months ended 30 September 2012 from 10,555 million rubles for the nine months ended 30 September 2011, which was primarily a result of our expansion in the fixed-line and broadband sectors, including through the acquisitions of NetByNet and Yugratel, among others, during the course of 2011. See “—Year Ended 31 December 2011 Compared to Year Ended 31 December 2010—Revenues—Wireline Revenues”. As a proportion of total revenues, wireline revenues increased to 6.7% for the nine months ended 30 September 2012 from 6.0% for the nine months ended 30 September 2011 for the same reason.

#### *Revenues from Sales of Handsets and Accessories*

Revenues from the sales of handsets and accessories increased by 3,559 million rubles, or 64.3%, to 9,096 million rubles, for the nine months ended 30 September 2012 from 5,537 million rubles, for the nine months ended 30 September 2011. The increase in our revenues from sales of handsets and accessories in the nine months ended 30 September 2012 was primarily due to an increase in the average price of devices sold by our distribution network. In particular, in the nine months ended 30 September 2012, we discontinued subsidies of our 3G USB modems, which resulted in an increase in prices of USB modems, offset in part by a decline in volume of units sold. As a proportion of total revenues, revenues from the sales of handsets and accessories increased to 4.5% for the nine months ended 30 September 2012 as compared to 3.1% for the nine months ended 30 September 2011.

### *Cost of revenues*

Cost of revenues increased by 7,879 million rubles, or 18.6%, to 50,145 million rubles for the nine months ended 30 September 2012 from 42,266 million rubles for the nine months ended 30 September 2011, primarily due to the expansion of our operations and increases in our Subscriber base. As a percentage of total revenues, cost of revenues increased to 24.9% of total revenues for the nine months ended 30 September 2012, from 23.9% for the nine months ended 30 September 2011. The increase in the cost of revenues as a percentage of total revenues was primarily the result of an expansion of our fixed-line business and of our retail distribution network, because such businesses command lower margins than our wireless business.

The following table sets forth details of our cost of revenues by category for the nine months ended 30 September 2012 and 2011:

	Nine Months ended 30 September		Ruble Change	%	% of Revenues Nine Months ended 30 September	
	2012	2011			2012	2011
	(in millions of rubles)				(% )	
Cost of services						
Interconnection charges	34,640	28,904	5,736	19.8	17.2	16.3
Cost of VAS	5,120	3,533	1,587	44.9	2.5	2.0
Roaming expenses	1,677	1,588	89	5.6	0.8	0.9
<b>Total cost of services</b>	<b>41,437</b>	<b>34,025</b>	<b>7,412</b>	<b>21.8</b>	<b>20.5</b>	<b>19.2</b>
Cost of handsets and accessories sold						
Cost of handsets and accessories	7,985	7,629	356	4.7	4.0	4.3
Cost of SIM cards	723	612	111	18.1	0.4	0.4
<b>Total cost of handsets and accessories sold</b>	<b>8,708</b>	<b>8,241</b>	<b>467</b>	<b>5.7</b>	<b>4.4</b>	<b>4.7</b>
<b>Total cost of revenues</b>	<b>50,145</b>	<b>42,266</b>	<b>7,879</b>	<b>18.6</b>	<b>24.9</b>	<b>23.9</b>

### *Cost of Services*

Our cost of services increased by 7,412 million rubles, or 21.8%, to 41,437 million rubles, or 20.5% of total revenues for the nine months ended 30 September 2012 compared to 34,025 million rubles, or 19.2% of total revenues for the nine months ended 30 September 2011. Our cost of services increased mainly due to increases in interconnection charges and cost of VAS.

#### *Interconnection Charges*

Interconnection charges increased by 5,736 million rubles, or 19.8%, to 34,640 million rubles for the nine months ended 30 September 2012 from 28,904 million rubles for the nine months ended 30 September 2011. As a percentage of total revenues, interconnection charges increased to 17.2% for the nine months ended 30 September 2012 compared to 16.3% for the nine months ended 30 September 2011. The increase in interconnection charges was primarily due to the growth of our Subscriber base, which resulted in a higher volume of outgoing traffic from Subscribers on our network and accordingly an increase in number of terminations on other networks. This increase was also driven by the growth in the rent of channels supporting the expansion of our fixed-line business as well as the acquisitions of NetByNet and Yugratel, among others, during the course of 2011.

#### *Cost of VAS*

Cost of VAS increased by 1,587 million rubles, or 44.9%, to 5,120 million rubles for the nine months ended 30 September 2012 from 3,533 million rubles for the nine months ended 30 September 2011. The increase in cost of VAS was primarily due to an increase in our Subscriber base and corresponds to the increase in our revenues from VAS. As a percentage of total revenues, cost of VAS increased to 2.5% for the nine months ended 30 September 2012 compared to 2.0% for the nine months ended 30 September 2011.

#### *Roaming Expenses*

Roaming expenses increased by 89 million rubles, or 5.6%, to 1,677 million rubles for the nine months ended 30 September 2012 from 1,588 million rubles for the nine months ended 30 September 2011. As a percentage of

total revenues, roaming expenses decreased to 0.8% for the nine months ended 30 September 2012 compared to 0.9% for the nine months ended 30 September 2011. The increase in roaming expenses was primarily due to an increase in roaming traffic as a result of the decreases in roaming tariffs in December 2011, which stimulated higher usage of voice and data services by our Subscribers roaming on other operators' networks. See “—Revenues—Wireless Revenues—Roaming Charges to other Operators”.

#### *Cost of Handsets and Accessories Sold*

##### *Cost of Handsets and Accessories*

Cost of handsets and accessories increased by 356 million rubles, or 4.7%, to 7,985 million rubles, 4.0% of total revenues, for the nine months ended 30 September 2012 from 7,629 million rubles, or 4.3% of total revenues, for the nine months ended 30 September 2011. The increase in our cost of handsets and accessories in the nine months ended 30 September 2012 was mainly due to an increase in the volume of portable electronic devices sold.

##### *Cost of SIM cards*

Cost of SIM cards increased by 111 million rubles, or 18.1%, to 723 million rubles for the nine months ended 30 September 2012 from 612 million rubles for the nine months ended 30 September 2011. As a percentage of total revenues, cost of SIM cards were 0.4% for the nine months ended 30 September 2012 and for the nine months ended 30 September 2011. Cost of SIM cards increased primarily as a result of increased purchases of SIM cards to meet demand.

#### *Sales and Marketing Expenses*

Sales and marketing expenses increased by 497 million rubles, or 3.3%, to 15,727 million rubles for the nine months ended 30 September 2012 from 15,230 million rubles for the nine months ended 30 September 2011. As a percentage of total revenues, sales and marketing expenses decreased from 8.6% during the nine months ended 30 September 2011 to 7.8% during the nine months ended 30 September 2012.

The following table sets forth details of our sales and marketing expenses for the nine month periods ended 30 September 2012 and 2011:

	<b>Nine Months ended 30 September</b>		<b>Ruble Change</b>	<b>% Change</b>	<b>% of Revenues Nine Months ended 30 September</b>	
	<b>2012</b>	<b>2011</b>			<b>2012</b>	<b>2011</b>
	<b>(in millions of rubles)</b>				<b>(%)</b>	
Advertising .....	6,165	5,037	1,128	22.4	3.1	2.8
Commissions to dealers for connection of new subscribers .....	6,069	6,322	(253)	(4.0)	3.0	3.6
Commissions to dealers for cash collection from subscribers .....	3,493	3,871	(378)	(9.8)	1.7	2.2
<b>Total sales and marketing expenses .....</b>	<b>15,727</b>	<b>15,230</b>	<b>497</b>	<b>3.3</b>	<b>7.8</b>	<b>8.6</b>

Advertising expenses increased by 1,128 million rubles, or 22.4%, to 6,165 million rubles for the nine months ended 30 September 2012, from 5,037 million rubles for the nine months ended 30 September 2011. The increase in advertising expenses was primarily due to additional costs associated with advertisements of new services and products. As a percentage of total revenues, advertising expenses increased slightly from 2.8% in the nine months ended 30 September 2011 to 3.1% in the nine months ended 30 September 2012.

Commissions to dealers for connection of new subscribers decreased by 253 million rubles, or 4.0%, to 6,069 million rubles for the nine months ended 30 September 2012 from 6,322 million rubles for the nine months ended 30 September 2011. Commissions to dealers for connection of new subscribers decreased primarily due to a change in the structure of dealers' commissions, as well as our efforts to manage Subscriber churn and to support an increase in new Subscribers with higher ARPU, which resulted in a lower increase in number of Subscribers. See “—Key income statement line items—Sales and Marketing Expenses”. As a percentage of total revenues, commissions to dealers for connection of new subscribers were 3.0% for the nine months ended 30 September 2012, as compared to 3.6% for the nine months ended 30 September 2011.

Commissions to dealers for cash collection from subscribers decreased by 378 million rubles, or 9.8%, to 3,493 million rubles for the nine months ended 30 September 2012 from 3,871 million rubles for the nine months

ended 30 September 2011. Commissions to dealers for cash collection from subscribers for the nine months ended 30 September 2011 were higher than for the nine months ended 30 September 2012 primarily due to temporary marketing initiatives introduced in the second half of 2011 during which we increased the commissions paid to payment system operators as compensation for their not charging fees to our Subscribers for payments made through their payment system terminals, and increased sales volumes. As a percentage of total revenues, commissions to dealers for cash collection from subscribers were 1.7% for the nine months ended 30 September 2012, as compared to 2.2% for the nine months ended 30 September 2011.

### *Operating Expenses*

Operating expenses increased by 5,228 million rubles, or 11.9%, to 49,288 million rubles for the nine months ended 30 September 2012 from 44,060 million rubles for the nine months ended 30 September 2011. As a percentage of total revenues, our operating expenses decreased to 24.5% for the nine months ended 30 September 2012 from 24.9% for the nine months ended 30 September 2011.

The following table sets forth details of our operating expenses for the nine months ended 30 September 2012 and 2011:

	Nine Months ended 30 September		Ruble Change	% Change	% of Revenues Nine Months ended 30 September	
	2012	2011			2012	2011
	(in millions of rubles)				(% )	
Salaries and social charges	19,461	17,222	2,239	13.0	9.7	9.7
Rent and utilities	11,871	10,315	1,556	15.1	5.9	5.8
Operating taxes	5,053	4,263	790	18.5	2.5	2.4
Network repair and maintenance	3,789	3,817	(28)	(0.7)	1.9	2.2
Radio frequency fees	3,012	2,633	379	14.4	1.5	1.5
Office maintenance	1,329	1,166	163	14.0	0.7	0.7
Bad debt expense	1,205	1,085	120	11.1	0.6	0.6
Professional services	1,114	963	151	15.7	0.6	0.5
Vehicle costs	480	460	20	4.3	0.2	0.3
Materials and supplies	167	197	(30)	(15.2)	0.1	0.1
Insurance	66	83	(17)	(20.5)	0.0	0.0
Other expenses	1,741	1,856	(115)	(6.2)	0.8	1.1
<b>Total operating expenses</b>	<b>49,288</b>	<b>44,060</b>	<b>5,228</b>	<b>11.9</b>	<b>24.5</b>	<b>24.9</b>

Operating expenses increased for the nine months ended 30 September 2012 as compared to the nine months ended 30 September 2011 primarily due to increases in salaries and social charges, rent and utilities, operating taxes, radio frequency fees, office maintenance and professional services. One of the drivers of the increase was the acquisition of NetbyNet in June 2011. See “Key Factors Affecting our Results of Operations—Acquisitions and Strategic Partnerships”.

Salaries and social charges increased by 2,239 million rubles, or 13.0%, to 19,461 million rubles for the nine months ended 30 September 2012 from 17,222 million rubles for the nine months ended 30 September 2011. The increase in salaries and social charges was primarily due to an increase in the number of employees. As of 30 September 2012 and 2011 we had approximately 33,678 and 30,835 full-time employees, respectively. As a percentage of total revenues, salaries and social charges were 9.7% for the nine months ended 30 September 2012 and for the nine months ended 30 September 2011.

Rent and utilities expense increased by 1,556 million rubles, or 15.1%, to 11,871 million rubles for the nine months ended 30 September 2012 from 10,315 million rubles for the nine months ended 30 September 2011. The increase in rent expense was primarily due to the lease of additional base station sites to allow for the expansion of our operations and the lease of additional premises in connection with the growth of our retail distribution network. As a percentage of total revenues, rent expense slightly increased to 5.9% for the nine months ended 30 September 2012 from 5.8% for the nine months ended 30 September 2011.

Operating taxes increased by 790 million rubles, or 18.5%, to 5,053 million rubles for the nine months ended 30 September 2012 from 4,263 million rubles for the nine months ended 30 September 2011. Operating taxes increased primarily due to an increase in Unified Service Fund charges as a result of increases in our revenues,

and an increase in property tax as a result of an increase in our investment in property, plant and equipment. As a percentage of total revenues, operating taxes increased to 2.5% for the nine months ended 30 September 2012 from 2.4% for the nine months ended 30 September 2011.

Network repair and maintenance expense decreased slightly, by 28 million rubles, or 0.7%, to 3,789 million rubles for the nine months ended 30 September 2012 from 3,817 million rubles for the nine months ended 30 September 2011. Network repair and maintenance expense decreased primarily as a result of the optimization of our operations and efficiencies resulting from the integration of the networks of entities we had acquired in 2011 into our network in 2012. As a percentage of total revenues, network repair and maintenance decreased to 1.9% for the nine months ended 30 September 2012 from 2.2% for the nine months ended 30 September 2011.

Radio frequency fees increased by 379 million rubles, or 14.4%, to 3,012 million rubles for the nine months ended 30 September 2012 from 2,633 million rubles for the nine months ended 30 September 2011. The increase in radio frequency fees was primarily a result of the expansion of our network coverage. As a percentage of total revenues, radio frequency fees were 1.5% for the nine months ended 30 September 2012 and for the nine months ended 30 September 2011.

Office maintenance expense increased by 163 million rubles, or 14.0%, to 1,329 million rubles for the nine months ended 30 September 2012 from 1,166 million rubles for the nine months ended 30 September 2011, primarily due to the growth of our retail distribution network. As a percentage of total revenues, office maintenance expense were 0.7% for the nine months ended 30 September 2012 and for the nine months ended 30 September 2011.

Bad debt expense increased by 120 million rubles, or 11.1%, to 1,205 million rubles for the nine months ended 30 September 2012 from 1,085 million rubles for the nine months ended 30 September 2011, mainly due to increased levels of accounts receivables corresponding to growth in our total revenues. As a percentage of total revenues, bad debt expense remained constant for the nine months ended 30 September 2012 as compared to the nine months ended 30 September 2011.

#### ***Depreciation***

Our depreciation expense increased by 4,236 million rubles, or 13.6 %, to 35,489 million rubles for the nine months ended 30 September 2012 from 31,253 million rubles for the nine months ended 30 September 2011. Depreciation expense increased primarily due to growth in our capital expenditure and because of the need to accelerate depreciation for equipment being replaced in connection with our network modernisation program. See “—Liquidity and Capital Resources—Capital Expenditures”. As a percentage of total revenues, depreciation expense increased to 17.7% for the nine months ended 30 September 2012 from 17.6% for the nine months ended 30 September 2011.

#### ***Amortisation***

Our amortisation expense increased by 866 million rubles, or 23.2%, to 4,594 million rubles for the nine months ended 30 September 2012 from 3,728 million rubles for the nine months ended 30 September 2011 primarily due to an increase in intangible assets from acquisitions carried out during the course of 2011. As a percentage of total revenues, amortisation increased to 2.3% for the nine months ended 30 September 2012 from 2.1% for the nine months ended 30 September 2011.

#### ***Other Income and Expenses***

The following table sets forth details of our other income and expenses for the nine month periods ended 30 September 2012 and 2011:

	Nine Months ended 30 September		Ruble Change	% Change	% of Revenues Nine Months ended 30 September	
	2012	2011			2012	2011
	(in millions of rubles)				(% )	
Interest expense . . . . .	(4,549)	(726)	(3,823)	526.6	(2.3)	(0.4)
Interest income . . . . .	1,047	2,606	(1,559)	(59.8)	0.5	1.5
Other gain/(loss), net . . . . .	(9)	83	(92)	(110.8)	(0.0)	0.0
Loss on derivatives, net . . . . .	—	(27)	27	(100.0)	—	(0.0)
Foreign currency exchange loss, net . . . . .	(8,758)	(406)	(8,352)	2,057.1	(4.3)	(0.2)
<b>Total other income/(expense), net . . . . .</b>	<b>(12,269)</b>	<b>1,530</b>	<b>(13,799)</b>	<b>(901.9)</b>	<b>(6.1)</b>	<b>0.9</b>



### *Interest Expense*

Interest expense increased by 3,823 million rubles or 526.6%, to 4,549 million rubles during the nine months ended 30 September 2012 from 726 million rubles during the nine months ended 30 September 2011. Interest expense increased mainly because of an increase in our borrowings, due to the special dividend and purchase of shares. See “—Shareholder Transactions” and “—Capital Resources and Liquidity—Indebtedness”.

### *Interest Income*

Interest income decreased by 1,559 million rubles, or 59.8%, to 1,047 million rubles during the nine months ended 30 September 2012 from 2,606 million rubles during the nine months ended 30 September 2011. Interest income decreased primarily as a result of decreases in our cash balances and short-term investments as a result of the special dividend and purchase of shares. See “—Shareholder Transactions”.

### *Foreign Currency Exchange Loss*

Foreign currency exchange loss increased by 8,352 million rubles, or 2,057.1%, to 8,758 million rubles during the nine months ended 30 September 2012 from 406 million rubles during the nine months ended 30 September 2011. The increase in our foreign currency exchange loss during the nine months ended 30 September 2012 was mainly caused by the significant increase in our borrowings, and a revaluation of our U.S. dollar-denominated obligations as a result of the significant depreciation of the ruble against the U.S. dollar during the second quarter of 2012, which was offset in part by a foreign currency exchange gain of 2,594 million rubles in the third quarter of 2012.

### *Provision for Income Taxes*

Our provision for income taxes decreased by 683 million rubles, or 8.3%, to 7,593 million rubles for the nine months ended 30 September 2012, compared to 8,276 million rubles for the nine months ended 30 September 2011. Our effective income tax rate was 22.6% for the nine months ended 30 September 2012, increased from 19.6% for the nine months ended 30 September 2011, mainly due to an increase in our non-deductible expenses and taxable gains from intragroup borrowings. The effective income tax rate for the nine months ended 30 September 2012 is based on our expected income tax rate for the full year of 2012, and the actual effective income tax rate for 2012 may ultimately differ from our estimate.

### *Noncontrolling Interest*

Our net gain attributable to noncontrolling interest was 93 million rubles for the nine months ended 30 September 2012 as compared to a net loss attributable to noncontrolling interest of 46 million rubles for the nine months ended 30 September 2011, primarily due to net income of entities incorporated outside the Russian Federation in which we hold an ownership interest of less than 100% for the nine months ended 30 September 2012, as compared to net losses of such entities for the nine months ended 30 September 2011.

### *Net Income attributable to MegaFon*

For the reasons set forth above, including, in particular, the increase in net foreign currency exchange loss, our net income decreased by 8,009 million rubles, or 23.6%, to 25,900 million rubles for the nine months ended 30 September 2012 from 33,909 million rubles for the nine months ended 30 September 2011, notwithstanding an increase in our net income by 2,538 million rubles, or 20.4%, to 14,978 million rubles for the three months ended 30 September 2012 as compared to 12,440 million rubles for the three months ended 30 September 2011. As a percentage of total revenues, our net income decreased to 12.9% for the nine months ended 30 September 2012 from 19.1% in the nine months ended 30 September 2011.

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

The following table sets forth certain financial information regarding our consolidated results of operations for the years ended 31 December 2011 and 2010:

	Year ended 31 December		Ruble Change	% Change	% of Revenues Year ended 31 December	
	2011	2010			2011	2010
	(in millions of rubles)				(%)	
<b>Revenues</b> .....	<b>242,608</b>	<b>215,515</b>	<b>27,093</b>	<b>12.6</b>	<b>100.0</b>	<b>100.0</b>
Cost of revenues .....	58,896	48,423	10,473	21.6	24.3	22.5
Sales and marketing expenses .....	21,841	19,471	2,370	12.2	9.0	9.0
Operating expenses .....	61,049	49,847	11,202	22.5	25.1	23.1
Depreciation .....	42,377	35,035	7,342	21.0	17.5	16.3
Amortisation .....	5,299	3,839	1,460	38.0	2.2	1.8
<b>Operating income</b> .....	<b>53,146</b>	<b>58,900</b>	<b>(5,754)</b>	<b>(9.8)</b>	<b>21.9</b>	<b>27.3</b>
Other income, net .....	2,759	2,286	473	20.7	1.1	1.1
<b>Income before taxes and noncontrolling interest</b> .....	<b>55,905</b>	<b>61,186</b>	<b>(5,281)</b>	<b>(8.6)</b>	<b>23.0</b>	<b>28.4</b>
Provision for income taxes .....	12,320	11,962	358	3.0	5.0	5.6
<b>Net income</b> .....	<b>43,585</b>	<b>49,224</b>	<b>(5,639)</b>	<b>(11.5)</b>	<b>18.0</b>	<b>22.8</b>
Net gain attributable to noncontrolling interests .....	(6)	(52)	46	(88.5)	(0.0)	(0.0)
<b>Net income attributable to MegaFon</b> .....	<b>43,579</b>	<b>49,172</b>	<b>(5,593)</b>	<b>(11.4)</b>	<b>18.0</b>	<b>22.8</b>

### Revenues

Our total revenues increased by 27,093 million rubles, or 12.6%, to 242,608 million rubles or the year ended 31 December 2011 from 215,515 million rubles for the year ended 31 December 2010. This growth was mainly due to an increase in our Subscriber base and a rise in the use of mobile data transfer services. Our Subscriber base in the Russian Federation grew by 5.0 million, or 8.8%, to 61.6 million as of 31 December 2011 from 56.6 million as of 31 December 2010.

The following table sets forth details of our revenues by segment for the years ended 31 December 2011 and 2010:

	Year ended 31 December		Ruble Change	% Change	% of Revenues Year ended 31 December	
	2011	2010			2011	2010
	(in millions of rubles)				(%)	
Wireless revenues .....	218,994	202,837	16,157	8.0	90.2	94.1
Wireline revenues .....	15,194	7,496	7,698	102.7	6.3	3.5
Sale of handsets and accessories .....	8,420	5,182	3,238	62.5	3.5	2.4
<b>Total Revenues</b> .....	<b>242,608</b>	<b>215,515</b>	<b>27,093</b>	<b>12.6</b>	<b>100.0</b>	<b>100.0</b>

### Wireless Revenues

Our wireless revenues increased by 16,157 million rubles, or 8.0%, to 218,994 million rubles, or 90.2% of total revenues for the year ended 31 December 2011 compared to 202,837 million rubles, or 94.1% of total revenues for the year ended 31 December 2010.

The following table sets forth the breakdown of our wireless revenues for the years ended 31 December 2011 and 2010:

	Year ended 31 December		Ruble Change	% Change	% of Revenues Year ended 31 December	
	2011	2010			2011	2010
	(in millions of rubles)					
Wireless revenues from local subscribers	126,101	126,347	(246)	(0.2)	51.9	58.6
<i>of which Russian revenues</i>	<i>124,774</i>	<i>125,151</i>	<i>(377)</i>	<i>(0.3)</i>	<i>51.4</i>	<i>58.2</i>
Revenues from data transfer services	27,077	18,632	8,445	45.3	11.2	8.6
<i>of which Russian revenues</i>	<i>26,950</i>	<i>18,632</i>	<i>8,318</i>	<i>44.6</i>	<i>11.0</i>	<i>8.6</i>
Revenues from VAS	30,356	26,688	3,668	13.7	12.5	12.4
<i>of which Russian revenues</i>	<i>30,031</i>	<i>26,392</i>	<i>3,639</i>	<i>13.8</i>	<i>12.4</i>	<i>12.2</i>
Revenues from interconnection charges	33,396	28,662	4,734	16.5	13.8	13.3
<i>of which Russian revenues</i>	<i>33,208</i>	<i>28,512</i>	<i>4,696</i>	<i>16.5</i>	<i>13.7</i>	<i>13.2</i>
Roaming charges to other operators	1,435	1,488	(53)	(3.6)	0.6	0.7
<i>of which Russian revenues</i>	<i>1,389</i>	<i>1,443</i>	<i>(54)</i>	<i>(3.7)</i>	<i>0.6</i>	<i>0.7</i>
Other revenues	629	1,020	(391)	(38.3)	0.2	0.5
<i>of which Russian revenues</i>	<i>552</i>	<i>1,017</i>	<i>(465)</i>	<i>(45.7)</i>	<i>0.2</i>	<i>0.5</i>
<b>Total wireless revenues</b>	<b>218,994</b>	<b>202,837</b>	<b>16,157</b>	<b>8.0</b>	<b>90.2</b>	<b>94.1</b>
<i>of which Russian revenues</i>	<i>216,904</i>	<i>201,147</i>	<i>15,757</i>	<i>7.8</i>	<i>89.3</i>	<i>93.4</i>

#### *Wireless Revenues from Local Subscribers*

Wireless revenues from local subscribers decreased by 246 million rubles, or 0.2%, to 126,101 million rubles for the year ended 31 December 2011, from 126,347 million rubles for the year ended 31 December 2010, notwithstanding an increase in our Subscriber base, which increase was offset by decreases in our tariffs for voice services as a result of competitive pressure.

As a proportion of wireless revenues, wireless revenues from local subscribers decreased to 57.6% for the year ended 31 December 2011 from 62.3% for the year ended 31 December 2010. The decline in percentage terms was a result of proportionately higher increases in revenues from data transfer services and VAS.

#### *Revenues from data transfer services*

During the year ended 31 December 2011, revenues from data transfer services was a significant source of growth for wireless revenues, comprising 12.4% of wireless revenues, as compared to 9.2% for the year ended 31 December 2010. Revenues from data transfer services increased by 8,445 million rubles, or 45.3%, to 27,077 million rubles for the year ended 31 December 2011 from 18,632 million rubles for the year ended 31 December 2010. This increase was primarily due to the increase in data services user base as well as a significant increase in DSU, which was partially offset by a decrease in APPMb.

#### *Revenues from VAS*

Revenues from VAS increased by 3,668 million rubles, or 13.7%, to 30,356 million rubles, or 13.9% of wireless revenues for the year ended 31 December 2011 from 26,688 million rubles, or 13.2% of wireless revenues for the year ended 31 December 2010. The increase was mainly due to an increase in our Subscriber base. Our revenues from VAS primarily include revenues from SMS, which were approximately 38.2% of revenues from VAS for the year ended 31 December 2011.

#### *Revenues from Interconnection Charges*

Revenues from interconnection charges increased by 4,734 million rubles, or 16.5%, to 33,396 million rubles, or 15.2% of wireless revenues, for the year ended 31 December 2011, from 28,662 million rubles, or 14.1% of wireless revenues, for the year ended 31 December 2010. The primary reason for the increase was due to an increased volume of calls to our Subscribers from users on other operator networks, as a result of growth in our Subscriber base, which resulted in an increased number of terminations on our network.

### *Roaming Charges to Other Operators*

Revenues from roaming charges to other operators decreased by 53 million rubles, or 3.6%, to 1,435 million rubles, or 0.6% of wireless revenues, for the year ended 31 December 2011 from 1,488 million rubles, or 0.7% of wireless revenues, for the year ended 31 December 2010. The decrease in our roaming revenues was primarily the result of a decrease in roaming tariffs in December 2011, pursuant to bilateral agreements with international wireless and wireline network operators. See “—Nine Months Ended 30 September 2012 Compared to Nine Months Ended 30 September 2011—Revenues—Wireless Revenues—Roaming Charges to Other Operators”.

### *Wireline revenues*

Wireline revenues increased by 7,698 million rubles, or 102.7%, to 15,194 million rubles, or 6.3% of total revenues for the year ended 31 December 2011 compared to 7,496 million rubles, or 3.5% of total revenues for the year ended 31 December 2010. This increase was mainly due to our continued expansion in the fixed-line sector through the acquisition of the NetByNet, WebPlus, Nakhodka Telecom, Luchshe.Net, LLC Internet Tsentri and LLC Svyazinform and OJSC Yuratel businesses during the course of 2011, which also strengthened our position with respect to high-end corporate and government customers. In addition, following the acquisition of Synterra in 2010, the results of operations of Synterra were consolidated in our financial statements only from 1 June 2010, whereas, in 2011, the results of operations of Synterra were consolidated for the full year.

### *Revenues from Sales of Handsets and Accessories*

Revenues from the sales of handsets and accessories increased by 3,238 million rubles, or 62.5%, to 8,420 million rubles for the year ended 31 December 2011 compared to 5,182 million rubles for the year ended 31 December 2010. The increase in our revenues from sales of handsets and accessories during the year ended 31 December 2011 was primarily as a result of the expansion of our distribution network and, in particular, increased sales of USB modems. See “Business—Sales and Distribution”.

### *Cost of revenues*

Our cost of revenues increased by 10,473 million rubles, or 21.6%, to 58,896 million rubles for the year ended 31 December 2011 from 48,423 million rubles for the year ended 31 December 2010. The increase in cost of revenues was primarily due to increased expenditures in connection with the expansion of our operations as well as increases in our Subscriber base. As a percentage of total revenues, cost of revenues increased to 24.3% for the year ended 31 December 2011 from 22.5% for the year ended 31 December 2010. Cost of revenues increased faster than revenues increased from 2010 to 2011 due to the expansion of our own retail distribution network and also the expansion of our wireline business, both of which in general are less profitable than our wireless business.

The following table sets forth details of our cost of revenues by category for the years ended 31 December 2011 and 2010:

	Year ended 31 December		Ruble Change	% Change	% of Revenues Year ended 31 December	
	2011	2010			2011	2010
	(in millions of rubles)				(% )	
Cost of services						
Interconnection charges	40,568	36,718	3,850	10.5	16.7	17.0
Cost of VAS	5,335	3,167	2,168	68.5	2.2	1.5
Roaming expenses	1,741	1,763	(22)	(1.2)	0.7	0.8
<b>Total cost of services</b>	<b>47,644</b>	<b>41,648</b>	<b>5,996</b>	<b>14.4</b>	<b>19.6</b>	<b>19.3</b>
Cost of handsets and accessories sold						
Cost of handsets and accessories	10,343	5,643	4,700	83.3	4.3	2.6
Cost of SIM cards	909	1,132	(223)	(19.7)	0.4	0.6
<b>Total cost of handsets and accessories sold</b>	<b>11,252</b>	<b>6,775</b>	<b>4,477</b>	<b>66.1</b>	<b>4.7</b>	<b>3.2</b>
<b>Total cost of revenues</b>	<b>58,896</b>	<b>48,423</b>	<b>10,473</b>	<b>21.6</b>	<b>24.3</b>	<b>22.5</b>

### *Cost of Services*

Our cost of services increased by 5,996 million rubles, or 14.4% to 47,644 million rubles, or 19.6% of total revenues for the year ended 31 December 2011 compared to 41,648 million rubles, or 19.3% of total revenues for the year ended 31 December 2010.

#### *Interconnection Charges*

Interconnection charges increased by 3,850 million rubles, or 10.5%, to 40,568 million rubles, for the year ended 31 December 2011 from 36,718 million rubles for the year ended 31 December 2010. The increase in interconnection charges was mainly due to the growth of our Subscriber base, which resulted in higher volumes of outgoing traffic from Subscribers on our network and, accordingly, an increase in the number of terminations on other networks. The increase was also driven by growth in our fixed-line business following the acquisition of Synterra in 2010, whose results of operations were consolidated for the full year in 2011, whereas they were consolidated only from 1 June 2010 in 2010. As a percentage of total revenues, interconnection charges decreased to 16.7% for the year ended 31 December 2011 from 17.0% for the year ended 31 December 2010.

#### *Cost of VAS*

Cost of VAS increased by 2,168 million rubles, or 68.5%, to 5,335 million rubles for the year ended 31 December 2011 from 3,167 million rubles for the year ended 31 December 2010. Cost of VAS increased primarily due to an increase in our Subscriber base on our network and corresponds to the increase in our VAS revenues. As a percentage of total revenues, cost of VAS increased to 2.2% for the year ended 31 December 2011 from 1.5% for the year ended 31 December 2010.

#### *Roaming Expenses*

Roaming expenses decreased by 22 million rubles, or 1.2%, to 1,741 million rubles for the year ended 31 December 2011 from 1,763 million rubles for the year ended 31 December 2010. As a percentage of total revenues, roaming expenses decreased to 0.7% for the year ended 31 December 2011 from 0.8% for the year ended 31 December 2010. The decrease in roaming expenses was primarily a result of a significant decrease in roaming tariffs in December 2011 pursuant to bilateral agreements with international wireless and wireline network operators.

#### *Cost of Handsets and Accessories Sold*

##### *Cost of Handsets and Accessories*

Cost of handsets and accessories increased by 4,700 million rubles, or 83.3%, to 10,343 million rubles, or 4.3% of total revenues, for the year ended 31 December 2011, from 5,643 million rubles, or 2.6% of total revenues, for the year ended 31 December 2010. The increase in our cost of handsets and accessories during the year ended 31 December 2011 was primarily as a result of increased purchases of handsets and accessories to meet the increase in sales of handsets and accessories. See “—Revenues—Revenues from Sales of Handsets and Accessories”. The cost of handsets and accessories sold for the year ended 31 December 2011 was higher than revenues from sales of handsets and accessories, mainly reflecting the sale of USB modems and smartphones bundled with prepaid mobile internet traffic at a discount.

##### *Cost of SIM cards*

Cost of SIM cards decreased by 223 million rubles, or 19.7%, to 909 million rubles for the year ended 31 December 2011 from 1,132 million rubles for the year ended 31 December 2010. As a percentage of total revenues, cost of SIM cards decreased to 0.4% for the year ended 31 December 2011 from 0.6% for the year ended 31 December 2010. Cost of SIM cards decreased primarily as a result of decreases in the unit cost of SIM cards, partially offset by our increased purchases of SIM cards to meet demand.

#### *Sales and Marketing Expenses*

Sales and marketing expenses increased by 2,370 million rubles, or 12.2%, to 21,841 million rubles for the year ended 31 December 2011 from 19,471 million rubles for the year ended 31 December 2010. As a percentage of total revenues, sales and marketing expenses remained stable at 9.0% for both the year ended 31 December 2011 and for the year ended 31 December 2010.



The following table sets forth details of our sales and marketing expenses for the years ended 31 December 2011 and 2010:

	Year ended 31 December		Ruble Change	% Change	% of Revenues Year ended 31 December	
	2011	2010			2011	2010
	(in millions of rubles)				(%)	
Advertising . . . . .	7,432	6,924	508	7.3	3.1	3.2
Commissions to dealers for connection of new subscribers . .	9,061	8,465	596	7.0	3.7	3.9
Commissions to dealers for cash collection from subscribers . . . . .	5,348	4,082	1,266	31.0	2.2	1.9
<b>Total sales and marketing expenses . . . . .</b>	<b>21,841</b>	<b>19,471</b>	<b>2,370</b>	<b>12.2</b>	<b>9.0</b>	<b>9.0</b>

Advertising expense increased by 508 million rubles, or 7.3%, to 7,432 million rubles for the year ended 31 December 2011 from 6,924 million rubles for the year ended 31 December 2010. This increase was a result of increased costs of advertising as well as an extensive Russian Federation-wide advertising campaign that was undertaken during the year. However, as a percentage of total revenues, advertising expense decreased to 3.1% for the year ended 31 December 2011 from 3.2% for the year ended 31 December 2010.

In aggregate, commissions to dealers increased by 1,862 million rubles, or 14.8%, to 14,409 million rubles for the year ended 31 December 2011, from 12,547 million rubles for the year ended 31 December 2010. Commissions to dealers increased primarily due to an increase in commissions to dealers for cash collection from subscribers as a result of marketing initiatives in the third quarter of 2011, during which we increased the commissions paid to payment system operators to compensate for their not charging fees to our Subscribers for payments made through their payment system terminals, and increased sales volumes. As a percentage of total revenues, commissions to dealers increased to 5.9% for the year ended 31 December 2011 from 5.8% for the year ended 31 December 2010.

### *Operating Expenses*

Operating expenses increased by 11,202 million rubles, or 22.5%, to 61,049 million rubles for the year ended 31 December 2011 from 49,847 million rubles for the year ended 31 December 2010.

The following table sets forth details of our operating expenses for the years ended 31 December 2011 and 2010:

	Year ended 31 December		Ruble Change	% Change	% of Revenues Year ended 31 December	
	2011	2010			2011	2010
	(in millions of rubles)				(%)	
Salaries and social charges . . . . .	23,604	19,061	4,543	23.8	9.7	8.8
Rent and utilities . . . . .	14,040	11,231	2,809	25.0	5.8	5.2
Operating taxes . . . . .	5,829	5,177	652	12.6	2.4	2.4
Network repair and maintenance . . . . .	5,162	4,322	840	19.4	2.1	2.0
Radio frequency fees . . . . .	3,527	2,963	564	19.0	1.5	1.4
Office maintenance . . . . .	1,743	1,407	336	23.9	0.7	0.7
Bad debt expense . . . . .	1,437	1,182	255	21.6	0.6	0.5
Professional services . . . . .	1,967	1,361	606	44.5	0.8	0.6
Vehicle costs . . . . .	650	555	95	17.1	0.3	0.3
Materials and supplies . . . . .	321	189	132	69.8	0.1	0.1
Insurance . . . . .	113	111	2	1.8	0.0	0.1
Other expenses . . . . .	2,656	2,288	368	16.1	1.1	1.0
<b>Total operating expenses . . . . .</b>	<b>61,049</b>	<b>49,847</b>	<b>11,202</b>	<b>22.5</b>	<b>25.1</b>	<b>23.1</b>

Operating expenses increased primarily due to increases in salaries and social charges, rent and utilities, operating taxes, network repair and maintenance, and professional services. One of the main drivers of the increase was that following the acquisition of Synterra in 2010, the results of operations of Synterra were consolidated in our financial statements only from 1 June 2010, whereas, in 2011, the results of operations of Synterra were consolidated for the full year.

Salaries and social charges increased by 4,543 million rubles, or 23.8%, to 23,604 million rubles for the year ended 31 December 2011 from 19,061 million rubles for the year ended 31 December 2010. The increase in salaries was primarily due to increases in employee headcount and increases in salaries and benefits, partly due to acquisitions completed during that period (such as of NetByNet), and also due to the accrual of expenses for our long-term incentive program. As of 31 December 2011 and 2010 we had approximately 33,163 and 27,487 full-time employees, respectively. In the Russian Federation all social charges paid during the years ended 31 December 2011 and 2010 represented contributions to governmental social funds, including the Pension Fund, the Social Security Fund and the Medical Insurance Fund. The increase in aggregated maximum nominal rates of contributions to those funds from up to 26% as of 31 December 2010 to up to 34% beginning 1 January 2011 was the main reason for the growth in social charges in 2011 in comparison to 2010. As a percentage of total revenues, salaries and social charges increased to 9.7% for the year ended 31 December 2011 from 8.8% for the year ended 31 December 2010.

Rent and utilities expense increased by 2,809 million rubles, or 25%, to 14,040 million rubles for the year ended 31 December 2011 from 11,231 million rubles for the year ended 31 December 2010. Rent and utilities expense increased primarily due to the lease of additional base station sites to allow for the expansion of our operations. As a percentage of total revenues, rent and utilities increased to 5.8% for the year ended 31 December 2011 from 5.2% for the year ended 31 December 2010.

Operating taxes increased by 652 million rubles, or 12.6%, to 5,829 million rubles for the year ended 31 December 2011 from 5,177 million rubles for the year ended 31 December 2010. Operating taxes increased primarily due to an increase in Unified Service Fund charges due to increases in our revenues, and an increase in property tax as a result of an increase in our investment in property, plant and equipment. As a percentage of total revenues, operating taxes remained stable at 2.4% for each of the years ended 31 December 2011 and 2010.

Network repair and maintenance expense increased by 840 million rubles, or 19.4%, to 5,162 million rubles for the year ended 31 December 2011 from 4,322 million rubles for the year ended 31 December 2010. Network repair and maintenance expense increased primarily as a result of the expansion of our operations and the increased infrastructure associated with such expansion. As a percentage of total revenues, network repair and maintenance increased to 2.1% for the year ended 31 December 2011 from 2.0% for the year ended 31 December 2010.

Radio frequency fees increased by 564 million rubles, or 19%, to 3,527 million rubles for the year ended 31 December 2011 from 2,963 million rubles for the year ended 31 December 2010. The increase in radio frequency fees was primarily due to an increase in the number of our base stations in operation. As a percentage of total revenues, radio frequency fees increased to 1.5% for the year ended 31 December 2011 from 1.4% for the year ended 31 December 2010.

Office maintenance expense increased by 336 million rubles, or 23.9%, to 1,743 million rubles for the year ended 31 December 2011 from 1,407 million rubles for the year ended 31 December 2010, primarily due to the growth of our retail network of owned-and-operated stores. See “Business—Sales and Distribution—Owned-and-Operated MegaFon Stores”. As a percentage of total revenues, office maintenance expense remained stable at 0.7% for each of the years ended 31 December 2011 and 2010.

Bad debt expense increased by 255 million rubles, to 1,437 million rubles for the year ended 31 December 2011, from 1,182 million rubles for the year ended 31 December 2010. The increase in bad debt expense corresponded to the increased level of accounts receivable in line with the growth of our operations.

Professional services expense increased by 606 million rubles, or 44.5%, to 1,967 million rubles for the year ended 31 December 2011 from 1,361 million rubles for the year ended 31 December 2010, primarily due to transaction costs associated with our acquisitions in 2011. See “—Key Factors Affecting our Results of Operations—Acquisitions and Strategic Partnerships”.

### ***Depreciation***

Depreciation expenses increased by 7,342 million rubles, or 21%, to 42,377 million rubles for the year ended 31 December 2011 from 35,035 million rubles for the year ended 31 December 2010. Depreciation increased primarily due to an increase in depreciation relating to capital expenditures on network equipment. As a percentage of total revenues, depreciation increased to 17.5% for the year ended 31 December 2011 from 16.3% for the year ended 31 December 2010.

### *Amortisation*

Our amortisation expense increased by 1,460 million rubles, or 38%, to 5,299 million rubles for the year ended 31 December 2011 from 3,839 million rubles for the year ended 31 December 2010 primarily due to amortisation of intangible assets arising from acquisitions completed during 2011, 2010 and 2009. As a percentage of total revenues, amortisation increased to 2.2% for the year ended 31 December 2011 from 1.8% for the year ended 31 December 2010.

### *Other Income and Expenses*

The following table sets forth details of our other income and expenses for the years ended 31 December 2011 and 2010:

	Year Ended 31 December		Ruble Change	% Change	% of Revenues Year Ended 31 December	
	2011	2010			2011	2010
	(in millions of rubles)				(%)	
Interest expense	(706)	(837)	131	(15.7)	(0.3)	(0.4)
Interest income	3,591	4,008	(417)	(10.4)	1.4	1.9
Other gain, net	30	18	12	66.7	—	—
Loss on derivatives, net	(51)	(203)	152	(74.9)	—	(0.1)
Foreign currency exchange loss, net	(105)	(700)	595	(85.0)	—	(0.3)
<b>Total other income, net</b>	<b>2,759</b>	<b>2,286</b>	<b>473</b>	<b>20.7</b>	<b>1.1</b>	<b>1.1</b>

### *Interest Expense*

Interest expense decreased by 131 million rubles, or 15.7%, to 706 million rubles for the year ended 31 December 2011 from 837 million rubles for the year ended 31 December 2010. Interest expense decreased primarily due to lower applicable interest rates on our outstanding indebtedness, resulting from decreases in LIBOR and EURIBOR. See “—Capital Resources and Liquidity—Indebtedness”.

### *Interest Income*

Interest income decreased by 417 million rubles, or 10.4%, to 3,591 million rubles for the year ended 31 December 2011, from 4,008 million rubles for the year ended 31 December 2010. Interest income decreased primarily due to lower average interest rates earned on our cash balances and short-term investments.

### *Loss on Derivatives*

Loss on derivatives decreased by 152 million rubles, or 74.9%, to 51 million rubles for the year ended 31 December 2011, from 203 million rubles for the year ended 31 December 2010. The losses in each case were primarily due to a change in the fair value of foreign currency derivative instruments caused by a depreciation of the forward euro and U.S. dollar exchange rates against the ruble. The decrease in loss on derivatives from 2010 to 2011 was due to the decrease in the number of outstanding foreign currency derivatives as a result of settlement of a number of contracts during 2011.

### *Foreign Currency Exchange Loss*

Foreign currency exchange loss decreased by 595 million rubles, or 85.0%, to 105 million rubles for the year ended 31 December 2011 from 700 million rubles for the year ended 31 December 2010. At 31 December 2011, our net monetary position, which primarily consists of foreign currency denominated cash and short-term investments minus foreign currency denominated debt, resulted in a net foreign currency denominated asset. At 31 December 2010, our net monetary position was also a foreign currency denominated asset. The loss for the year ended 31 December 2011 was primarily a result of the volatility of the ruble against the U.S. dollar and the euro during the year.

### *Provision for Income Taxes*

Our provision for income taxes increased by 358 million rubles, or 3.0%, to 12,320 million rubles for the year ended 31 December 2011 from 11,962 million rubles for the year ended 31 December 2010. Our effective

income tax rate was 22.0% for the year ended 31 December 2011, up from 19.6% for the year ended 31 December 2010. The increase in our effective income tax rate was mainly due to an increase in the amount of non-deductible expenses for income tax purposes and de-recognition of certain tax benefits.

### *Noncontrolling Interests*

Our net gain attributable to noncontrolling interests was 6 million rubles for the year ended 31 December 2011 compared to net gain of 52 million rubles attributable to noncontrolling interests for the year ended 31 December 2010. The decrease in our net gain attributable to noncontrolling interests in the year ended 31 December 2011 as compared to the year ended 31 December 2010 was due to a decrease in net income of entities incorporated outside the Russian Federation in which we hold an ownership interest of less than 100%.

### *Net Income*

For the reasons set forth above, our net income decreased by 5,593 million rubles, or 11.4%, to 43,579 million rubles for the year ended 31 December 2011 from 49,172 million rubles for the year ended 31 December 2010. As a percentage of total revenues, our net income decreased to 18.0% for the year ended 31 December 2011 from 22.8% for the year ended 31 December 2010.

### **Year Ended 31 December 2010 Compared to Year Ended 31 December 2009**

The following table sets forth certain financial information regarding our consolidated results of operations for the years ended 31 December 2010 and 2009:

	Year Ended 31 December		Ruble Change	% Change	% of Revenues Year Ended 31 December	
	2010	2009			2010	2009
	(in millions of rubles)				(%)	
<b>Revenues</b> .....	215,515	181,883	33,632	18.5	100.0	100.0
Cost of revenues .....	48,423	37,204	11,219	30.2	22.5	20.5
Sales and marketing expenses .....	19,471	17,361	2,110	12.2	9.0	9.5
Operating expenses .....	49,847	39,126	10,721	27.4	23.1	21.5
Depreciation .....	35,035	28,269	6,766	23.9	16.3	15.6
Amortisation .....	3,839	3,075	764	24.8	1.8	1.7
<b>Operating income</b> .....	58,900	56,848	2,052	3.6	27.3	31.2
Other income / (expense), net .....	2,286	(983)	3,269	332.6	1.1	(0.5)
<b>Income before taxes and noncontrolling interest</b> .....	61,186	55,865	5,321	9.5	28.4	30.7
Provision for income taxes .....	11,962	10,565	1,397	13.2	5.6	5.8
<b>Net income</b> .....	49,224	45,300	3,924	8.7	22.8	24.9
Net gain attributable to noncontrolling interest .....	(52)	(11)	(41)	372.7	(0.0)	(0.0)
<b>Net income attributable to MegaFon</b> .....	<b>49,172</b>	<b>45,289</b>	<b>3,883</b>	<b>8.6</b>	<b>22.8</b>	<b>24.9</b>

### *Revenues*

Our total revenues increased by 33,632 million rubles, or 18.5%, to 215,515 million rubles or the year ended 31 December 2010 from 181,883 million rubles for the year ended 31 December 2009. We attribute this growth mainly to an increase in our Subscriber base and the acquisition of Synterra. Our Subscriber base in the Russian Federation grew by 6.4 million, or 12.7%, to 56.6 million as of 31 December 2010 from 50.2 million as of 31 December 2009.

The following table sets forth details of our revenues by segment for the years ended 31 December 2010 and 2009:

	Year ended 31 December		Ruble Change	%	% of Revenues Year ended 31 December	
	2010	2009			2010	2009
	(in millions of rubles)				(% )	
Wireless revenues	202,837	178,824	24,013	13.4	94.1	98.3
Wireline revenues	7,496	674	6,822	1,012.2	3.5	0.4
Sale of handsets and accessories	5,182	2,385	2,797	117.3	2.4	1.3
<b>Total revenue</b>	<b>215,515</b>	<b>181,883</b>	<b>33,632</b>	<b>18.5</b>	<b>100</b>	<b>100</b>

#### *Wireless Revenues*

Our wireless revenues increased by 24,013 million rubles, or 13.4%, to 202,837 million rubles, or 94.1% of total revenues for the year ended 31 December 2010 compared to 178,824 million rubles, or 98.3% of total revenues for the year ended 31 December 2009. The decrease in our wireless revenues as a percentage of total revenues was mainly the result of the proportionately greater increase in wireline revenues and revenues from sale of handsets and accessories.

The following table sets forth the breakdown of our wireless revenues for the years ended 31 December 2010 and 2009:

	Year ended 31 December		Ruble Change	%	% of Revenues Year ended 31 December	
	2010	2009			2010	2009
	(in millions of rubles)				(% )	
Wireless revenues from local subscribers	126,347	118,423	7,924	6.7	58.6	65.1
<i>of which Russian revenues</i>	<i>125,151</i>	<i>117,576</i>	<i>7,575</i>	<i>6.4</i>	<i>58.2</i>	<i>64.5</i>
Revenues from data transfer services	18,632	10,767	7,865	73.0	8.6	5.9
<i>of which Russian revenues</i>	<i>18,632</i>	<i>10,767</i>	<i>7,865</i>	<i>73.0</i>	<i>8.6</i>	<i>5.9</i>
Revenues from VAS	26,688	21,824	4,864	22.3	12.4	12.0
<i>of which Russian revenues</i>	<i>26,392</i>	<i>21,698</i>	<i>4,694</i>	<i>21.6</i>	<i>12.2</i>	<i>11.9</i>
Revenues from interconnection charges	28,662	25,702	2,960	11.5	13.3	14.1
<i>of which Russian revenues</i>	<i>28,512</i>	<i>25,557</i>	<i>2,955</i>	<i>11.6</i>	<i>13.2</i>	<i>14.1</i>
Roaming charges to other operators	1,488	1,592	(104)	(6.5)	0.7	0.9
<i>of which Russian revenues</i>	<i>1,443</i>	<i>1,559</i>	<i>(116)</i>	<i>(7.4)</i>	<i>0.7</i>	<i>0.9</i>
Other revenues	1,020	516	504	97.7	0.5	0.3
<i>of which Russian revenues</i>	<i>1,017</i>	<i>446</i>	<i>571</i>	<i>128.0</i>	<i>0.5</i>	<i>0.3</i>
<b>Total wireless revenues</b>	<b>202,837</b>	<b>178,824</b>	<b>24,013</b>	<b>13.4</b>	<b>94.1</b>	<b>98.3</b>
<i>of which Russian revenues</i>	<i>201,147</i>	<i>177,603</i>	<i>23,544</i>	<i>13.3</i>	<i>93.4</i>	<i>97.6</i>

#### *Wireless Revenues from Local Subscribers*

Wireless revenues from local subscribers increased by 7,924 million rubles, or 6.7%, to 126,347 million rubles for the year ended 31 December 2010, from 118,423 million rubles for the year ended 31 December 2009. The increase was primarily due to an increase in the Subscriber base, partially offset by decreases in ARPU and APPM.

As a proportion of wireless revenues, wireless revenues from local subscribers decreased to 62.3% for the year ended 31 December 2010 from 66.2% for the year ended 31 December 2009. The decline in percentage terms was a result of proportionately higher growth of other types of revenues, in particular, data transfer services and VAS.

#### *Revenues from data transfer services*

Revenues from data transfer services were an increasingly significant source of growth for wireless revenues, comprising 9.2% of the wireless revenues for the year ended 31 December 2010, as compared to 6.0% for the



year ended 31 December 2009. Revenues from data transfer services increased by 7,865 million rubles, or 73.0%, to 18,632 million rubles for the year ended 31 December 2010 from 10,767 million rubles for the year ended 31 December 2009. This increase was primarily due to the increase in data services user base as well as in DSU, which was partially offset by a decrease in APPMb.

#### *Revenues from VAS*

Revenues from VAS increased by 4,864 million rubles, or 22.3%, to 26,688 million rubles, or 13.2% of wireless revenues for the year ended 31 December 2010 from 21,824 million rubles, or 12.2% of wireless revenues for the year ended 31 December 2009. The increase was primarily due an increase in our Subscriber base. Our revenues from VAS primarily include SMS, which was approximately 45.0% of revenues from VAS for the year ended 31 December 2010, and was approximately 52.5% of revenues from VAS for the year ended 31 December 2009.

#### *Revenues from Interconnection Charges*

Revenues from interconnection charges increased by 2,960 million rubles, or 11.5%, to 28,662 million rubles, or 14.1% of wireless revenues, for the year ended 31 December 2010 from 25,702 million rubles, or 14.4% of wireless revenues, for the year ended 31 December 2009. The main reasons for the increase were an increased volume of calls to our Subscribers from users on other operator networks, as a result of growth in our Subscriber base and the expansion of our network, both of which resulted in higher incoming traffic terminating on our network.

#### *Roaming Charges to Other Operators*

Revenues from roaming charges to other operators decreased by 104 million rubles, or 6.5%, to 1,488 million rubles, or 0.9% of wireless revenues, for the year ended 31 December 2010 from 1,592 million rubles, or 0.9% of wireless revenues, for the year ended 31 December 2009. The decrease in our revenues from roaming charges to other operators was primarily the result of decline in visitor roaming, as a result of the economic crisis.

#### *Wireline Revenues*

Wireline revenues increased by 6,822 million rubles, or 1,012.2%, to 7,496 million rubles, or 3.5% of total revenues for the year ended 31 December 2010 compared to 674 million rubles, or 0.4% of total revenues for the year ended 31 December 2009. This increase was due to our expansion in the fixed-line and broadband markets, primarily through the acquisition of Synterra in June 2010.

#### *Revenues from Sales of Handsets and Accessories*

Revenues from sales of handsets and accessories increased by 2,797 million rubles, or 117.3%, to 5,182 million rubles for the year ended 31 December 2010 compared to 2,385 million rubles for the year ended 31 December 2009. The increase in our revenues from sales of handsets and accessories during the year ended 31 December 2010 was primarily as a result of increased sales of USB modems and the expansion of our distribution network, in particular through the increase in owned-and-operated MegaFon stores. See “—Key income statement line items—Sales and Marketing Expenses” and “Business—Sales and Distribution—Owned-and-Operated MegaFon Stores”. As a result of our bundling plans offered to stimulate the usage of data traffic, revenues from sales of handsets and accessories were less than the cost of handsets and accessories. See “—Cost of Revenues—Cost of Handsets and Accessories Sold—Cost of Handsets and Accessories”.

#### *Cost of Revenues*

Our cost of revenues increased by 11,219 million rubles, or 30.2%, to 48,423 million rubles for the year ended 31 December 2010 from 37,204 million rubles for the year ended 31 December 2009. The increase in cost of revenues was primarily due to expenditure associated with the expansion of our operations and increases in our Subscriber base. As a percentage of total revenues, cost of revenues increased to 22.5% for the year ended 31 December 2010 from 20.5% for the year ended 31 December 2009. Cost of revenues increased faster than revenues increased from 2009 to 2010 due to an increase in our wireline business which in general was less profitable than our wireless business.

The following table sets forth details of our cost of revenues by category for the years ended 31 December 2010 and 2009:

	Year ended 31 December		Ruble Change	% Change	% of Revenues Year ended 31 December	
	2010	2009			2010	2009
	(in millions of rubles)				(% )	
Cost of services						
Interconnection charges	36,718	30,393	6,325	20.8	17.0	16.7
Cost of VAS	3,167	941	2,226	236.6	1.5	0.5
Roaming expenses	1,763	1,794	(31)	(1.7)	0.8	1.0
<b>Total cost of services</b>	<b>41,648</b>	<b>33,128</b>	<b>8,520</b>	<b>25.7</b>	<b>19.3</b>	<b>18.2</b>
Cost of handsets and accessories sold						
Cost of handsets and accessories	5,643	2,726	2,917	107.0	2.6	1.5
Cost of SIM cards	1,132	1,350	(218)	(16.1)	0.6	0.8
<b>Total cost of handsets and accessories sold</b>	<b>6,775</b>	<b>4,076</b>	<b>2,699</b>	<b>66.2</b>	<b>3.2</b>	<b>2.3</b>
<b>Total cost of revenues</b>	<b>48,423</b>	<b>37,204</b>	<b>11,219</b>	<b>30.2</b>	<b>22.5</b>	<b>20.5</b>

### *Cost of Services*

Our cost of services increased by 8,520 million rubles, or 25.7% to 41,648 million rubles, or 19.3% of total revenues for the year ended 31 December 2010 compared to 33,128 million rubles, or 18.2% of total revenues for the year ended 31 December 2009.

#### *Interconnection Charges*

Interconnection charges increased by 6,325 million rubles, or 20.8%, to 36,718 million rubles, for the year ended 31 December 2010 from 30,393 million rubles for the year ended 31 December 2009. This increase mainly resulted from the growth in our Subscriber base, which lead to increased demand for interconnection to other networks. This increase was also driven by the growth in our fixed line business following the completion of the acquisition of Synterra in June 2010. See “—Key Factors Affecting Our Results of Operations—Acquisitions and Strategic Partnerships”. As a percentage of total revenues, interconnection charges increased to 17.0% for the year ended 31 December 2010 from 16.7% for the year ended 31 December 2009.

#### *Cost of VAS*

Cost of VAS increased by 2,226 million rubles, or 236.6%, to 3,167 million rubles for the year ended 31 December 2010 from 941 million rubles for the year ended 31 December 2009. Cost of VAS increased primarily due to an increase in our Subscriber base on our network and corresponds to the increase in our VAS revenues. As a percentage of total revenues, cost of VAS increased to 1.5% for the year ended 31 December 2010 from 0.5% for the year ended 31 December 2009.

#### *Roaming Expenses*

Roaming expenses decreased by 31 million rubles, or 1.7%, to 1,763 million rubles for the year ended 31 December 2010 from 1,794 million rubles for the year ended 31 December 2009. As a percentage of total revenues, roaming expenses decreased to 0.8% for the year ended 31 December 2010 from 1.0% for the year ended 31 December 2009. The decrease in roaming expenses was primarily a result of a decrease in roaming by our Subscribers, as a result of the economic crisis.

#### *Cost of handsets and accessories sold*

##### *Cost of handsets and accessories*

Cost of handsets and accessories increased by 2,917 million rubles, or 107.0%, to 5,643 million rubles, or 2.6% of total revenues, for the year ended 31 December 2010, from 2,726 million rubles, or 1.5% of total revenues, for the year ended 31 December 2009. The increase in our cost of handsets and accessories during the year ended 31 December 2010 was primarily due to increased purchases of handsets and accessories to meet the increase in sales of handsets and accessories. See “—Revenues—Revenues from Sales of Handsets and Accessories”.

### *Cost of SIM cards*

Cost of SIM cards decreased by 218 million rubles, or 16.1%, to 1,132 million rubles for the year ended 31 December 2010 from 1,350 million rubles for the year ended 31 December 2009. As a percentage of total revenues, cost of SIM cards decreased to 0.6% for the year ended 31 December 2010 from 0.8% for the year ended 31 December 2009. Cost of SIM cards decreased primarily as a result of decreases in the unit cost of SIM cards, partially offset by our increased purchases of SIM cards to meet demand.

### *Sales and Marketing Expenses*

Sales and marketing expenses increased by 2,110 million rubles, or 12.2%, to 19,471 million rubles for the year ended 31 December 2010 from 17,361 million rubles for the year ended 31 December 2009. As a percentage of total revenues, sales and marketing expenses decreased to 9.0% for the year ended 31 December 2010 from 9.5% for the year ended 31 December 2009.

The following table sets forth details of our sales and marketing expenses for the years ended 31 December 2010 and 2009:

	Year ended 31 December		Ruble Change	%	% of Revenues Year ended 31 December	
	2010	2009			2010	2009
	(in millions of rubles)				(% )	
Advertising .....	6,924	6,200	724	11.7	3.2	3.4
Commissions to dealers for connection of new subscribers .....	8,465	7,763	702	9.0	3.9	4.2
Commissions to dealers for cash collection from subscribers .....	4,082	3,398	684	20.1	1.9	1.9
<b>Total sales and marketing .....</b>	<b>19,471</b>	<b>17,361</b>	<b>2,110</b>	<b>12.2</b>	<b>9.0</b>	<b>9.5</b>

Advertising expense increased by 724 million rubles, or 11.7%, to 6,924 million rubles for the year ended 31 December 2010 from 6,200 million rubles for the year ended 31 December 2009, mainly due to increases in the costs of advertising. As a percentage of total revenues, advertising expense decreased to 3.2% for the year ended 31 December 2010 from 3.4% for the year ended 31 December 2009.

In aggregate, commissions to dealers increased by 1,386 million rubles, or 12.4%, to 12,547 million rubles for the year ended 31 December 2010 from 11,161 million rubles for the year ended 31 December 2009. Commission to dealers increased primarily due to an increase in the Subscriber base. As a percentage of total revenues, commissions to dealers decreased to 5.8% for the year ended 31 December 2010 from 6.1% for the year ended 31 December 2009.

### *Operating Expenses*

Operating expenses increased by 10,721 million rubles, or 27.4%, to 49,847 million rubles for the year ended 31 December 2010 from 39,126 million rubles for the year ended 31 December 2009.

The following table sets forth details of our operating expenses for the years ended 31 December 2010 and 2009:

	Year ended 31 December		Ruble Change	%	% of Revenues Year ended 31 December	
	2010	2009			2010	2009
	(in millions of rubles)				(% )	
Salaries and social charges . . . . .	19,061	13,514	5,547	41.0	8.8	7.4
Rent and utilities . . . . .	11,231	8,919	2,312	25.9	5.2	4.9
Operating taxes . . . . .	5,177	4,388	789	18.0	2.4	2.4
Network repair and maintenance . . . . .	4,322	3,502	820	23.4	2.0	1.9
Radio frequency fees . . . . .	2,963	2,651	312	11.8	1.4	1.5
Office maintenance . . . . .	1,407	1,324	83	6.3	0.7	0.7
Bad debt expense . . . . .	1,182	1,122	60	5.3	0.5	0.6
Professional services . . . . .	1,361	697	664	95.3	0.6	0.4
Vehicle costs . . . . .	555	544	11	2.0	0.3	0.3
Materials and supplies . . . . .	189	234	(45)	(19.2)	0.1	0.1
Insurance . . . . .	111	152	(41)	(27.0)	0.1	0.1
Other expenses . . . . .	2,288	2,079	209	10.1	1.0	1.2
<b>Total operating expenses . . . . .</b>	<b>49,847</b>	<b>39,126</b>	<b>10,721</b>	<b>27.4</b>	<b>23.1</b>	<b>21.5</b>

Operating expenses increased primarily due to increases in salaries and social charges, rent and utilities, operating taxes, network repair and maintenance, and professional services for the reasons set out below, including, in particular, due to acquisitions consummated during 2010.

Salaries and social charges increased by 5,547 million rubles, or 41.0%, to 19,061 million rubles for the year ended 31 December 2010 from 13,514 million rubles for the year ended 31 December 2009. The increase in salaries and social charges was primarily due to increases in employee headcount and increases in salaries and benefits, including as a result of acquisitions during that period (such as of Synterra), as well as accrued expenses for our long-term incentive program. As of 31 December 2010 and 2009 we had approximately 27,487 and 20,367 full-time employees, respectively. As a percentage of total revenues, salaries and social charges increased to 8.8% for the year ended 31 December 2010 from 7.4% for the year ended 31 December 2009.

Rent and utilities expense increased by 2,312 million rubles, or 25.9%, to 11,231 million rubles for the year ended 31 December 2010 from 8,919 million rubles for the year ended 31 December 2009. Rent and utilities expense increased primarily due to the lease of additional base station sites to allow the expansion of our operations and also due to the increase in the number of our owned-and-operated retail stores. As a percentage of total revenues, rent increased to 5.2% for the year ended 31 December 2010 from 4.9% for the year ended 31 December 2009.

Network repair and maintenance expense increased by 820 million rubles, or 23.4%, to 4,322 million rubles for the year ended 31 December 2010 from 3,502 million rubles for the year ended 31 December 2009. Network repair and maintenance expense increased primarily as a result of the expansion of our network infrastructure. As a percentage of total revenues, network repair and maintenance increased to 2.0% for the year ended 31 December 2010 from 1.9% for the year ended 31 December 2009.

Operating taxes increased by 789 million rubles, or 18.0%, to 5,177 million rubles for the year ended 31 December 2010 from 4,388 million rubles for the year ended 31 December 2009. Operating taxes increased primarily due to an increase in Unified Service Fund charges which was linked to an increase in our total revenues, and an increase in property tax as a result of an increase in our investment in property, plant and equipment. As a percentage of total revenues, operating taxes remained stable at 2.4% for each of the years ended 31 December 2009 and 2010.

Radio frequency fees increased by 312 million rubles or 11.8%, to 2,963 million rubles for the year ended 31 December 2010 from 2,651 million rubles for the year ended 31 December 2009. The increase in radio frequency fees was primarily due to an increase in the number of our base stations in operation. As a percentage of total revenues, radio frequency fees decreased to 1.4% for the year ended 31 December 2010 from 1.5% for the year ended 31 December 2009.

Office maintenance expense increased by 83 million rubles, or 6.3%, to 1,407 million rubles for the year ended 31 December 2010 from 1,324 million rubles for the year ended 31 December 2009, primarily due to growth in the number of our owned-and-operated stores. As a percentage of total revenues, office maintenance expense remained stable at 0.7% for each of the years ended 31 December 2009 and 2010.

Bad debt expense increased by 60 million rubles, to 1,182 million rubles for the year ended 31 December 2010, from 1,122 million rubles for the year ended 31 December 2009. The increase in bad debt expense corresponded to the increased level of accounts receivable in line with the organic growth of our operations.

Professional services expense increased by 664 million rubles, or 95.3%, to 1,361 million rubles for the year ended 31 December 2010 from 697 million rubles for the year ended 31 December 2009, primarily due to transaction costs associated with our acquisitions during the course of 2010, including the acquisition of Synterra.

### ***Depreciation***

Depreciation expense increased by 6,766 million rubles, or 23.9%, to 35,035 million rubles for the year ended 31 December 2010 from 28,269 million rubles for the year ended 31 December 2009. Depreciation increased primarily due to an increase in depreciation related to capital expenditures on network equipment. As a percentage of total revenues, depreciation increased to 16.3% for the year ended 31 December 2010 from 15.6% for the year ended 31 December 2009.

### ***Amortisation***

Our amortisation expense increased by 764 million rubles, or 24.8%, to 3,839 million rubles for the year ended 31 December 2010 from 3,075 million rubles for the year ended 31 December 2009 primarily due to amortisation of intangible assets arising from acquisitions consummated during 2009 and 2010. As a percentage of total revenues, amortisation increased to 1.8% for the year ended 31 December 2010 from 1.7% for the year ended 31 December 2009.

### ***Other Income and Expenses***

The following table sets forth details of our other income and expenses for the years ended 31 December 2010 and 2009:

	<b>Year ended 31 December</b>		<b>Ruble Change</b>	<b>% Change</b>	<b>% of Revenues Year ended 31 December</b>	
	<b>2010</b>	<b>2009</b>			<b>2010</b>	<b>2009</b>
	<b>(in millions of rubles)</b>				<b>(%)</b>	
Interest expense . . . . .	(837)	(1,657)	820	(49.5)	(0.4)	(0.9)
Interest income . . . . .	4,008	3,255	753	23.1	1.9	1.8
Other gain/(loss), net . . . . .	18	(89)	107	120.2	—	—
Loss on derivatives, net . . . . .	(203)	(300)	97	(32.3)	(0.1)	(0.2)
Foreign currency exchange loss, net . . . . .	(700)	(2,192)	1,492	(68.1)	(0.3)	(1.2)
<b>Total other income/ (expense), net . . . . .</b>	<b><u>2,286</u></b>	<b><u>(983)</u></b>	<b><u>3,269</u></b>	<b><u>332.6</u></b>	<b><u>1.1</u></b>	<b><u>(0.5)</u></b>

### ***Interest Expense***

Interest expense decreased by 820 million rubles, or 49.5%, to 837 million rubles for the year ended 31 December 2010 from 1,657 million rubles for the year ended 31 December 2009. Interest expense decreased primarily due to the repayment of our outstanding eurobonds in December 2009 and lower applicable interest rates on our outstanding indebtedness, resulting from decreases in LIBOR and EURIBOR. See “—Capital Resources and Liquidity—Indebtedness”.

### ***Interest Income***

Interest income increased by 753 million rubles, or 23.1%, to 4,008 million rubles for the year ended 31 December 2010, from 3,255 million rubles for the year ended 31 December 2009. Interest income increased primarily due to higher average interest rates earned on our cash balances and short-term investments.



### *Loss on Derivatives*

Loss on derivatives decreased by 97 million rubles, or 32.3%, to 203 million rubles for the year ended 31 December 2010, from 300 million rubles for the year ended 31 December 2009. The losses in each case were primarily due to a change in the fair value of foreign currency derivative instruments caused by a depreciation of the forward euro and U.S. dollar exchange rates against the ruble. The decrease in loss on derivatives from 2009 to 2010 was due to a decrease in the number of outstanding foreign currency derivatives through settlement of those contracts during the course of 2010.

### *Foreign Currency Exchange Loss*

Foreign currency exchange loss decreased by 1,492 million rubles, or 68.1%, to 700 million rubles for the year ended 31 December 2010 from 2,192 million rubles for the year ended 31 December 2009. At 31 December 2010, our net monetary position, which primarily consisted of foreign currency denominated cash and short-term investments minus foreign currency denominated debt, resulted in a net foreign currency denominated asset. At 31 December 2009, our net monetary position was also a foreign currency denominated asset. The loss for the year ended 31 December 2010 was primarily a result of the volatility of the ruble against the U.S. dollar and the euro during the year.

### *Provision for Income Taxes*

Our provision for income taxes increased by 1,397 million rubles, or 13.2%, to 11,962 million rubles for the year ended 31 December 2010 from 10,565 million rubles for the year ended 31 December 2009. Our effective income tax rate was 19.6% for the year ended 31 December 2010, up from 18.9% for the year ended 31 December 2009. The increase in income tax expense was due to the expansion of our business, which resulted in an increase in income and related taxes. The increase in our effective income tax rate was primarily a result of the lower levels of income tax preferences used in 2010 as compared to 2009.

### *Noncontrolling Interests*

Our net gain attributable to noncontrolling interests was 52 million rubles for the year ended 31 December 2010 compared to net gain of 11 million rubles attributable to noncontrolling interests for the year ended 31 December 2009. The increase in our net gain attributable to noncontrolling interests in the year ended 31 December 2010 as compared to the year ended 31 December 2009 was due to an increase in net income of entities incorporated outside the Russian Federation in which we hold an ownership interest of less than 100%.

### *Net Income*

For the reasons set forth above, our net income increased by 3,883 million rubles, or 8.6%, to 49,172 million rubles for the year ended 31 December 2010 from 45,289 million rubles for the year ended 31 December 2009. As a percentage of total revenues, our net income decreased to 22.8% for the year ended 31 December 2010 from 24.9% for the year ended 31 December 2009.

### **Liquidity and Capital Resources**

Our historical liquidity needs have arisen primarily from the need to finance capital expenditures for the maintenance and expansion of our operations, including deployment of new technologies, expansion of network coverage and efforts to improve our quality of service. In the past, we have financed the expansion of our operations primarily via cash flow from operations, domestic and international bank borrowings, and domestic and foreign bond issuances. We plan to continue to finance our future capital requirements through a mixture of cash flows from operating and financing activities, including domestic and international bank borrowings and bond issuances. With the exception of operating leases, we do not depend on off-balance sheet financing arrangements. Our ability to generate cash from our operations will depend on our future operating performance, which in turn depends, to some extent, on general economic, financial, competitive, market, regulatory and other factors, many of which are beyond our control.

## Cash Flow

The following table summarises our cash flow for the years ended 31 December 2011, 2010 and 2009 and the nine months ended 30 September 2012 and 2011:

	Year ended 31 December			Nine Months ended 30 September	
	2011	2010	2009	2012	2011
	(in millions of rubles)				
<b>Consolidated Cash Flow Data</b>					
Net cash provided by operating activities . . . . .	97,295	86,613	79,350	82,170	74,510
Net cash provided by/ (used in) investing activities . . . . .	(102,656)	(88,821)	(60,303)	37,647	(77,940)
of which cash paid for capital expenditures <sup>(1)</sup> . . . . .	(73,332)	(63,860)	(46,036)	(33,589)	(50,419)
Net cash provided by/ (used in) financing activities . . . . .	5,945	(7,161)	(10,583)	(104,608)	7,343

(1) This represents the actual cash paid for capital expenditures, which may relate to capital expenditures accrued in other periods.

### *Net cash provided by operating activities*

Our cash flow from operating activities primarily results from net income, as adjusted for non-cash items such as depreciation and amortisation, provision for deferred taxes, bad debt expense, changes in our current assets and liabilities and net foreign exchange loss.

We receive substantial advance payments in cash for the provision of future services, due to the significant proportion of our Subscribers who prepay for services. We do not recognise these cash payments as revenues until either:

- We render the service to these Subscribers; or
- A Subscriber fails to use a non-refundable service within a specified time period.

Net cash provided by operating activities during the nine months ended 30 September 2012 was 82,170 million rubles compared to 74,510 million rubles for the nine months ended 30 September 2011. This change was primarily attributable to an increase in operating income as a result of an increase in total revenues (201,098 million rubles for the nine months ended 30 September 2012 as compared to 177,146 million rubles for the nine months ended 30 September 2011) and the implementation of various cost-cutting initiatives. Changes in net working capital structure did not have significant effect on change in net cash provided by operating activities for the nine months ended 30 September 2012 as compared to the nine months ended 30 September 2011.

Net cash provided by operating activities during the year ended 31 December 2011 was 97,295 million rubles compared to 86,613 million rubles for the year ended 31 December 2010. This change was primarily as a result of an increase in total revenues (242,608 million rubles for the year ended 31 December 2011 as compared to 215,515 million rubles for the year ended 31 December 2010) and improvements to net working capital structure. In particular, there was a larger increase in accounts payable and accrued expenses of 6,962 million rubles for the year ended 31 December 2011, as compared to an increase of 448 million rubles for the year ended 31 December 2010. The increase for the year ended 31 December 2011 was mainly due to increases in our cost of revenues and operating expenses during that period. In addition, cash flows were helped by a decrease in net VAT (equal to VAT receivable less VAT payable) of 2,375 million rubles for the year ended 31 December 2011 due to a temporary increase in VAT payable arising from intragroup transactions, as compared to cash flows used in an increase in net VAT of 519 million rubles for the year ended 31 December 2010. The cash flow impact of these changes was partially offset by cash flows used in a larger increase in accounts receivable of 3,870 million rubles for the year ended 31 December 2011, as compared to an increase of 1,927 million rubles for the year ended 31 December 2010. The larger increase in the year ended 31 December 2011 was mainly due to an increase in wireless revenues and the expansion of our fixed line business, which is generally post-paid. In addition, there was a smaller increase in cash flows used in prepayments and other current assets of 1,053 million rubles for the year ended 31 December 2011, as compared to an increase of 3,555 million rubles for the year ended 31 December 2010, mainly due to the accounting treatment of expected tax rebates that were treated as prepayments in the year ended 31 December 2010, part of which were realized in the year ended 31 December 2011 and part of which are expected to be realized in the future.

Net cash provided by operating activities during the year ended 31 December 2010 was 86,613 million rubles compared to 79,350 million rubles for the year ended 31 December 2009. This change was primarily as a result of an increase in operating income as a result of an increase in total revenues (215,515 million rubles for the year ended 31 December 2010 as compared to 181,883 million rubles for the year ended 31 December 2009). In addition, there was a lower increase in prepayments and other current assets of 3,555 million rubles for the year ended 31 December 2010, as compared to an increase of 4,770 million rubles for the year ended 31 December 2009. The larger increase for the year ended 31 December 2009 was mainly due to a significant prepayment in accordance with the terms of the dealership contract that was then in place with Euroset made such period. This was partially offset by cash flows used in an increase in inventory of 1,606 million rubles for the year ended 31 December 2010, as compared to cash flows provided from a decrease in inventory of 1,156 million rubles for the year ended 31 December 2009. The increase in inventory for the year ended 31 December 2010 was mainly due to the rapid development of our retail chain in that period. The decrease in inventory for the year ended 31 December 2009 was mainly caused by reduced demand for handsets caused by the economic crisis in Russia. In addition, cash flows were used in an increase in accounts receivable of 1,927 million rubles for the year ended 31 December 2010, as compared to cash flows provided by a decrease in accounts receivable of 484 million rubles for the year ended 31 December 2009. The increase for the year ended 31 December 2010 was mainly due to an increase in wireless revenues and the expansion of our fixed line business, which is generally post paid. Further, there was a lower increase in cash flows provided by accounts payable and accrued expenses of 448 million rubles for the year ended 31 December 2010, as compared to an increase in accounts payable and accrued expenses of 1,335 million rubles for the year ended 31 December 2009, largely due to payment of both 2009 and 2010 annual bonuses in the course of 2010.

#### *Net cash provided by / (used in) investing activities*

During the nine months ended 30 September 2012, we had net cash provided by investing activities of 37,647 million rubles, compared to net cash used in investing activities of 77,940 million rubles during the nine months ended 30 September 2011. This was primarily due to a reduction in short-term investments and long-term deposits to fund the distribution of a dividend to shareholders in the amount of 151,863 million rubles and also due to a reduction in capital expenditures for the period, benefiting from significant capital expenditures incurred during preceding years.

Our amount of net cash used in investing activities during the year ended 31 December 2011 increased by 15.6% compared to the year ended 31 December 2010. This increase was primarily due to an increase in capital expenditures and acquisitions, including NetByNet, as well as an increase in cash used in short-term investments and long-term deposits, which was deposited with banks in accordance with our cash management policy. Our amount of net cash used in investing activities during the year ended 31 December 2010 increased by 47.3% compared to the year ended 31 December 2009. This increase was mainly a result of an increase in capital expenditures and acquisitions, including the acquisitions of Synterra and Metrocom. See “—Key Factors Affecting Our Results of Operations—Acquisitions and Strategic Partnerships”.

#### *Net cash provided by / (used in) financing activities*

During the nine months ended 30 September 2012, we had net cash used in financing activities of 104,608 million rubles, compared to net cash provided by financing activities of 7,343 million rubles during the nine months ended 30 September 2011, reflecting cash outflows in the re-purchase of our shares through our wholly-owned subsidiary MICL and the payment of an extraordinary dividend to our shareholders, partially offset by cash provided by an increase in proceeds from borrowings to finance these transactions. See “—Indebtedness”.

The amount of net cash provided by financing activities during the year ended 31 December 2011 was 5,945 million rubles, compared to net cash used in financing activities of 7,161 million rubles during the year ended 31 December 2010. This was mainly due to an increase in cash provided from proceeds from long-term debt as well as a decrease in cash used in repayments of long-term debt during the year ended 31 December 2011. There was a decrease in net cash used in financing activities for the year ended 31 December 2010 as compared to the year ended 31 December 2009, when net cash used in financing activities was 10,583 million rubles. This decrease was mainly due to a higher level of cash received from proceeds of long-term debt than cash used in repayment of long-term debt.

For a discussion of our working capital, see “—Shareholder Transactions—Effects of Shareholder Transactions”.

### *Capital Expenditures*

During the nine months ended 30 September 2012, we had total capital expenditures of 28,226 million rubles, which related primarily to investment in building new 2G and 3G base stations (in the amount of approximately 11,143 million rubles), backhaul (in the amount of approximately 1,004 million rubles), other fixed-line transportation network (in the amount of approximately 5,493 million rubles), other network capital expenditures (in the amount of approximately 2,556 million rubles) and IT infrastructure (in the amount of approximately 4,060 million rubles).

During the year ended 31 December 2011 we had total capital expenditures of 70,871 million rubles, which related primarily to investment in building new 2G and 3G base stations (in the amount of approximately 25,073 million rubles), backhaul (in the amount of approximately 1,744 million rubles), other fixed-line transportation network (in the amount of approximately 20,990 million rubles), other network capital expenditures (in the amount of approximately 13,014 million rubles) and IT infrastructure (in the amount of approximately 7,590 million rubles).

During the year ended 31 December 2010 we had total capital expenditures of 67,240 million rubles, which related primarily to investment in building new 2G and 3G base stations (in the amount of approximately 26,757 million rubles), backhaul (in the amount of approximately 4,332 million rubles), other fixed-line transportation network (in the amount of approximately 17,740 million rubles), other network capital expenditures (in the amount of approximately 8,823 million rubles) and IT infrastructure (in the amount of approximately 6,954 million rubles).

During the year ended 31 December 2009 we had total capital expenditures of 52,476 million rubles, which related primarily to investment in building new 2G and 3G base stations (in the amount of approximately 21,310 million rubles), backhaul (in the amount of approximately 2,157 million rubles), other fixed-line transportation network (in the amount of approximately 9,139 million rubles), other network capital expenditures (in the amount of approximately 7,334 million rubles) and IT infrastructure (in the amount of approximately 6,559 million rubles).

During the years ended 31 December 2011, 2010 and 2009, our capital expenditures were 29.2%, 31.2% and 28.9% of our total revenues, respectively. The increase in the proportion of capital expenditures to revenues in 2010 was mainly due to a significant roll-out of our 2G and 3G base stations network which enabled us to differentiate ourselves on the basis of our network quality and to gain leading position on mobile data transfer market.

### *Future capital requirements*

We estimate that our total capital expenditures for 2012 will be approximately 45,000 to 50,000 million rubles, of which we had incurred 28,226 million rubles during the nine months ended 30 September 2012. We expect our capital expenditures for 2012 to include investment in building new 2G and 3G base stations, backhaul, other fixed-line transportation network, other network capital expenditures and IT infrastructure. Approximately 35,000 to 40,000 million rubles are expected to be incurred in respect of non-discretionary capital expenditure.

The company expects its aggregate capital expenditure for the years 2013 to 2015 to be between approximately 165,000 million rubles and 180,000 million rubles, of which a substantial majority is expected to be incurred in respect of non-discretionary capital expenditure. Our expected future capital expenditures include capital expenditures relating to the roll out of the 4G network, in respect of which we are obligated to make capital expenditures in a minimum amount of 15,000 million rubles per annum until the 4G network is fully deployed. We are also expected to incur capital expenditures to clear frequencies currently allocated to the military; however it is not currently possible to reasonably estimate the amount of such capital expenditures. See “—Contractual Obligations—Licence commitments”. The amount and timing of our future capital requirements may differ materially from our current estimates for various reasons, many of which are beyond our control. As in the past, we plan to finance our capital expenditures primarily through operating cash flows and, to the extent necessary, through additional external financing activities and, accordingly, our ability to make these capital expenditures in the future will primarily depend on our ability to maintain adequate operating cash flows and on our ability to obtain adequate external financing. Our ability to generate cash from our operations depends on our future operating performance, which is in turn dependent on general economic, financial, competitive, market, regulatory and other factors, including those discussed under “Risk Factors”, while 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. If our future cash flows from operations and other capital resources are insufficient to fund our planned capital expenditures, we may be forced to reduce or delay our capital expenditures.

### ***Contractual Obligations***

We have various contractual obligations and commercial commitments to make future payments, including short-term and long-term debt agreements related interest payments, marketing related liabilities, our obligations under our long-term incentive program and asset retirement obligations. See Note 24 to the Audited Consolidated Financial Statements as of and for the years ended 31 December 2011, 2010 and 2009 and Note 13 to the Unaudited Condensed Consolidated Financial Statements as of 30 September and for the three and nine months ended 30 September 2012 and 2011 included in this Prospectus. Asset retirement obligations are legal obligations related to rented sites for base stations and masts. See Notes 2 and 10 of the Audited Consolidated Financial Statements as of and for the years ended 31 December 2011, 2010 and 2009 included elsewhere in this Prospectus.

The following table sets forth the amounts of our future obligations due during the periods indicated, as of 30 September 2012. This table does not reflect any contractual obligations in respect of our proposed acquisition of an indirect stake in Euroset. See “Management’s Discussion and Analysis of Financial Condition and Results of Operations—Key Factors Affecting Results of Operations—Acquisitions and Strategic Partnerships—Euroset”.

	<u>Total</u>	<u>Payment due by period</u>			
		<u>Less than 1 year</u>	<u>1-3 years</u>	<u>4-5 years</u>	<u>Thereafter</u>
		(in millions of rubles)			
Short-term and long-term debt obligations . . . . .	159,114	28,494	49,301	70,335	10,984
Interest payments <sup>(1)(2)</sup> . . . . .	25,642	9,891	13,857	1,867	27
Marketing related liabilities . . . . .	2,369	1,009	1,360	—	—
Contingent consideration . . . . .	2,845	2,845	—	—	—
Long-term incentive program . . . . .	834	493	341	—	—
Asset retirement obligations . . . . .	5,567	—	—	—	5,567
<b>Total</b> . . . . .	<b>196,371</b>	<b>42,732</b>	<b>64,859</b>	<b>72,202</b>	<b>16,578</b>

(1) This does not reflect the effect of any refinancing and/or prepayment of long-term and short-term indebtedness subsequent to 30 September 2012, and related interest payments, except for the prepayment in part of the loan from VTB Bank OJSC in the amount of 10,000 million rubles from the net proceeds from our ruble-denominated bonds issued in October 2012. See “—Indebtedness”.

(2) Interest payments represent expected future interest payable in respect of short-term and long-term debt obligations. Future interest payments in respect of short-term and long-term debt obligations that are subject to variable interest rates are calculated on the basis of applicable LIBOR and EURIBOR as of 30 September 2012.

### ***Marketing related liabilities***

In April 2009, we and OJSC Rostelecom entered into an agreement with the Organizational Committee of the 2014 XXII Olympic Winter Games and XI Paralympic Winter Games in Sochi to acquire rights and licences to use the Olympic mascot, logos and other Olympic symbols and, in our case, to be referred to as “the General Mobile Partner of the 2014 XXII Olympic Winter Games”. Under the agreement, we committed to make a payment of U.S.\$65 million (2,093 million rubles at the exchange rate as of 31 December 2011) in cash to be made in several installments from 2009 through 2014, which are included in our marketing related liabilities. In addition, we and Rostelecom are jointly responsible to provide equal amounts of services in-kind up to a combined total value of U.S.\$130 million (4,185 million rubles at the exchange rate as of 31 December 2011) from 2009 through 2014. We obtained the rights and licences in 2009, at which time we assumed a liability with a net present value of future cash installments of 1,334 million rubles and deferred revenues with a fair value of 1,516 million rubles. See Note 11 of the Audited Consolidated Financial Statements as of and for the years ended 31 December 2011, 2010 and 2009 included in this Prospectus.

### ***Licence commitments***

In July 2012, the Federal Service for Supervision in Communications, Information Technologies and Mass Media granted us a licence and allocated frequencies to provide services under LTE/4G standard in the Russian Federation. Under the terms and conditions of this licence, we are obligated to provide LTE/4G services in each



population center with over 50,000 inhabitants in the Russian Federation by 2019. We are also obligated to make capital expenditures of at least 15,000 million rubles annually toward the roll-out of the LTE/4G network, until the network is fully deployed, to clear frequencies currently allocated to the military at our own cost. We have also compensated other operators for surrendering frequencies in an aggregate amount of 401 million rubles. See “Business—Licences—LTE/4G and MVNO Licences”.

Our 3G licence was granted subject to certain capital commitments. Among these conditions is a requirement to build a certain number of base stations by the end of the third, fourth and fifth years from the date of granting of the licence. We are in full compliance with these licence conditions, including constructing the number of base stations required at the date of this Prospectus.

### ***Distributions to Shareholders***

No dividends were declared in 2011, 2010 or 2009. On 24 April 2012, the Board of Directors approved the distribution of dividends to shareholders in the amount of 151,863 million rubles, which dividend was made to shareholders of record on 24 April 2012. See “—Shareholder Transactions”, “Principal and Selling Shareholders” and Note 9 to the Unaudited Condensed Consolidated Financial Statements for the three and nine months ended 30 September 2012 and 2011 included in this Prospectus. On 8 June 2012, our Board of Directors adopted a dividend policy. See “Dividend Policy”.

### ***Indebtedness***

As at 31 December 2009, 2010 and 2011 and 30 September 2012, we had current bank and other loans in the amount of 7,811 million rubles, 12,171 million rubles, 7,415 million rubles and 28,494 million rubles, respectively. Our non-current bank loans as at the same dates were in the amount of 19,335 million rubles, 20,750 million rubles, 36,294 million rubles and 130,620 million rubles, respectively.

The table below summarises our material financing facilities, including the amount outstanding in respect of such facilities as at 30 September 2012. For additional information, please refer to Note 13 of our Annual Consolidated Financial Statements as of and for the years ended 31 December 2011, 2010 and 2009 and Note 10 to the Unaudited Condensed Consolidated Financial Statements for the three and nine months ended 30 September 2012 and 2011 included in this Prospectus. The table below does not include information concerning any indebtedness incurred following 30 September 2012.

<b>Lender</b>	<b>Currency</b>	<b>Nominal Annual Effective Rate</b>	<b>Principal amount outstanding as of 30 September 2012 (millions of rubles)</b>	<b>Maturity</b>
<b><i>Equipment Financings:</i></b>				
China Development Bank and Bayerische Landesbank . . . . .	U.S. dollar	LIBOR <sup>(1)</sup> plus 1.1% to 2.7%	26,945	2012-2016
BNP Paribas, London branch and Nordea Bank Finland . . . . .	U.S. dollar	2.91% to 4.54%	6,965	2012-2016
Bayerische Landesbank, Bayerische Landesbank Filiale Di Milano, Commerzbank Aktiengesellschaft . . . . .	euro	3.74% and EURIBOR <sup>(2)</sup> plus 0.35%	2,715	2012-2015
Cisco Systems Finance International . . . . .	U.S. dollar	3.50% to 4.11%	1,239	2012-2017
Fortis Bank, Nordea Bank Finland and Skandinaviska Enskilda Banken . . . . .	U.S. dollar	1.92%	2,893	2013-2017
<b><i>Bank Loans:</i></b>				
Nordea Bank Moscow . . . . .	U.S. dollar	LIBOR <sup>(1)</sup> plus 2.0%	1,546	2015
UniCredit Bank Moscow . . . . .	U.S. dollar	LIBOR <sup>(1)</sup> plus 3.5%	464	2012-2013
Sberbank . . . . .	ruble	8.71 %	29,512	2014-2015
Sberbank . . . . .	ruble	9.02 %	46,693	2015-2016
VTB Bank OJSC . . . . .	ruble	MosPrime plus 2.20%	30,000	2013
Gazprombank . . . . .	ruble	9.05%	6,300	2016
Nordic Investment Bank . . . . .	euro	EURIBOR <sup>(2)</sup> plus 2.05%	3,198	2019

(1) London Interbank Offered Rate (“LIBOR”).

(2) Euro Interbank Offered Rate (“EURIBOR”).

To finance the payment of a dividend to our shareholders and the re-purchase (through our wholly owned subsidiary MICL) of our ordinary shares from one of our then shareholders, in April 2012, we entered into certain new financing facilities, pursuant to which we incurred additional borrowings (net of repayments) in an aggregate principal amount of approximately 142,400 million rubles. These additional borrowings included a bridge facility with Barclays Bank PLC, BNP Paribas and Citibank, N.A., London branch, under which we drew U.S.\$1.5 billion (equivalent to 46,375 million rubles at the exchange rate as of 30 September 2012) in April 2012. This bridge facility was voluntarily repaid in full in June and July 2012 using part of the proceeds from the facilities entered into with Sberbank referred to in the table above. See “—Distributions to Shareholders” and “—Key Factors Affecting Our Results of Operations—Shareholder Transactions”.

On 11 October 2012 we issued ruble-denominated bonds in an aggregate principal amount of 10,000 million rubles, the net proceeds of which were applied immediately in prepayment in part of the loan from VTB Bank OJSC referred to in the table above. The bonds bear interest at a rate of 8.05% per annum, payable semi-annually. The bonds are due in 2022, subject to a two-year put option.

On [●] November 2012, we entered into an export credit facility agreement for a facility of up to U.S.\$110 million (equivalent to 3,489 million rubles at the exchange rate as of 14 November 2012) arranged by Société Générale and Crédit Agricole CIB and guaranteed by Finnvera plc, as export credit agency. As at the date of this Prospectus, no amounts have been drawn under the facility. The facility will bear interest at a rate of between LIBOR plus [●]% and LIBOR plus [●]%, plus a further residual risk margin. The facility will have two tranches, which will each be subject to repayment in 17 semi-annual installments, with the final maturity date expected to fall in 2022.

As of 8 November 2012, we had approximately 79,000 million rubles available to be drawn under our existing financing facilities. For a discussion of certain issues relating to the increase in our level of indebtedness, see “Risk Factors—Risks Relating to our Financial Condition—Our dividend and share buyback have increased our indebtedness and substantially depleted our working capital”. Our indebtedness, including our available credit lines, may in the future be affected by our proposed acquisition of an indirect stake in Euroset. See “Management’s Discussion and Analysis of Financial Condition and Results of Operations—Key Factors Affecting Results of Operations—Acquisitions and Strategic Partnerships—Euroset”.

Certain of the financing facilities referred to above contain restrictive covenants, which, among other things, limit our ability to incur debt, encumber our assets, make distributions, undertake mergers and acquisitions and material changes in the nature of the business without prior consent from the required majority of lenders. In addition, these financing facilities require us to meet various financial covenants.

### **Qualitative and Quantitative Disclosures About Market Risk**

In the normal course of business, our financial position is subject to a variety of risks. We are exposed to market risks associated with foreign currency exchange rates and interest rates. We use derivative contracts, primarily interest rate swaps and foreign currency swaps to manage exchange rate and interest rate risks. We are also subject to the risks associated with the business environment in which we operate. We generally have not, in the past, held or issued derivative or other financial instruments for trading purposes. Our use of currency hedging or derivative transactions may or may not increase in the future.

#### ***Foreign Currency Risk***

We are exposed to market risk from adverse movements in foreign currency exchange rates. In accordance with our policies, we do not enter into any treasury management transactions of a speculative nature.

Until 31 December 2005, our functional currency was the U.S. dollar as the largest portion of our revenues, capital expenditures and operating and borrowing costs were either denominated in U.S. dollars or linked to the U.S. dollar. However, from 1 January 2006, we introduced a number of ruble denominated tariff plans and from that date, we changed our functional currency from the U.S. dollar to the ruble for our subsidiaries domiciled in the Russian Federation, Abkhazia and South Ossetia. The functional currency of our subsidiary in Tajikistan is the U.S. dollar.

A significant portion of our costs, expenditures and liabilities continue to be denominated in U.S. dollars or euro. If the ruble were to decline dramatically against the U.S. dollar or euro, we could have difficulty repaying or refinancing our foreign currency denominated indebtedness. In addition, a decrease in the value of ruble against the U.S. dollar or euro could, unless effectively hedged, result in a net foreign exchange loss due to an increase in the ruble value of our U.S. dollar or euro denominated liabilities. Accordingly, fluctuations in the value of the ruble against the U.S. dollar or the euro could adversely affect our financial condition and results of operations.

To the extent permitted by the Russian law, we keep part of our cash and cash equivalents in U.S. dollars and euro interest bearing accounts to manage against the risk of ruble devaluation, and also to match our foreign currency liabilities. Although we attempt to match revenues and cost in terms of their respective currencies, we may experience economic losses and negative impacts on earnings as a result of foreign currency exchange rate fluctuations. Under Russian income tax rules, maintaining cash balances denominated in any foreign currency creates taxable translation gains.

To minimise our foreign exchange exposure to fluctuations in foreign currency exchange rates, we are migrating most of our foreign currency linked costs to ruble based costs to balance assets and liabilities and revenues and expenses denominated in rubles. However, this migration could increase our cost exposure to Russian ruble inflationary pressure.

As a result of the special dividend and the purchase of our shares, and the new borrowings incurred in connection with such transactions, we had significant net U.S. dollar-denominated liability as of 30 September 2012. See “—Key Factors Affecting Our Results of Operations—Shareholder Transactions” and “—Liquidity and Capital Resources—Indebtedness”.

As of 30 September 2012, we had approximately 159,114 million rubles of consolidated total debt of which 40,394 million rubles were denominated in U.S. dollars (at the exchange rate of 30.9169 rubles per one U.S. dollar as of 30 September 2012), 5,993 million rubles were denominated in euro (at the exchange rate of 39.9786 rubles per one euro as of 30 September 2012) and the remaining amount was in rubles. The table below summarises information about the maturity of our financial instruments that are sensitive to foreign currency exchange rates as of 30 September 2012. These are primarily foreign currency denominated debt obligations. The table below does not include information concerning any indebtedness incurred following 30 September 2012, does not include amortization of deferred finance charges and does not reflect the effect of interest rate swaps which may convert variable rate indebtedness into fixed rate indebtedness. See “—Liquidity and Capital Resources—Indebtedness”.

	Falling due during the Year Ending 31 December							Total
	2012	2013	2014	2015	2016	2017	Thereafter	
<b>Fixed rate indebtedness</b>								
U.S.\$ (in million rubles) . . . . .	1,340	3,438	3,269	1,777	1,240	339	—	11,403
euro (in million rubles) . . . . .	—	381	381	199	17	9	—	987
<b>Total fixed rate indebtedness</b> . . . . .	<b>1,340</b>	<b>3,819</b>	<b>3,650</b>	<b>1,976</b>	<b>1,257</b>	<b>348</b>	<b>—</b>	<b>12,390</b>
Weighted average interest rate . . . . .	3.25%	3.18%	2.97%	2.60%	2.38%	2.03%	—	3.09%
<b>Variable rate indebtedness</b>								
U.S.\$ (in million rubles) . . . . .	1,217	3,869	4,038	11,367	8,500	—	—	28,991
euro (in million rubles) . . . . .	452	1,396	944	492	492	492	738	5,006
<b>Total variable rate indebtedness</b> . . . . .	<b>1,669</b>	<b>5,265</b>	<b>4,982</b>	<b>11,859</b>	<b>8,992</b>	<b>492</b>	<b>738</b>	<b>33,997</b>
Weighted average interest rate . . . . .	2.94%	2.97%	3.00%	3.01%	2.91%	2.21%	2.21%	3.00%

### **Derivative Instruments and Hedging Activities**

#### *Foreign Currency Derivatives*

During 2006 to 2007, we entered into several long-term fixed-to-fixed rate cross-currency swaps. These derivative financial instruments were used to limit exposure to changes in foreign currency exchange rates on certain of our long-term debts denominated in foreign currencies. The swaps effectively converted, using the then-effective foreign currency exchange rates, some of our outstanding fixed-to-fixed long-term U.S. dollar and euro denominated loans into synthetically equivalent ruble long-term loans with fixed rates ranging from 3.95% to 6.65%. The carrying amount of such long-term loans was 972 million rubles as at 31 December 2010. These long-term loans were repaid in 2011. All of our derivative instruments are recorded on the balance sheet at their respective fair values. For accounting purposes, we have chosen not to designate these long-term fixed-to-fixed rate cross-currency swaps as hedging instruments and, therefore, report all gains and losses from the change in fair value of these derivative financial instruments directly in our consolidated statements of comprehensive income.

In 2010, we entered into a number of dual-currency deposits with various banks. The dual currency deposits are financial instruments, which combine features of a time deposit and a sold foreign currency put option. The dual-currency deposits are settled either in the original deposit currency (euro or U.S. dollar) or in another pre-agreed currency (ruble, euro or U.S. dollar) depending on which currency has depreciated relative to the other currency

since the date of entering into the dual-currency deposit. All dual-currency deposits bear interest at over-the-market rates, which include a put option premium payable upon settlement. The purpose of entering into these financial instruments is for yield enhancement on our foreign currency cash investments. The respective embedded derivative financial instrument, which is a put option, is bifurcated and measured at fair value using the Black-Scholes model. For accounting purposes, we report all gains and losses from the change in fair value of these derivative financial instruments directly in our consolidated statements of comprehensive income.

### ***Interest Rate Risk***

We are exposed to fluctuations in the interest rates of our long-term debt. Our debt consists of both fixed and variable rate obligations. Upward fluctuations in interest rates might increase the cost of new debt, both at fixed and variable interest rates, and the cost of outstanding variable rate borrowings. We use interest rate swaps as part of our interest rate risk management strategy. In 2011 and 2012, we entered into a number of interest rate swap arrangements with total notional amount outstanding as of 30 September 2012 of 45 million euro (1,799 million rubles at the exchange rate as of 30 September 2012) and U.S.\$693 million (21,425 million rubles at the exchange rate as of 30 September 2012), all of which were designated as cash flow hedges of interest rate risks.

We estimate that, based on a simple average, the amount of debt under variable rate borrowing facilities during the year ended 31 December 2011 and the nine months ended 30 September 2012 was approximately 23,065 million rubles and 59,699 million rubles, respectively. Therefore, in the absence of interest rate swaps, a one-percentage point change in interest rates would have resulted in an increase or decrease in interest expense of 231 million rubles and 448 million rubles for the year ended 31 December 2011 and the nine months ended 30 September 2012, respectively. We manage our interest rate exposure by limiting the proportion of variable rate debt in our total debt portfolio. We may use fixed-rate cross-currency swaps to hedge both currency and interest rate risk. Our objective in using interest rate derivatives is to add certainty and stability to interest expense and to manage exposure to interest rate movements. To accomplish this objective, we primarily use interest rate swaps as part of our interest rate risk management strategy. Interest rate swaps involve the receipt of variable-rate amounts from a counterparty in exchange for making fixed-rate payments over the life of the agreements without the exchange of the underlying principal amount of long-term debt.

### ***Concentration of Credit Risk***

Financial instruments that potentially subject us to concentration of credit risk include cash, cash equivalents, short-term investments, accounts receivable and long-term deposits. We deposit available cash with various banks in the Russian Federation. Deposit insurance is either not offered or only offered in *de minimis* amounts in respect of bank deposits within the Russian Federation. To manage the concentration of credit risk, we allocate available cash to domestic branches of international banks and a limited number of Russian banks. A majority of these Russian banks are either owned or controlled by the Russian government.

We extend credit to certain counterparties, principally international and national telecommunications operators, for roaming services, and to certain dealers. We minimise our exposure to the risk by ensuring that credit risk is spread across a number of counterparties, and by continuously monitoring the credit standing of counterparties based on their credit history and credit ratings reviews. Other preventative measures to minimise credit risk include obtaining advance payments, bank guarantees and other security.

### ***Critical Accounting Policies***

Our accounting policies affecting our financial condition and results of operations are more fully described in our Audited Consolidated Financial Statements for the years ended 31 December 2011, 2010 and 2009. The preparation of our consolidated financial statements requires us to make judgments in selecting appropriate assumptions for calculating financial estimates, which inherently contain some degree of uncertainty. We base our estimates on historical experience and on various other assumptions that we believe to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities and the reported amounts of revenues and expenses that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions. We believe that the following discussion addresses our most critical accounting policies, which require management's most difficult, subjective and complex judgments.

### ***Fair Value Measurements***

Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. The fair value hierarchy contains three levels as follows:

Level 1—Unadjusted quoted prices that are available in active markets for the identical assets or liabilities at the measurement date.

Level 2—Other observable inputs available at the measurement date, other than quoted prices included in Level 1, either directly or indirectly, including: (1) quoted prices for similar assets or liabilities in active markets; (2) quoted prices for identical or similar assets in non-active markets; (3) inputs other than quoted prices that are observable for the asset or liability; and (4) inputs that are derived principally from or corroborated by other observable market data.

Level 3—Unobservable inputs that cannot be corroborated by observable market data and reflect the use of significant management judgment. These values are generally determined using pricing models for which the assumptions utilise management's estimates of market participant assumptions.

We apply fair value measurements in several of our most significant accounting determinations, including the allocation of purchase price in transactions accounted for as business combinations; the periodic re-measurement of contingent consideration; the determination of impairment for goodwill, intangible assets, and other long-lived assets; along with the periodic measurement of derivative instruments. In most cases these measurements are either Level 2 or 3 wherein we may exercise significant judgment in determining the application of unobservable inputs.

While we believe we use all information available to us at the time of making such assessments, our judgments by their nature are subject to our interpretation of market and other data at that time and these judgments may prove to be inaccurate and the result could be material.

### ***Useful Lives of Property, Plant and Equipment and Amortisable Intangible Assets***

We generally calculate depreciation and amortisation expense for property, plant and equipment and intangible assets on a straight-line basis over their estimated useful lives. We establish useful lives for each category of property, plant and equipment and intangible assets based on our assessment of the use of the assets, anticipated technology evolution, contractual terms, regulatory environment changes and other relevant factors. At least annually, we review and revise if appropriate the assumptions used in the determination of useful lives of property, plant and equipment and intangible assets. With regard to certain equipment, we cannot predict with certainty how and when developing technology will require us to replace such equipment.

### ***Long-lived Assets Impairment***

Our long-lived assets to be held and used are reviewed to determine whether an event or change in circumstances indicates that the carrying amount of the asset may not be recoverable. For long-lived assets to be held and used, we base its evaluation on such impairment indicators as the nature of the assets, the future economic benefit of the assets, any historical or future profitability measurements, as well as other external market conditions or factors that may be present. If such impairment indicators are present or other factors exist that indicate that the carrying amount of the asset may not be recoverable, we determine whether impairment has occurred through the use of an undiscounted cash flows analysis of assets at the lowest level for which identifiable cash flows exist. If impairment has occurred, we recognise a loss for the difference between the carrying amount and the fair value of the asset.

### ***Goodwill Impairment Assessment***

Goodwill is reviewed for impairment annually, at the beginning of the fourth quarter, and between annual evaluations if events occur or circumstances change that would more likely than not reduce the fair value of the reporting unit below its carrying amount. Such circumstances could include, but are not limited to 1) a significant adverse change in legal factors or in business climate, 2) unanticipated competition, or 3) an adverse action or assessment by a regulator. We determine whether impairment has occurred by assigning goodwill to the reporting units identified and comparing the carrying amount of the reporting unit, including goodwill, to the fair value of the reporting unit. The fair value of the reporting unit is estimated using a discounted cash flows



approach. If goodwill impairment has occurred, we recognise a loss for the difference between the carrying amount of reporting unit goodwill and its implied fair value. In calculating the implied fair value of reporting unit goodwill, the fair value of the reporting unit is allocated to all of the other assets and liabilities of that unit based on their fair values. The excess of the fair value of a reporting unit over the amount assigned to its other assets and liabilities is the implied fair value of goodwill. As of 31 December 2011, the fair value was in excess of the carrying value for all reporting units, and for the wireless segment, it was significantly in excess.

In June 2012, we finalised the allocation of the purchase price for the acquisition of NetByNet to individual assets and liabilities along with allocation of resulting goodwill to reporting units. There were no changes to the previously reported amounts of the net assets and goodwill upon finalisation of the purchase price allocation. We believe that, as of 30 September 2012, the carrying amount of the NetByNet reporting unit approximates its fair value. However, if we do not achieve planned cost savings assumed in the original fair value calculation of NetByNet, we may recognise an impairment loss.

### ***Revenue Recognition***

#### *Wireless revenues from local subscribers*

We earn service revenues for usage of our cellular system, which include airtime and data transfer charges from prepaid and postpaid Subscribers, monthly contract fees, interconnect fees from other mobile and fixed-line operators, roaming charges and charges for VAS. VAS include SMS, MMS, GPRS, “Ring Back Tone” and other services. The content revenues relating to VAS are presented net of related costs when we act as an agent of the content providers while gross revenues and related costs are recorded when we are a primary obligor in the arrangement. Generally, these features generate additional revenues through monthly subscription fees or increased mobile usage through utilisation of the features. Service revenues are generally recognised when the services are rendered.

#### *Revenue Recognition for Arrangements with Multiple Deliverables*

We enter into multiple element revenue arrangements in which a customer may purchase a combination of the equipment (e.g. USB modems, handsets) and telecommunication services (e.g. airtime, traffic and other services). The consideration received from a Subscriber is allocated to the separate units of accounting embedded in the contract based on their relative fair values. The allocated revenues are recognised in accordance with the type of element, limited to up-front cash received.

#### *Wireline revenues*

We earn wireline revenues for usage of our fixed-line system, which include payments from individual, corporate and government customers for local and long-distance telephony and data services contracts. Charges are based either upon usage (for example, minutes or megabytes of traffic processed), period of time (e.g., monthly service fees) or other established fee schedules.

Revenues from service contracts are recognised when the services are rendered. Billings received in advance of a service being rendered are deferred and recognised as revenues when the service is rendered.

### ***Taxation***

We recognise deferred tax assets and liabilities for the expected future tax consequences of existing differences between financial reporting and tax reporting bases of assets and liabilities, and for the loss or tax credit carry-forwards using enacted tax rates expected to be in effect at the time these differences are realised. Taxable benefits associated with capital and operating losses from prior years, are evaluated based on our expectation and ability to utilise these amounts to offset taxable income in future filings. We record valuation allowances for deferred tax assets when it is likely that these assets will not be realised.

Generally, tax declarations remain open and subject to inspection for a period of three years following the tax year. While most of our tax declarations have been inspected without significant penalties, these inspections do not eliminate the possibility of re-inspection.

At each reporting date, we account for uncertain tax positions and reflect liabilities for unrecognised income tax benefits together with corresponding interest and penalties in the consolidated statement of comprehensive income as income tax expense.

We believe that we have adequately provided for tax liabilities in our Consolidated Financial Statements; however, the risk remains that relevant authorities could take differing positions with regard to interpretive issues and the effect could be significant.

## **Recent Accounting Pronouncements**

### ***Disclosures—Offsetting Assets and Liabilities***

In December 2011, the FASB issued ASU 2011-11, “*Disclosures about Offsetting Assets and Liabilities*”, which enhances disclosures by requiring improved information about financial instruments and derivative instruments that are either offset on the balance sheet or subject to an enforceable master netting arrangement or similar agreement. For public entities, the amendment is effective for fiscal years, and interim periods within those years, beginning on or after 15 December 2010. The adoption of the guidance did not have a material impact on our financial statements.

### ***Goodwill Impairment Testing***

In August 2011, the FASB issued ASU 2011-08, “*Intangibles – Goodwill and Other (Topic 350): Testing Goodwill for Impairment*”, which allows an entity to first assess qualitative factors to determine whether it is necessary to perform the two-step quantitative goodwill impairment test. Under this amendment, an entity would not be required to calculate the fair value of a reporting unit unless the entity determines, based on a qualitative assessment, that it is more likely than not that its fair value is less than its carrying amount. The amendment includes a number of events and circumstances for an entity to consider in conducting the qualitative assessment. The amendment is effective for fiscal years beginning after 15 December 2011. Early adoption is permitted.

We have adopted the amendment starting from the impairment review performed in the fourth quarter of 2011. The adoption of the guidance did not have a material impact on our financial statements.

In December 2010, the FASB issued ASU 2010-28, “*Intangibles – Goodwill and Other (Topic 350): When to Perform Step 2 of the Goodwill Impairment Test for Reporting Units with Zero or Negative Carrying Amounts*”, which modifies Step 1 of the goodwill impairment test for reporting units with zero or negative carrying amounts. For those reporting units, an entity is required to perform Step 2 of the goodwill impairment test if it is more likely than not that a goodwill impairment exists. In determining whether it is more likely than not that a goodwill impairment exists, an entity should consider whether there are any adverse qualitative factors indicating that an impairment may exist. The amendment is effective for fiscal years, and interim periods within those years, beginning on or after 15 December 2011. We are currently evaluating the impact of this amendment on our financial statements.

### ***Comprehensive Income***

In June 2011, the FASB issued ASU 2011-05, “*Comprehensive Income*”, which gives an entity the option to present total comprehensive income, the components of net income, and the components of other comprehensive income either in a single continuous statement of comprehensive income or in two separate but consecutive statements. In both choices, an entity is required to present each component of net income along with total net income, each component of other comprehensive income along with a total for other comprehensive income, and a total amount for comprehensive income. This ASU eliminates the option to present the components of other comprehensive income as part of the statement of changes in shareholders’ equity.

In December 2011, the FASB issued ASU 2011-12, “*Deferral of the Effective Date for Amendments to the Presentation of Reclassifications of Items Out of Accumulated Other Comprehensive Income in Accounting Standards Update No. 2011-05*”, which deferred the requirement to present on the face of the financial statements reclassification adjustments for items that are reclassified from other comprehensive income to net income while the FASB further deliberates this aspect of the proposal.

ASU 2011-05, as amended by ASU 2011-12 is effective for public entities for fiscal years, and interim periods within those years, beginning on or after 15 December 2011 with early adoption permitted.

We have adopted this ASU as of 1 January 2009 and presented total comprehensive income, the components of net income, and the components of other comprehensive income/(loss) in a single continuous statement of comprehensive income.

### ***Fair Value Measurements***

In May 2011, the FASB issued ASU 2011-04, “Fair Value Measurement (Topic 820): Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs”, which clarifies Topic 820, “Fair Value Measurements and Disclosures”, but also includes some instances where a particular principle or requirement for measuring fair value or disclosing information about fair value measurements has changed.

This ASU results in common principles and requirements for measuring fair value and for disclosing information about fair value measurements in accordance with U.S. GAAP and International Financial Reporting Standards issued by the International Accounting Standards Board (IFRS).

The amendment is effective for interim and annual periods beginning after 15 December 2011. We are currently evaluating the impact of this ASU on our financial statements.

### ***Receivables***

In April 2011, the FASB issued ASU 2011-02, “*Receivables (Topic 310): A Creditor’s Determination of Whether a Restructuring is a Troubled Debt Restructuring*”, which provides additional guidance to assist creditors in determining whether a restructuring of a receivable meets the criteria to be considered a troubled debt restructuring. The amendment is effective for public entities for the first interim or annual period beginning on or after 15 June 2011. Early adoption is permitted. We do not expect this amendment to have a material impact on our financial statements.

In July 2010, the FASB issued ASU 2010-20, “*Receivables (Topic 310): Disclosures about the Credit Quality of Financing Receivables and the Allowance for Credit Losses*”, which improves disclosure requirements that facilitate financial statement users’ evaluation of the nature of credit risk inherent in the entity’s portfolio of financing receivables, the allowance for credit losses and changes in the allowance for credit losses. ASU 2010-20 is effective for interim and annual reporting periods ending on or after 15 December 2011. The adoption of the guidance did not have a material impact on our financial statements.

### ***Intangibles—Goodwill and Other***

In July 2012, the FASB issued ASU 2012-02 “*Intangibles—Goodwill and Other (Topic 350): Testing Indefinite-Lived Intangible Assets for Impairment*”. This ASU states that an entity has the option first to assess qualitative factors to determine whether the existence of events and circumstances indicates that it is more likely than not that the indefinite-lived intangible asset is impaired. If, after assessing the totality of events and circumstances, an entity concludes that it is not more likely than not that the indefinite-lived intangible asset is impaired, then the entity is not required to take further action. However, if an entity concludes otherwise, then it is required to determine the fair value of the indefinite-lived intangible asset and perform the quantitative impairment test by comparing the fair value with the carrying amount in accordance with Codification Subtopic 350-30, “*Intangibles—Goodwill and Other, General Intangibles Other than Goodwill*”.

Under the guidance in this ASU, an entity also has the option to bypass the qualitative assessment for any indefinite-lived intangible asset in any period and proceed directly to performing the quantitative impairment test. An entity will be able to resume performing the qualitative assessment in any subsequent period.

The amendments in this ASU are effective for annual and interim impairment tests performed for fiscal years beginning after 15 September 2012. Early adoption is permitted. We do not expect this ASU to have a material impact on our financial statements.

### ***Technical Corrections and Improvements***

In October 2012, the FASB issued ASU 2012-04 “*Technical Corrections and Improvements*”. This ASU contains amendments which were made to clarify the Codification, correct unintended application of guidance or make minor improvements to the Codification that are not expected to have a significant effect on current accounting practice. In addition, the amendments are intended to make the Codification easier to understand and the fair value measurement guidance easier to apply by eliminating inconsistencies and providing needed clarifications.

The amendments in this ASU that do not have transition guidance are effective upon issuance. For public entities, the amendments that are subject to the transition guidance will be effective for fiscal periods beginning after December 15, 2012. Early adoption is permitted. The adoption of this ASU did not have a material impact on our financial statements.

## THE RUSSIAN TELECOMMUNICATIONS INDUSTRY

### Overview

The Russian Federation has experienced more than a decade of strong GDP growth averaging 6.9% per annum prior to 2009<sup>16</sup>. Despite having been hit by the 2008-2009 global economic crisis, the country has witnessed a healthy recovery since the beginning of 2010, driven by higher oil and commodity prices. The Russian Federation continues to benefit from strong fundamentals, including: (i) a declining unemployment rate of 5.2% as of September 2012<sup>17</sup>; (ii) a flexible fiscal policy with a relatively low corporate tax rate of 20% as compared to a Western European average of approximately 30%, as well as a low personal tax rate of 13%, which supports the purchasing power of Russian households<sup>18</sup>; and (iii) sound Government finances, with a Government debt to GDP ratio of 9% in 2011 as compared to a Western European average of 87%<sup>19</sup>.

The combination of these and other macroeconomic factors is expected to translate into average real GDP growth of 3.9% compared to a Western European average of 0.6% between 2012 and 2014<sup>19</sup>. In the second quarter of 2012, the Russian Federation demonstrated real GDP growth of 4.0%.<sup>20</sup> Additionally, in 2011-2015, real GDP per capita in the Russian Federation is expected to grow at a compound annual growth rate (“CAGR”) of 4.2% as compared to 0.2% in Western Europe. This will continue the current trend of real GDP per capita growth at a CAGR of 4.1% in the Russian Federation, over three times faster than the Western European average of 1.2% since 2009<sup>19</sup>; this in turn is expected to accelerate the growth of a rapidly expanding middle class with increasing spending power. The percentage of the Russian population with individual income of over U.S.\$4,000 rose to 66% of population in 2010 up from 55% in 2008<sup>21</sup>.

The telecommunications market in the Russian Federation has grown at 9.1% per annum since 2009, reaching 1,607 billion rubles in 2011, and is expected to continue expanding at a CAGR of 6.0% between 2011 and 2015.<sup>22</sup> In 2011, wireless services accounted for approximately 48% of the overall telecommunications market in the Russian Federation<sup>23</sup>, with wireline voice, broadband and other products comprising 29% and retail mobile telecommunication device sales comprising 24% of the telecommunications market in 2011<sup>22</sup>.

The Russian wireless telecommunications industry is the largest in Europe by number of subscribers (229.8 million as of 30 September 2012)<sup>22</sup> and has grown rapidly over the last decade driven by increased demand from individuals and private businesses resulting from: (i) a favourable economic backdrop and rising disposable income levels; (ii) a relatively benign regulatory environment; (iii) the absence of strong incumbents (unlike in many Western European markets); and (iv) a relatively low wireline penetration. Other commercial factors have also played an important role in the development of the market in its current form, including (i) the introduction of lower tariffs and more affordable handsets; (ii) an increasing availability of modems and smartphones; (iii) the development of innovative value added services; and (iv) the increased marketing and distribution activities of telecommunications operators. Future growth of the Russian wireless market is expected to be driven primarily by increasing usage of data and value added services (excluding messaging) while the share of voice and peer-to-peer messaging in total revenues is expected to decline<sup>22</sup>.

The Russian wireline industry is dominated by the state-controlled operator Rostelecom which controls approximately 70% of wireline voice and approximately 40% of wireline broadband markets (using old ADSL technology) with independent operators active primarily in the highly populous Moscow and North-West regions<sup>24</sup>. Wireline voice penetration in the Russian Federation stood at 75% of households as of 31 December 2011<sup>24</sup>, while wireline broadband penetration was 41.8% of households as of 30 June 2012<sup>25</sup>.

<sup>16</sup> Source: Rosstat. Constant prices.

<sup>17</sup> Source: Rosstat.

<sup>18</sup> Source: CIA World Factbook, KPMG. Hereafter, “Western Europe” or “Western European” average denotes an average based on the relevant telecommunications markets in France, Germany, Italy, Spain and the United Kingdom.

<sup>19</sup> Source: CIA World Factbook

<sup>20</sup> Source: Bloomberg.

<sup>21</sup> Source: Federal State Statistics Service.

<sup>22</sup> Source: AC&M Consulting, Direct-INFO.

<sup>23</sup> Source: AC&M Consulting, Direct-INFO.

<sup>24</sup> Source: Rostelecom August 2012 Investor Presentation.

<sup>25</sup> Source: Informa Telecoms and Media.

The Russian Federation is geographically divided into 8 macro regions namely Central, North-West, Volga, South, Moscow, Ural, Siberia and Far East<sup>26</sup>. The degree of telecommunications market maturity differs across these regions, with wireless penetration rates<sup>27</sup> varying from 142% in the South to 197% in the Moscow region as of 30 June 2012<sup>28</sup>.

<u>Macro region</u>	<u>Wireless penetration rate as of 30 September 2012</u>
North-West .....	182%
Volga .....	154%
South .....	142%
Moscow .....	199%
Ural .....	160%
Central .....	147%
Siberia .....	150%
Far East .....	155%
Russian Federation overall .....	160%

Source: AC&M Consulting, Federal Statistics Service.

### The Wireless Telecommunications Market

The Russian wireless telecommunications market has expanded in terms of revenue from 653 billion rubles in 2009 to 769 billion rubles in 2011 (CAGR of 8.5% over that time period)<sup>28</sup>. Voice, messaging, data and VAS revenues grew at a CAGR of 5.0%, 1.7%, 44.1% and 24.1% respectively between 2009 and 2011. The market is forecast to expand at a CAGR of 4.9% in 2011-2015, driven primarily by the Russian Federation's improving macroeconomic fundamentals, greater availability of cheaper handsets and tariffs as well as expanding network coverage and better mobile technologies<sup>28</sup>.

The Russian wireless market exhibits a rare combination of relatively low prices for wireless services and operators' profitability (as demonstrated by relatively high OIBDA margins of the Big Three operators)<sup>29</sup>.

Between 2009 and June 2012, the total subscriber base in the Russian Federation increased from 207.9 million to 227.6 million<sup>28</sup> and wireless penetration, measured by the number of SIM cards, increased from 143.2% to 159.3%<sup>28</sup>. This current penetration rate can be compared with approximately 142% in Italy, 131% in Germany, 124% in the U.K, 116% in Spain and 105% in France<sup>30</sup>. However, the statistics for the Russian Federation may overstate actual human penetration, estimated at approximately 90%<sup>31</sup>, for two reasons: (i) many registered subscribers use more than one SIM card; and (ii) the Russian market has a higher proportion of inactive subscribers compared to Western European markets.

	<u>As of 31 December</u>			<u>As of 30 September</u>	
	<u>2011</u>	<u>2010</u>	<u>2009</u>	<u>2012</u>	<u>2011</u>
<b>Moscow Macro Region</b>					
Subscribers (in thousands) .....	36,016	34,159	32,397	36,554	35,511
Penetration Rate .....	193.7%	183.7%	174.2%	196.5%	209.1%
Annual Subscribers Growth .....	5.4%	5.4%	3.0%	2.9%	5.2%
<b>Russian Federation</b>					
Subscribers (in thousands) .....	227,620	219,180	207,910	229,820	225,200
Penetration Rate <sup>32</sup> .....	156.8%	151.0%	143.2%	160.9%	155.1%
Annual Subscribers Growth .....	3.9%	5.4%	10.7%	2.1%	4.0%

Source: AC&M Consulting.

The subscriber base in the Russian Federation is projected to grow in the coming years, albeit at a slower pace than it has done historically, and reach approximately 232 million in 2012 and 240 million in 2015<sup>36</sup>.

<sup>26</sup> The regional divisions used by MegaFon are different from the administrative regional divisions in the Russian Federation.

<sup>27</sup> Measured as number of active SIM-cards as percentage of total population.

<sup>28</sup> Source: AC&M Consulting.

<sup>29</sup> Source: Informa Telecoms & Media, Ovum.

<sup>30</sup> Source: IDC WE and CEE Telecom Services Database (Q3-12).

<sup>31</sup> Source: Levada-Center.

<sup>32</sup> Note that in Q2 2012 AC&M changed its population base in accordance with the 2010 Russian Census.



The relatively high share of pre-paid subscribers in the Russian market (approximately 83.2% as compared to Western European average of 45.7%)<sup>33</sup>, national roaming charges (leading to customers buying local SIM cards for temporary use while travelling within Russia) and rising competition have resulted in a high annual churn level of approximately 50.2% as compared to the Western European average of 27.4% in April–June 2012<sup>34</sup>. Competition for subscribers has been intensifying: in regions with high penetration rates such as Moscow growth is only possible by attracting subscribers from other operators, selling new devices that require additional SIM cards or, more recently, selling wireless broadband services (e.g., via USB modems). Unlike in other markets, handset subsidies are largely non-existent in the Russian Federation. As a result of increased competition, wireless operators are focused on new marketing efforts, including aggressive price promotions to retain existing subscribers, reduce churn rates and attract new subscribers. Competition is primarily based on local tariffs and network coverage. In order to strengthen their position in the market place, wireless operators have shifted their retail strategies, expanding owned-and-operated retail distribution networks to improve the level of service and manage churn better. In 2011, the Big Three operators—we, MTS and VimpelCom had annual mobile churn rates of 48.3%, 47.6% and 62.8% respectively, as compared to 49.8%, 45.9% and 50.9% respectively in 2010<sup>35</sup>.

Despite competition and slowing subscriber growth, operators have been able to grow their revenues from wireless services at a CAGR of 8.5% on average in the period from 2009 to 2011<sup>36</sup>. ARPU in the Russian Federation grew by approximately 2.1% from 2009 to 2011, unlike in Western European markets where ARPU levels have decreased on average by 4.6% during that time<sup>37</sup>. ARPU growth in the Russian Federation in 2009-2011 was driven by increases in traffic (MOU) which grew by 9.5% as compared to 9.4% in Western Europe<sup>38</sup>. Such increases in traffic have offset declines in tariffs. Furthermore, growing demand for data and other value added services has also helped offset competitive pressures on voice services. In contrast, ARPU levels in Western Europe have been affected by intense competition and regulation and in some cases, a weak macroeconomic environment which has hampered overall consumption. Russian market ARPU is expected to further grow at a CAGR of 3.0% in 2011-2015<sup>36</sup>.

	<u>Year ended 31 December</u>		
	<u>2011</u>	<u>2010</u>	<u>2009</u>
<b>Russian Federation</b>			
Average Revenue Per User (in rubles per month) . . . . .	287	280	275

Source: AC&M Consulting.

The Russian wireless telecommunications market is highly concentrated, with three major nationwide operators (us, MTS, VimpelCom) collectively capturing an 82.4% market share (as measured by the number of subscribers (effectively, active SIM cards)) as of 30 June 2012<sup>39</sup>. By June 2012, MTS, VimpelCom and we were operating in all 83 Russian regions. Historically, a number of smaller wireless operators (including Tele2, Skylink and Smarts) have competed with the three major operators on a regional and nationwide level. In 2011 and 2012, several regional operators owned by Svyazinvest, controlled by the Russian Government, were merged into Rostelecom, another subsidiary of Svyazinvest; as a result of this merger, Rostelecom became the fifth-largest wireless operator in the Russian Federation with a market share by subscribers of 6.3% as of 30 June 2012, surpassed only by the Big Three and Tele 2 (9.5%)<sup>39</sup>. Most recently, Rostelecom has announced plans to further expand its presence in the wireless segment.

<sup>33</sup> Source: Informa Telecoms and Media.

<sup>34</sup> Source: Informa Telecoms & Media. Monthly churn rate data has been annualised.

<sup>35</sup> Source: Respective company data. Three-month churn policy for MegaFon and VimpelCom and six-month churn policy for MTS.

<sup>36</sup> Source: AC&M Consulting.

<sup>37</sup> Source: Calculated using total mobile revenues and average mobile subscribers based on IDC WE Telecom Services Database (Q3-12). ARPU for Russia is based on research by AC&M Consulting.

<sup>38</sup> Source: IDC WE and CEE Telecom Services Database (Q3-12).

<sup>39</sup> Source: AC&M Consulting.

Our market share, as measured by number of subscribers, has been consistently rising as shown in the table below driven among other factors by the high quality of our network and our attractive product offering in data services. As of 30 September 2012, we reported a total subscriber base of 62.81 million in the Russian Federation, up from 59.74 million as of 30 September 2011. We are currently the country's second largest wireless operator, having overtaken VimpelCom in 2010<sup>39</sup>:

Wireless Operators	As of 31 December					As of 30 September	
	2011	2010	2009	2008	2007	2012	2011
	Number of subscriber (in thousands)						
<b>MegaFon</b> .....	<b>61,631</b>	<b>56,607</b>	<b>50,222</b>	<b>43,289</b>	<b>35,517</b>	<b>62,805</b>	<b>59,740</b>
MTS .....	69,954	71,442	69,342	64,628	57,426	70,726	70,122
VimpelCom .....	57,224	52,020	50,886	47,677	42,221	56,181	56,824
Other operators .....	38,811	39,111	37,461	32,236	28,304	40,108	38,514
	Market share by subscribers (%)						
<b>MegaFon</b> .....	<b>27.1%</b>	<b>25.8%</b>	<b>24.2%</b>	<b>23.0%</b>	<b>21.7%</b>	<b>27.3%</b>	<b>26.5%</b>
MTS .....	30.7%	32.6%	33.4%	34.4%	35.1%	30.8%	31.2%
VimpelCom .....	25.1%	23.7%	24.5%	25.4%	25.8%	24.4%	25.2%
Other operators .....	17.1%	17.8%	18.0%	17.2%	17.3%	17.5%	17.1%

Source: AC&M Consulting. Note: Operators' subscriber numbers and market shares are affected by churn policies which differ among companies. Specifically, number of MTS subscribers might be overstated due to the 6-month churn policy adopted by MTS as opposed to 3-month churn policies used by us and VimpelCom.

As of 30 September 2012, MTS remained the country's biggest operator with a market share of 30.8% and 70,726 million subscribers, up from 70,122 million users as of 30 September 2011. VimpelCom lost its number two market position in terms of wireless subscribers in the Russian Federation during 2010, although it has demonstrated growth in subscriber base in both 2010 and 2011. For the twelve months ended 30 September 2012 our market share of the total net additions of mobile subscribers was 66%, as compared to 13% for MTS, 35% for other operators and a negative share of 14% for VimpelCom. Our market share by wireless revenue for the six months ended 30 June 2012 was 28.5% as compared to 30.3% and 27.2% for MTS and VimpelCom respectively<sup>39</sup>.

Despite competition, our, MTS' and VimpelCom's total reported revenues increased at a CAGR of 15.5%, 11.7% and 7.8%<sup>40</sup> respectively from 2009 to 2011, and reported OIBDA CAGR of 6.9%, 7.1% and 1.1% respectively in the same time period. Overall OIBDA margins for the Big Three have remained consistently above or around 40% during the same period. The Russian telecommunications industry was characterised by higher OIBDA margins than those found in Western Europe in 2011 (44.1% as compared to a Western European average of 38.2%<sup>41</sup>).

In 2011, we and MTS remained largely focused on the Russian market while VimpelCom had recently undertaken international expansion. We derived 99% of our revenues from the Russian Federation in 2011, unchanged from 2009. This compares with 83% and 86% for MTS and 86% and 39% for Vimpelcom in 2009 and 2011 respectively<sup>42</sup>. Tele2 increased its exposure to the Russian Federation between 2009 and 2011, raising its share of Russian revenues from 19% to 28%<sup>42</sup>.

In March 2009, the Ministry approved the introduction of MVNOs into the Russian wireless sector. There were less than one million MVNO subscribers in the Russian Federation at the end of 2011 (mostly in Moscow), which is less than 1% of the Big Three's customer base<sup>43</sup>.

<sup>40</sup> Source: CAGR calculated from 2009-2010 and 2010-2011 growth rates which were derived from respective operators' financial statements.

<sup>41</sup> Source: Informa Telecoms and Media, AC&M Consulting. OIBDA margin for Russia is based on reported Service OIBDA margin for VimpelCom and Tele2 and average quarterly OIBDA margin for MegaFon and MTS. Western European average was based on Service OIBDA margins.

<sup>42</sup> Source: Respective company data.

<sup>43</sup> Source: AC&M Consulting.

## Wireless Voice Services

Voice services remain core services for Russian mobile operators and continue to dominate their revenues with a 76% share of total wireless revenues in 2011<sup>43</sup>. The relative contribution of voice services has decreased from 81% in 2009 and is expected to fall further to 67% in 2015 as revenues from data and VAS services are projected to grow at a higher rate<sup>43</sup>. Voice services revenues demonstrated growth at a CAGR of 5.0% in 2009–2011 which was lower than the overall wireless market CAGR of 8.5% in the same period<sup>43</sup>. The main driver behind voice services growth between 2009 and 2011 was a 9.5% increase in traffic volume (MOU) which offset the negative effect from decreasing prices<sup>44</sup>. In 2011–2015, growth in wireless voice services in the Russian Federation is estimated to stabilise at approximately a CAGR of 1.8%<sup>43</sup>.

	For the year ended 31 December		
	2009	2010	2011
<b>Russian Federation</b>			
Voice Services Revenues (in billion rubles) . . . . .	583	567	529
MOU per Subscriber (minutes per month) . . . . .	121	131	145

Source: AC&M Consulting, IDC.

## Data Services

Demand for wireless data in the Russian Federation has been driven by a combination of factors including: (i) increasing availability of high quality 3G networks and services; (ii) acceleration of adoption of smartphones and USB modems; and (iii) introduction of data focused tariff plans. Between 2009 and 2011, wireless data services in the Russian Federation experienced robust growth in revenue terms, with a CAGR of 44.1%<sup>43</sup>. This growth continued in the six months ended 30 June 2012 with wireless data revenues increasing by 32.3% compared to the same period in 2011<sup>43</sup>.

There are a number of factors which will drive future growth in data traffic and increasing demand for value added services in the Russian Federation, particularly as the country's relatively low smartphone and wireless broadband penetration rates catch up with Western European levels. First, smartphone penetration in the Russian Federation as of 31 December 2011 was 10.7%, as compared to a Western European average of 31.0%<sup>45</sup>. Second, wireline broadband is relatively underdeveloped, with penetration as of 30 June 2012 of approximately 41.8% of households, as compared to a Western European average of 71.8%<sup>46</sup>; following substantial investments in 3G technology, wireless broadband is emerging as a viable substitute to fill a continued need. Third, as of 31 December 2011 3G penetration in the Russian Federation was estimated at approximately 22.0% of total wireless subscribers, up from 8.1% in 2009 but still well below the Western European average of 46.7%<sup>47</sup>. As a result, data services are likely to remain the fastest growing segment of the Russian wireless market with a CAGR of 20.5% between 2011 and 2015, and are estimated to account for 17.2% of wireless revenues by 2015, compared to 9.8% currently.<sup>48</sup>

Over the past few years, we have cemented our position as a leader in the wireless data market, capturing 36.9% of total wireless data revenues in the first half of 2012, ahead of MTS at 33.2% and VimpelCom at 25.0%. Our success is a product of our 3G network coverage<sup>49</sup> and capacity, as well as our being the first to introduce a number of data and value added services, including MMS and Mobile TV to the Russian Federation<sup>48</sup>.

<sup>43</sup> Source: AC&M Consulting.

<sup>44</sup> Source: IDC CEE Telecom Services Database (Q3-12).

<sup>45</sup> Source: Informa Telecoms and Media

<sup>46</sup> Source: Informa Telecoms and Media

<sup>47</sup> Source: Ovum, AC&M Consulting, IDC WE and CEE Telecom Services Database (Q3-12), as of 31 December 2011.

<sup>48</sup> Source: AC&M Consulting.

<sup>49</sup> According to an AMC survey conducted in Q3 2012, MegaFon was ranked best of the Big Three for 3G network coverage and quality.

Wireless Operators	2011	For the year ended 31 December				For six months ended 30 June		
		2010	2009	2008	2007	2012	2011	
		Data Revenue (million rubles)						
Russian Federation	75,634	53,026	36,416	23,101	15,012	46,211	34,927	
		Market share by data revenue (%)						
MegaFon	37.3	36.1	32.1	31.4	28.9	36.9	37.6	
MTS	33.6	32.0	29.4	30.9	29.8	33.2	33.7	
VimpelCom	24.2	26.0	30.7	27.0	31.0	25.0	23.8	
Other operators	5.0	5.9	7.8	10.6	10.4	5.0	4.9	

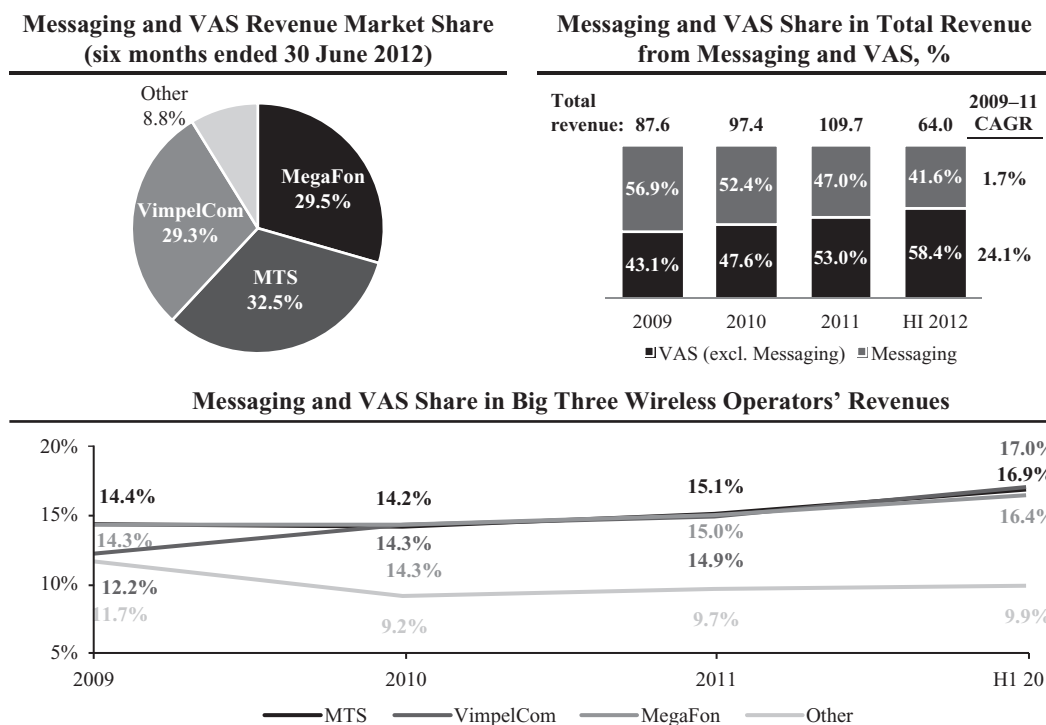
Source: AC&M Consulting.

### Messaging and Wireless Value Added Services

The Russian value added services and peer-to-peer messaging markets have increased in terms of revenue at a CAGR of 24.1% and 1.7% between 2009 and 2011 respectively. Growth accelerated in the first six months of 2012, and reached 39.7% and 5.2% respectively year-on-year. Peer-to-peer messaging services (SMS and MMS) continue to contribute significantly to overall wireless revenues; however, going forward their relative importance is expected to decrease with the substitution of data-based and aggregator services. Messaging revenues are expected to decrease at a CAGR of 2.3% between 2011 and 2015.<sup>48</sup>

Given the growing demand for value added services, operators are focusing on developing a broad set of wireless content and applications, including Mobile TV, Location Based Services and portal access, e-commerce and other subscription based platforms, among others. Some of these offerings may be different for the corporate segment and include fixed-to-mobile convergence unified numbers, wireless PBX, IP-VPN, push based mobile email as well as fleet management applications.

The below charts illustrate the composition and evolution of the wireless data market for Messaging and VAS<sup>50</sup> services in the Russian Federation:



Source: AC&M Consulting.

The VAS market in the Russian Federation has substantial growth potential, as evidenced by the low content revenues per subscriber compared to developed—and some developing—economies. In 2011, an average Russian wireless subscriber spent U.S.\$1.0<sup>51</sup> per month on content which is higher than in Ukraine and India

<sup>50</sup> VAS includes: m-Commerce, CSD, VoIP, PTT, FMC, basic VAS (Voice Mail, Caller ID/Anti-Caller ID, Conference Connection) and Live Balance. Source: AC&M Consulting.

<sup>51</sup> All \$ are USD.

(U.S.\$0.5 and U.S.\$0.4, respectively) and yet significantly lower than in the USA (U.S.\$10.2), China (U.S.\$6.6), the UK (U.S.\$6.4) and Brazil (U.S.\$3.2)<sup>52</sup>. Revenues from VAS and new products including mobile payments, online advertising, content and media, cloud and IT and machine-to-machine (“M2M”) services amounted to approximately 108 billion rubles in 2011, and industry specialists<sup>53</sup> estimate that they will grow by 150% in the next four years, reaching approximately 269 billion rubles in 2015.

### **2G, 3G and LTE/4G Network Development**

The first GSM licences were granted to wireless operators in the Russian Federation in the early 1990s. The future members of the Big Three (MTS, VimpelCom and us (at that time, Northwest GSM)) launched GSM networks in 1994, 1997, and 1995 respectively. By 2000, the majority of Russian regions were covered by GSM wireless networks operated by the Big Three and regional operators, since GSM technology was superior to the old AMPS analogue systems. In 2007, the Government conducted a second round of auctions for GSM licences. This resulted in smaller independent operators such as Tele2 and Skylink obtaining such licences for a number of regions outside of Moscow and St Petersburg. The last round of GSM-1800 licence auctions was held in 2011, with the majority of the licences awarded to Rostelecom and Tele2. Competing 2G technologies (CDMA and D-AMPS) failed to achieve comparable subscriber levels in the Russian Federation, with the former still being used by a number of wireless operators (most notably, Rostelecom) and the latter largely phased out by March 2012.

The first 3G licences in the Russian Federation were awarded in April 2007 and we received frequencies along with MTS and VimpelCom,. Although each of the Big Three had successfully completed 3G trials in Moscow and St Petersburg ahead of the auction, we launched the first commercial 3G service in the Russian Federation, a limited switch-on in St Petersburg in October 2007. MTS was the next to roll out 3G services, launching in St Petersburg in May 2008. VimpelCom started offering 3G services to its customers in St Petersburg in September 2008. No operator was able to launch 3G services in Moscow until December 2009—until that date 3G frequencies in Moscow had been solely in military use (although by that time most other densely populated areas in the Russian Federation were covered by 3G).

For the period 2009-2011, we, MTS and VimpelCom invested 183.2, 178.8 and 126.0 billion rubles respectively in the development of our networks<sup>54</sup>. A substantial part of this investment was allocated to the roll out of the Big Three operators’ 3G networks, including expansion of fibre optic backbone networks to support growing volumes of data transferred over 3G networks. As a result, we, MTS and VimpelCom currently operate approximately 104,000, 65,000 and 24,300 kilometres of fibre optic lines across the Russian Federation, respectively<sup>55</sup>. In April-June 2012, 3G networks operated by us, MTS and VimpelCom provided wireless data transmission at average speeds of 1.4, 1.2 and 0.9 Mbps respectively across the Russian Federation (with higher speeds of 2.4, 1.7 and 1.3 Mbps respectively in Moscow)<sup>56</sup>.

The 3G market in the Russian Federation is relatively underdeveloped by international standards, with an estimated penetration rate of 22.0%<sup>57</sup> as compared to a Western European average of 46.7%<sup>58</sup>. This has been largely due to limitations on spectrum availability, resulting in a relatively late rollout of 3G networks and launch of relevant services. Going forward, 3G services are expected to continue to increase, thus increasing the relevance of data and value added services as one of the main growth drivers of revenues for operators.

In March 2010, the Government took a step towards LTE/4G when it held a tender to sell LTE/4G licences covering 40 of 83 Russian regions. Each licence included 30 MHz of spectrum in the 2300 – 2400 MHz frequency band and required the successful operator to construct a LTE/4G network using only Russian-made equipment. Rostelecom was awarded 38 (39 including the licence for the Tomsk region awarded to Sibirtelecom, which became a Rostelecom subsidiary in April 2011) of the 40 licences available; the remaining licence was

<sup>52</sup> Source: iKS-Consulting and SNL.

<sup>53</sup> Source: Mobile Payments—2015E mobile payments transaction value of USD13.7 Bn based on Arthur D. Little “M-Payments in M-BRIC” report (2010), market size for MegaFon based on assumed margin of 10%; Online Advertising—Zenith Optimedia (forecast 2014E); Content and Media—AC&M; Cloud—Kominfo; M2M—Company estimates. Numbers for each product were found by aggregating data from the aforementioned different sources.

<sup>54</sup> Source: Respective company data.

<sup>55</sup> Source: Respective company data, as of 30 June 2012 for MegaFon and 31 December 2011 for MTS and VimpelCom.

<sup>56</sup> Source: AMC, April-June 2012.

<sup>57</sup> Source: Ovum and AC&M Consulting.

<sup>58</sup> Source: Ovum and IDC WE Telecoms Services Database (Q3-12).



awarded to Vainakh Telecom in the Chechen Republic. Under the licence conditions, the operator was given 18 months to build and launch LTE/4G networks using Russian-made equipment in the concession areas. However, following the conclusion of the tender process, Rostelecom had difficulties in obtaining access to the frequencies as essential parts were in constant military use. In March 2011, Tele2 conducted tests of LTE technology in one micro-region using another operator's existing 1800 MHz band. The trial sought to demonstrate that GSM and LTE technologies could share the same frequencies without degrading the quality of service. The operator, however, failed to obtain Roscomnadzor permission for dual-use of its GSM frequencies<sup>59</sup>, as well as to obtain the Decision of the State Commission on Radio Frequencies to allocate GSM-1800 bands for LTE-1800<sup>60</sup>.

In March 2011, an agreement was entered into between us, MTS, Rostelecom and VimpelCom on a joint rollout of a national LTE/4G network by 2014. The agreement also included the WiMAX operator, Yota, which was to construct and manage the LTE/4G network for the consortium. Under the agreement, the four operators intended to lease the necessary infrastructure from Yota and purchase capacity from it on a wholesale basis. In addition, each of the four operators was to acquire a 20% equity interest in Yota. In July 2010, Yota received formal regulatory approval from Roscomnadzor to abandon WiMAX and re-use its existing spectrum for LTE/4G. However, as a result of subsequent developments (notably the announcement by MTS and VimpelCom in September 2011 of separate plans for joint LTE/4G development and the Russian Federation's Ministry of Defence giving clearance for Rostelecom to begin work on its own LTE/4G network (on the 2300-2400 MHz spectrum allocated in the March 2010 auction)), the project in its original form was abandoned by all the parties.

In September 2011, we and MTS were awarded frequencies for TDD LTE/4G licences covering Moscow and the Moscow region in accordance with the State Commission on Frequencies decision No. 11-12-02. However, neither of us were permitted to provide services pursuant to these licences until the results of the nationwide LTE/4G tender were officially announced in July 2012 (see below). MTS commenced the deployment of its TDD network on 1 September 2012, and we commenced the deployment of our TDD LTE network in Moscow Region in mid-October 2012

In February 2012, we entered into a new non-exclusive 10-year MVNO agreement with Yota for the use of its LTE/4G networks in the Russian Federation. Under the agreement, we will be able to provide LTE/4G services to our clients using Yota frequencies and infrastructure, while Yota will be able to use our infrastructure to provide 2G and 3G voice and data services to its subscribers. The agreement has a five-year duration, with an automatic renewal option for an additional five years. Either party can terminate the agreement unilaterally by giving three years' notice. We have already started providing LTE/4G services under this agreement in fourteen major Russian cities as of the date hereof (Novosibirsk, Moscow, Sochi, Krasnodar, Samara, Vladivostok, Ufa, Kazan, St. Petersburg, Kostroma, Tula, Vladimir, Yoshkar-Ola and Khabarovsk).

In July 2012, the shareholders of AF Telecom and Yota entered into a joint venture agreement establishing a joint venture, Garsdale, which holds 100% equity interests in both AF Telecom and Scartel. The erstwhile shareholders of AF Telecom and Scartel hold 82% and 18% of the shares in Garsdale, respectively. For further details, please see "Principal and Selling Shareholders—Changes in Shareholding Structure and Ultimate Beneficial Owners—AF Telecom Shareholder Arrangements".

In July 2012, Roscomnadzor announced results of a tender for LTE/4G licences. The auction offered four 2x7.5 MHz blocks of spectrum in 791–821/832–862 MHz band. In addition, upon the completion of certain bandwidth clearance operations, the winners of the auction will be allocated four 2x7.5 MHz blocks in 720–750/761–791 MHz band and four blocks 2x10 MHz in 2530–2570/2650–2690 MHz band covering the entire territory of the Russian Federation. Paired blocks were limited to one operator apiece. The Big Three and Rostelecom were announced as the winners of the tender and will be required to fully establish their networks within seven years and offer LTE/4G services in all towns with at least 50,000 residents. Winners have also committed to clear certain frequency bandwidth and invest a minimum of 15 billion rubles per year in the roll out of the LTE/4G technology. The frequency spectrum allocated to us as a result of the tender is adjacent to the spectrum used by Yota for its LTE/4G network. For related issues see "Risk Factors—Risks relating to our Business and Industry—Any failure to obtain sufficient frequency, or renewals or extensions of our frequency allocations, for our networks, or any order to vacate part of the frequency spectrum we are allocated or that, in any case, we currently use, could disrupt our business".

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<sup>59</sup> Source: Telegeography.

<sup>60</sup> Source: Telegeography.

### Key Spectrum Licences

Licences for the 453-457.5/463-467.5 MHz spectrum are currently owned by Skylink (a subsidiary of Rostelecom) and used for Skylink's CDMA-450 network. Spectrum in the 710-862 MHz band is at present actively utilised by military authorities but is expected to be released for commercial use by mobile operators following results of the July 2012 tender. 2G spectrum in the 900 MHz and 1800 MHz ranges was allocated to the Big Three, along with Tele2, the Svyazinvest regional operators (which are now part of Rostelecom) and Skylink for the development of GSM/EDGE/GPRS. 3G spectrum in the 1920-2170 MHz range was awarded to the Big Three operators and Skylink in April 2007 and October 2010, respectively. Licences for the 1900-1920 MHz spectrum range belong to a group of companies (Antares, Arthur and Integral) controlled by private entrepreneurs. Licences for the 2300-2400 MHz spectrum range were awarded to Rostelecom and the Svyazinvest regional operators in March 2010 (for 39 regions). In September 2011, the remaining spectrum in the 2300-2400 MHz band was allocated to Osnova Telecom, a company affiliated with Russian military authorities. However, there has been no development in this band due to the inability to clear frequencies currently used by the military. Finally, selected sub-bands in the 2500-2690 MHz spectrum range were controlled by Scartel (~70 MHz) and used for Yota's WiMAX network (currently being replaced with its LTE/4G network). Roscomnadzor awarded additional capacity in the 791-821/832-862 MHz band (four blocks 2x7.5 MHz), in the 2530-2570/2650-2690 MHz band (four blocks 2x10 MHz) and in the 720-750/761-791 MHz band (four blocks 2x7.5 MHz) for the development of LTE/4G to the Big Three and Rostelecom in July 2012.

<u>Company</u>	<u>Generation</u>	<u>Band</u>
Skylink (Rostelecom)	—	453–457.5 / 463–467.5 MHz
MegaFon, Vimpelcom, MTS, Tele2, Rostelecom (Svyazinvest regional operators and Skylink)	2G	900 MHz and 1800 MHz
MegaFon, Vimpelcom, MTS, Rostelecom (Skylink)	3G	1920–2170 MHz
Antares, Arthur and Integral group of companies	—	1900–1920 MHz
Rostelecom (Svyazinvest regional operators), Osnova (Russian military authorities)	—	2300–2400 MHz
Scartel	LTE/4G	2500–2530/2620–2650 MHz
MegaFon, Vimpelcom, MTS, Rostelecom	LTE/4G	791–821/832–862 MHz (4 blocks 2x7.5 MHz)
MegaFon, Vimpelcom, MTS, Rostelecom	LTE/4G	2530–2570 / 2650–2690 MHz (4 blocks 2x10 MHz)
MegaFon, Vimpelcom, MTS, Rostelecom	LTE/4G	720–750/761–791 MHz (4 blocks 2x7.5 MHz)

### The Wireline Telecommunications Market

Although it is the largest in Europe, growth within the Russian Federation's wireline voice sector has decreased dramatically in recent years, with fixed-mobile substitution increasingly prevalent across the country. At the end of 2011 there were approximately 45.0 million fixed subscribers, an increase of 0.2% compared to the 44.9 million one year earlier<sup>61</sup>. The scant growth witnessed in 2011 follows an increase of just 0.2% in 2010 and a contraction of 0.2% in 2009, as the wireline market in the Russian Federation approached saturation<sup>61</sup>.

Revenue from wireline voice and other wireline products and wireline broadband in 2011 reached 352 million rubles and 108 million rubles respectively as compared with 353 and 85 million rubles respectively in 2009<sup>62</sup>. It is estimated that wireline products (including wireline voice) and wireline broadband services will grow at a CAGR of 2.9% and 10.5%, respectively, in 2011–2015<sup>62</sup>.

Wireline broadband penetration in the Russian Federation is still relatively low compared to other developed countries due to fragmented infrastructure. Household wireline broadband penetration remains at just 41.8% as of 31 June 2012 which is nevertheless significantly above the 31 December 2009 level of 24.4%<sup>63</sup>. Moscow and the North-West region have traditionally attracted higher investment as compared to the Southern and Eastern regions, creating a digital divide between urban and rural areas. In particular, Internet penetration (including broadband, dial-up and other technologies) in Moscow, St Petersburg and other Russian cities with population above 1 million inhabitants stood on average at 51–55% in 2009 as compared with 20–25% in smaller cities and regional centres and a Russian average of 34–37%<sup>64</sup>. However, broadband usage is rising as a result of new

<sup>61</sup> Source: Telegeography.

<sup>62</sup> Source: Direct-INFO.

<sup>63</sup> Source: Informa Telecoms and Media.

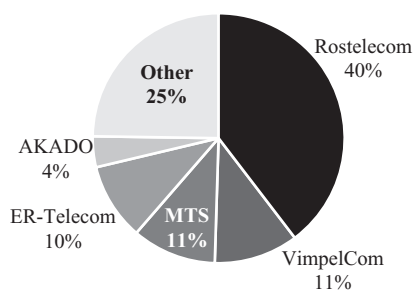
network deployments, growing disposable income, the decreasing cost and increasing availability of equipment, competition in the broadband access market and market consolidation. Growth in Internet penetration is particularly noticeable in areas outside of Moscow and St Petersburg (these two cities accounted for only 10% of growth in the number of Internet users in 2010)<sup>64</sup>.

The limited quality and lack of existing wireline infrastructure in some areas has resulted in a variety of technology platforms being used to offer broadband, including xDSL (approximately 50% of the market as of 31 December 2011), FTTx (approximately 42% of the market) and other technologies (approximately 8% of the market)<sup>65</sup>. Market consolidation started with the creation of state-controlled telecommunications holding Svyazinvest in 1995 and the formation of a company which was predicated on the integration of small local operators into regional platforms. Following the liberalisation of the international long-distance and domestic long-distance markets in March 2005, operators began to roll out their own backbone and backhaul infrastructure to connect regional networks as opposed to relying on Rostelecom. Competition in the local wireline market has been shaped by the lack of a regulatory framework for local loop and fibre unbundling in the past. As a result, alternative operators have slowly deployed their alternative access network infrastructure, including FTTx and wireless solutions.

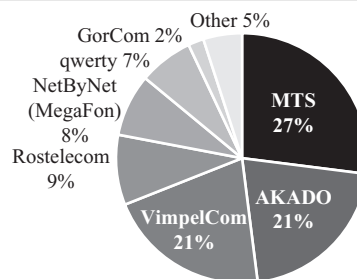
The state had substantial influence over the development of these wireline markets through Svyazinvest, which, prior to April 2011, operated through seven regional operators: Center Telecom, North-West Telecom, VolgaTelecom, Southern Telecommunications (UTK), Uralsvyazinform, Sibirtelecom and Far East Telecom (DalSvyaz). In 2009, Svyazinvest unveiled plans to re-organise its regional assets, merging Rostelecom with the seven aforementioned companies to create a unified national platform which would provide nationwide wireline telephony, broadband and wireless services. Rostelecom's newly consolidated subscriber base now makes it the largest wireline broadband operator in the country by far. As at 31 December 2011, Rostelecom had a fixed residential broadband subscriber base of 8.2 million households, giving it a 40% share of the high speed residential internet market<sup>66</sup>. As of 30 June 2012, Rostelecom's fixed broadband subscriber base was 8.6 million households<sup>67</sup>. At the end of 2011, Rostelecom's wireline voice market share in the Russian Federation by the number of subscribers stood at approximately 70% or 28.5 million subscribers<sup>68</sup>.

As the growth of wireless voice revenues has slowed, Russian wireless operators have been increasingly focused on other areas of growth, including fixed-mobile convergence products, for which fixed broadband is required. In particular, we have acquired various wireline operators, including Synterra (2010), Metrocom (2010), NetByNet (2011), Nakhodka Telecom (2011), Luchshe.Net (2011), ChebNet (2011) Yugratel (2011) and others. In addition, VimpelCom has acquired various wireline operators (including Golden Telecom (2007) and Corbina Telecom (2007)), as has MTS (including Comstar UTS (2009), MGTS (2009), Lanck Telecom (2010), Infocentr (2011), Teleradiokompania TVT (2011), Intellect (2011) and Elf Group (2012)). Through these acquisitions, the Big Three have strengthened their consumer broadband businesses, expanded backbone capacity and decreased dependence on leasing capacity from Rostelecom and other backbone providers. Independent wireline players such as Akado and ER-Telecom lack a nationwide footprint. However, they continue to hold strong positions in wireline broadband in certain regional markets (e.g. Moscow).

**Russian Wireline Broadband Market Share as of 31 December 2011 (by household subscribers)**



**Moscow Wireline Broadband Market Share as of 31 December 2011 (by household subscribers)**



Source: AC&M Consulting.

<sup>64</sup> Source: FOM.

<sup>65</sup> Source: The Ministry.

<sup>66</sup> Source: Rostelecom May 2012 Investor Presentation.

<sup>67</sup> Source: Rostelecom October 2012 Investor Presentation.

<sup>68</sup> Source: Rostelecom May 2012 Investor Presentation.

## Mobile Telecommunication Device Market

The Russian Federation's mobile telecommunication device market is among the largest in the world. In 2011, retail sales of mobile telecommunication devices in the Russian Federation totalled 379 billion rubles<sup>69</sup>. The Russian handset market is also among the fastest growing globally, having demonstrated a CAGR of 20.9% between 2009 and 2011<sup>69</sup>. Significant under-penetration in terms of per capita spending on mobile telecommunication devices compared to developed countries, replacement of regular phones with smartphones and an accelerated smartphone replacement cycle due to technological innovations and development of 3G networks were among key factors contributing to this growth. Sales of mobile telecommunication devices in the Russian Federation are estimated to grow at a CAGR of 9.5% between 2011 and 2015 and reach approximately 544 billion rubles by 2015<sup>69</sup>. Unlike in many Western markets sales of handsets and other mobile equipment are rarely subsidised in the Russian Federation.

## Client Segmentation

While retail clients represent the majority of Russian telecommunication operators' subscriber base, corporate clients, Government bodies and other operators account for a significant share of revenues. Revenues from corporate clients (B2B) stood at 196 billion rubles in 2011, up 3.8% from 2010<sup>70</sup>. The B2B market is dominated by wireline and wireless voice services, which contributed 47% and 35% to B2B revenues respectively in 2011; share of Internet access, leased line/VPN and other services was approximately 17%<sup>70</sup>. The market for Governmental clients (B2G) in the Russian Federation is estimated at 59 billion rubles in 2011, up 13.5% from 2010<sup>70</sup>. Wireline voice, Internet access, leased line/VPN and wireless services accounted for 42%, 19%, 19% and 15% of the B2G market size in 2011<sup>70</sup>. Telecommunication operators (B2O) represent the smallest customer group (revenue of 36 billion rubles in 2011, up 19.2% from 2010) of telecommunication companies in the Russian Federation<sup>70</sup>. Key services utilised by B2O clients are leased line and IP transit.

## Our Key Competitors

*MTS.* MTS (founded in 1993) is the largest wireless telecommunications operator in the Russian Federation in terms of subscribers—as of 30 June 2012, MTS had approximately 69.6 million wireless subscribers in the Russian Federation, representing a market share of 30.6%<sup>71</sup>. In 2011, 82% of MTS' revenue in the Russian Federation came from wireless services and 18%<sup>72</sup> from wireline services. Outside the Russian Federation, MTS provides telecommunications services in a number of jurisdictions, including Ukraine, Turkmenistan, Armenia and Belarus (the latter via an equity accounted associate). MTS is majority owned by Sistema JSFC (52.8%)<sup>73</sup>, and is listed on the MICEX-RTS along with an ADR listing on the NYSE.

*VimpelCom.* VimpelCom OJSC (founded in 1992) is the third largest wireless telecommunications operator in the Russian Federation in terms of subscribers: as of 30 June 2012, VimpelCom had approximately 55.7 million wireless subscribers in the Russian Federation, representing a market share of 24.5%<sup>71</sup>. VimpelCom markets its services under the Beeline brand which was launched in 1997. In 2011, 83% of VimpelCom's revenue in the Russian Federation came from wireless services and 17%<sup>74</sup> from wireline services. In 2011, the Dutch parent of VimpelCom (VimpelCom Ltd) acquired Wind Telecom, an international telecommunications holding company. Currently, VimpelCom's main countries of operation are the Russian Federation and Italy, with services also provided in Ukraine, Kazakhstan, Uzbekistan, Tajikistan, Armenia, Georgia, Kyrgyzstan, Cambodia, Laos, Algeria, Bangladesh, Pakistan, Burundi, Zimbabwe, Central African Republic and Canada. According to its website, VimpelCom's key shareholders according to its share register are Telenor (39.5%), Altimo Coöperatief (part of Alfa Group) (41.9%), Bertofan Investments Ltd (6.0%) and Weather Investments II (controlled by Naguib Sawiris) (3.5%)<sup>75</sup>, however these shareholdings may change in the future as a result of certain reported transactions. VimpelCom Ltd's ADRs are listed on the NYSE. VimpelCom also owns a 49.9% stake in Euroset, a company in which we are expecting to acquire an indirect 25% interest.

*Tele2 Russia.* Tele2 Russia has been operating in the Russian Federation since 2003 and is now a significant player in the Russian telecommunications market. As of 30 June 2012, Tele2 Russia had approximately

<sup>69</sup> Source: Direct-INFO.

<sup>70</sup> Source: Direct-INFO.

<sup>71</sup> Source: AC&M Consulting.

<sup>72</sup> Source: MTS Q4 2011 Investor Presentation.

<sup>73</sup> Source: MTS 20-F (data as of 1 April 2012).

<sup>74</sup> Source: VimpelCom Q4 2011 Investor Presentation.

<sup>75</sup> Source: VimpelCom Company website as of 14 November 2012, % of voting rights.

21.6 million wireless subscribers, representing a market share of 9.5%<sup>71</sup>. Tele2 Russia currently provides GSM wireless services in 43 regions of the Russian Federation<sup>76</sup>. However, the company does not currently have 3G or 4G licences in the Russian Federation. Tele2 Russia is owned by Tele2 AB, a pan-European telecom operator, which also provides services in Sweden, Norway, Estonia, Latvia, Lithuania, the Netherlands, Germany, Austria, Croatia and Kazakhstan. Tele2 AB is listed on the NASDAQ OMX.

*Rostelecom.* In 2011, the Russian Government completed the first stage of the restructuring of Rostelecom, a subsidiary of Svyazinvest, the state-controlled telecommunications company, by means of a merger of Svyazinvest's regional subsidiary telecommunications operators into Rostelecom. In 2012, Rostelecom acquired a CDMA operator (SkyLink) from Svyazinvest. The second stage of the Rostelecom restructuring envisages the merger of Rostelecom and Svyazinvest. Currently, Rostelecom provides predominantly wireline services, with only 12%<sup>77</sup> of revenue in 2011 coming from wireless (such services only being available in certain Russian regions rather than on a nationwide basis). As of 30 June 2012, Rostelecom had approximately 14.2 million wireless subscribers in the Russian Federation, representing a market share of 6.3%<sup>78</sup>. Rostelecom is controlled by the Russian Government via shares held by Svyazinvest, Federal Agency for State Property Management and Vnesheconombank, and is listed on the MICEX-RTS.

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<sup>76</sup> Source: Tele2 Company website.

<sup>77</sup> Source: Rostelecom May 2012 Investor Presentation.

<sup>78</sup> Source: AC&M Consulting.



## BUSINESS

### Overview

We are a leading universal telecommunications provider with approximately 63 million Subscribers in the Russian Federation as of 30 September 2012. We offer a broad range of voice, data and other mobile and fixed-line telecommunications services to retail customers, businesses, Government clients and other telecommunications services providers. Among the Russian mobile operators, we are ranked first in terms of data revenues and second in terms of overall mobile revenues for the six months ended 30 June 2012<sup>79</sup>, and second in terms of Subscribers as of 30 June 2012<sup>80</sup>. Our total revenue increased by 13.5%, to 201,098 million rubles for the nine months ended 30 September 2012 as compared to the same period in 2011.

We focus on an integrated customer-centric business model, which reduces the division of the mobile and fixed-line businesses. This unified model is focussed on offering integrated services to four client segments. Besides retail clients (B2C), who have been our traditional focus, we also serve corporate (B2B), Governmental (B2G) and operator (B2O) segments.

We have been awarded licences to provide 2G and 3G services in each of the 83 micro-regions of the Russian Federation and, as of 30 September 2012, our 2G and 3G networks covered approximately 92% and 72%, respectively, of the Russian population. As of 31 March 2012 we operated the largest 3G network in the Russian Federation based on the number of 3G base stations<sup>81</sup>. This has allowed us to become the leader in mobile data services, generating 38.8% of the revenues in this market segment among the Big Three in the first six months of 2012<sup>82</sup>. This segment of the telecommunication market has recently demonstrated high growth rates and we believe it holds the greatest potential for future growth. We also operate a backhaul and backbone fibre-optic network spanning over 130,000 kilometres, as of 30 September 2012. We believe that our mobile assets coupled with our fixed-line assets will enable us to develop and provide fixed-mobile convergent telecommunications solutions to our clients by taking advantage of cross-selling opportunities.

We are also closely observing the developments in the next generation of wireless technology, known variously as long term evolution (“LTE”) standard or fourth generation (“4G”), for deployment on our networks. We have already conducted tests of the LTE/4G technology and we are planning to employ it during the 2014 Winter Olympic and Paralympic Games to be held in Sochi, for which we are the official mobile provider. Furthermore, on 25 July 2012, we were issued an LTE/4G licence covering the entire territory of the Russian Federation. While we believe we are well-positioned to create our own LTE/4G network in the near future (possibly in cooperation with other operators), in February 2012 we have also entered into an MVNO agreement with Yota that has allowed us to provide LTE/4G services to our customers in fourteen major Russian cities as at the date hereof (Novosibirsk, Moscow, Sochi, Krasnodar, Samara, Vladivostok, Ufa, Kazan, St. Petersburg, Kostroma, Tula, Vladimir, Yoshkar-Ola and Khabarovsk) with expected coverage of more than 40 cities by the end of 2012. Yota has been a related party of MegaFon since July 2012. See “Transactions with Related Parties”.

We actively monitor our client base to hone our services, analysing statistical data to determine the preferences and needs of customers within each client sector in which we operate. We continue to develop new products and solutions to be offered to the public in an effort to grow in a competitive market. As part of this effort, we have developed MegaLabs, a subsidiary whose principal objective is to research, develop and bring to market innovative value-added services for our clients.

As of 30 September 2012, our distribution network included 1,841 owned-and-operated stores, 1,821 third-party points of sale operating solely under the “MegaFon” brand, approximately 16,500 independently-owned multi-brand telecommunications retailers and 27,000 additional third-party operated points of sale, our on-line shop, our direct sales force and our call centre. We focus on our distribution network as a key instrument to improve customer retention and lower SAC. In particular, we intend to continue increasing the number of our owned-and-operated stores, which offer higher quality customer service and boost customer loyalty. Our proposed acquisition of a stake in Euroset, the largest retailer of wireless equipment in the Russian Federation is expected to further our initiative to reduce dealers’ commissions, and may reduce our subscriber acquisition costs.

<sup>79</sup> As derived from the publicly available financial information of our competitors.

<sup>80</sup> Source: AC&M Consulting.

<sup>81</sup> Source: Respective operator’s websites.

<sup>82</sup> Source: AC&M Consulting.

## Our Strengths and Key Investment Highlights

- **Attractive Russian telecommunications market in the early stages of digital transition.** We operate primarily in the Russian Federation, which is characterised by strong macroeconomic fundamentals with projected average annual GDP growth of 3.9% between 2012 and 2014 (while growth for the rest of Europe for the same period is projected at approximately 1%<sup>84</sup>), an expanding middle-class, low personal tax rate of 13%, corporate tax rate of 20% and robust Government finances as indicated by a 9% Government debt to GDP ratio at the end of 2011. Operators in the Russian telecommunications market benefit from a relatively benign regulatory framework, a balanced competitive environment, high OIBDA margins and stable MOUs and ARPUs. In addition, increased availability of more affordable smartphones, and other mobile data devices and limited handset subsidies offer market participants the potential to capture profitably their share of the lucrative mobile data market. Finally, the Russian Federation is one of the most attractive markets in terms of balance between consumer satisfaction (reflected in high mobile penetration and relatively low prices of provided services) and return on capital in the telecommunications sector (as evidenced by the relatively high OIBDA margins in the sector).
- **A leading market position with strong recent performance.** We are the No. 1 Russian mobile data provider in terms of revenues, with a revenues share of 38.8% among the Big Three in the first six months of 2012<sup>85</sup>, and the No. 2 Russian mobile operator in terms of subscribers with a subscriber market share of 27.3% as of 30 June 2012<sup>86</sup>—significantly larger than the 21.7% subscriber market share we had at year end 2007. The momentum in our business has been strong recently: this is evidenced by our approximately 3.1 million mobile net additions in the Russian Federation for the 12 months ended 30 September 2012<sup>87</sup>.
- **Unique network position overall on the back of substantial historical investments.** Our well-invested network offers high service quality and fast mobile broadband speeds to our customers, and has the capacity to absorb high volumes of data traffic and provide the most extensive 3G coverage on the back of over 27,621 base stations as of 30 September 2012 (whereas, as of 30 June 2012, MTS had approximately 25,000 base stations and as of 31 March 2012 (the latest period for which data is available) VimpelCom had approximately 15,600 base stations)<sup>88</sup> and a nationwide fibre-optic backbone network, spanning over 100,000 kilometres. Our current network leadership position is the result of higher historical investments as compared to our competitors. We believe that the bilateral MVNO agreement with Yota that we recently established will allow us to capture the LTE/4G opportunity more quickly and more capital-efficiently than our competitors and also improve our competitive position vis-à-vis fixed broadband providers. We were the first among the Big Three operators to launch LTE/4G services using the Yota spectrum and network infrastructure, and we believe that being the first-mover among the Big Three in this field may have positive brand perception implications for us. We expect to provide coverage of more than 40 cities (including fourteen major cities) by year-end 2012. Furthermore, on 25 July 2012, we, together with MTS, VimpelCom and Rostelecom were issued an LTE/4G licence covering the entire territory of the Russian Federation and are now in a position to build our own LTE/4G network in the near future, possibly in cooperation with other operators. We have complemented our strong mobile network position with fixed-line and broadband acquisitions, expanding our product offering and strengthening our backhaul and backbone network.
- **Customer-centric and innovative player with a leading position in digital services and content.** Our business is characterised by high brand recognition and awareness as well as high subscriber satisfaction. We have achieved this position through our continuous focus on customer experience and by leading the industry in bringing innovative services to our customers. We were the first Russian mobile operator to launch MMS and mobile TV services in 2004, first to introduce free incoming calls in 2006, first to introduce 3G services in 2007, first to significantly reduce European roaming charges in 2011, and first among the Big Three to offer LTE/4G services in 2012. Our strong historical track record in innovation and customer centricity has allowed us to develop a position as a leading digital value-added services provider among telecommunications players in the Russian Federation, a market which has significant growth potential. Value-added services (excluding SMS) represented 7.7% of our overall revenues and 8.6% of our revenues from wireless service in 2011. We have centralised the

<sup>84</sup> Source: IMF (World Economic Outlook Database, April 2012).

<sup>85</sup> Source: AC&M Consulting.

<sup>86</sup> Source: AC&M Consulting.

<sup>87</sup> Source: AC&M Consulting.

<sup>88</sup> Source: MTS's and VimpelCom's websites.

development of new and innovative digital value-added services into our new wholly-owned subsidiary MegaLabs, which, augmented with intelligent partnerships, plans to further develop services in the high growth business verticals such as content and media, mobile finance, mobile advertising, M2M and cloud services. In addition, our extensive owned-and-operated retail network of 1,841 stores as of 30 September 2012 gives us a platform to provide high quality customer service and support.

- ***Strong historical growth among Big Three with future growth potential.*** We have a track record of superior organic growth. We have delivered a 15.5% average annual revenue growth between 2009 and 2011. Our revenue growth was 13.5% in the nine months of 2012 compared to the corresponding period in 2011, superior to that of our key industry peers. Despite our strong historical growth, we believe our business has significant untapped growth potential. First, we believe that our mobile data revenues have room to grow substantially going forward as the currently low smartphone and 3G penetration rates of 11% and 22%, respectively, catch up with levels seen in more developed markets. Moreover, the currently limited broadband infrastructure in Russian non-urban areas, which results in an overall low broadband penetration rate of 41.8% of households in the Russian Federation as of 30 June 2012<sup>89</sup>, offers mobile operators an opportunity to become the de-facto broadband providers in these regions, resulting in a significant incremental growth opportunity. Second, according to industry specialists, revenues from VAS and new products (including mobile payments, online advertising, content and media, cloud and IT and machine-to-machine (“M2M”) services) were estimated to be approximately 108 billion rubles in 2011 and have the potential to more than double in the next four years<sup>90</sup>.
- ***High OIBDA margins with lower expected capital intensity expected to translate into growing cash flows.*** We believe that our 41.7% OIBDA margin in the twelve month period from 30 September 2011 to 30 September 2012 has the potential for increase through cost savings, resulting from customer retention initiatives, distribution channel management improvements, network sharing initiatives, consolidation of IT systems and plans to improve efficiency and productivity in our organisation, which we are in the process of implementing. We believe that our substantial historical investments, our leading network position combined with network sharing initiatives as well as our return-on-capital driven capital allocation process will continue to allow us to lower our capital intensity going forward with positive implications to our cash flow profile.
- ***Attractive shareholder remuneration policy.*** We have approved an annual dividend policy for the payment of the sum of (a) the higher of (X) 50% of Net Profit or (Y) 70% of free cash flows, as set out in “Dividend Policy”, and (b) a value (which may be negative) corresponding to the net debt capacity of the Company within the bounds of a net debt-to-adjusted OIBDA ratio between 1.2 and 1.5 times. See “Dividend Policy”.
- ***Highly-experienced management team and strong sponsorship from incumbent shareholders.*** Our management team is highly experienced with a strong industry track record. This management has the support of a wider group of talent that has helped transform us into one of the leading Russian telecommunications firms. Our strategic shareholders are valuable to our business, offering a wealth of telecom expertise (TeliaSonera) and deep insight into the Russian market and digital media (AF Telecom). We believe that the quality of our corporate governance has benefited and will benefit significantly from the shareholder re-organisation in April 2012.

## **Our Strategy**

We aim to be the leading universal telecommunications provider in the Russian Federation while retaining financial discipline. Going forward, the key elements of our strategy are set out below:

- ***Strengthen leadership position in our core business with continued focus on the Russian Federation.*** We are the No. 1 mobile data provider in the Russian Federation in terms of revenue, with a revenue share of 38.8% among the Big Three in the first six months of 2012<sup>91</sup>, and the No. 2 Russian mobile operator with a subscriber market share of 27.3% as of 30 June 2012<sup>92</sup>. We intend to continue to focus on the Russian Federation and strengthen such leadership position by utilising our in-depth understanding of our customer base to allow us to continue to deliver high speed connectivity and high quality, innovative products and services tailored to the needs of each customer segment. Furthermore, we believe that mobile data growth will continue to outpace the growth in traditional voice services in the near and medium term. We therefore plan to continue to expand our 3G network and backbone

<sup>89</sup> Source: Informa Telecoms and Media.

<sup>90</sup> Source: Arthur D. Little, Zenith Optimedia, AC&M Consulting, Kominfo, Company estimates.

<sup>91</sup> Source: AC&M Consulting.

<sup>92</sup> Source: AC&M Consulting.

capacity and implement new technologies, such as LTE/4G, in an efficient manner to capture opportunities arising from data transfer growth. We intend to pursue high monetisation of the data traffic on our network through a combination of such continued expansion of the capacity of our network coupled with maintaining prudent pricing policies.

- ***Roll out LTE/4G services in the Russian Federation in a capital efficient manner.*** We believe that one of our key competitive advantages has been the quality of our network and we intend to maintain our leadership position in the Russian mobile broadband segment. As such, one of our key priorities has been the implementation of the most advanced technologies, including the rollout of LTE/4G in a capital efficient manner. In February 2012, we signed an agreement with Yota to jointly develop LTE/4G networks in the Russian Federation, and have already started providing LTE/4G services under this agreement in fourteen major Russian cities at the date hereof (Novosibirsk, Moscow, Sochi, Krasnodar, Samara, Vladivostok, Ufa, Kazan, St. Petersburg, Kostroma, Tula, Vladimir, Yoshkar-Ola and Khabarovsk) and expect to cover more than 40 cities by the end of 2012. We believe that this early start will give us the opportunity to fortify our image as the most innovative data provider among the Big Three as well as to assess the potential of LTE/4G technology at moderate cost and capital. Furthermore, on 25 July 2012, we were issued a LTE/4G licence covering the entire territory of the Russian Federation and we will be building out our own LTE/4G network, possibly in cooperation with other operators. We are confident that our investments in LTE/4G technology will be paramount in maintaining our leadership within mobile data.
- ***Continue to improve the quality and reach of our network.*** Our goal is to deliver required services to our customers regardless of their location and required data volume, at high speed. To achieve this, we have invested significantly in our radio access, fixed last-mile backhaul and backbone networks over the years, giving us a platform to efficiently expand and upgrade our integrated network. We believe this will improve our network's geographical coverage, capacity, speed and reliability. In particular, we believe there is a significant opportunity to offer mobile broadband as the de facto broadband connection in non-urban areas of the Russian Federation where fixed broadband infrastructure is underdeveloped and may be cost prohibitive. In addition, we carefully evaluate opportunities to grow our fixed broadband business both organically and through selective M&A opportunities. With our acquisitions of Synterra, NetByNet and a number of regional broadband providers, we have been able to significantly expand our footprint in provision of fixed broadband and integrated telecommunications services. We currently operate more than 100,000 kilometres of nationwide fibre-optic backbone, with planned available capacity of up to 8 Tbps by 2016, which will greatly enhance our ability to provide integrated nationwide access.
- ***Continue to expand new and innovative value-added services to capture growth opportunities.*** We believe that to adapt to the changing market realities, we will need to capture the value shift from provision of plain access to communications networks towards provision of value-added services, which will allow us to stay close to our customers and avoid disintermediation by new non-traditional players. We plan to achieve this goal, among other methods, through MegaLabs, our wholly-owned subsidiary, whose focus is to significantly reduce the time required to bring to market innovative products and services in the areas of content and media, mobile finance, mobile advertising, M2M services and cloud services, among others. We expect that these services will significantly contribute to our growth, both directly and by driving data traffic to our network, without requiring significant investments from us due to MegaLabs' focus on partnerships with established and up-and-coming teams of developers and its products and services using MegaFon's well-invested network.
- ***Emphasise customer-centric approach.*** We focus on a customer-centric business model. This approach led us to be the first among our competitors to launch a number of client-friendly initiatives, such as the reduction in roaming tariffs and the introduction of flat rates on long distance calls on several tariff packages. We have recently conducted an extensive qualitative and quantitative study of our B2C client segment and segmented it further into sub-segments on the basis of their information and communication technology ("ICT") requirements, spend and preferences; we believe that this analysis will provide a valuable tool in providing optimal solutions to our clients' needs. Furthermore, we continue to strive to provide the best customer-experience to our clients, monitoring the quality of our customer care services and the level of service offered in "MegaFon" branded stores. We believe that our network of owned-and-operated stores not only represents a valuable resource to acquire new Subscribers but is also, given the level of customer care we provide through it, an important tool for an effective customer retention policy. For this reason, we plan to further expand the number of our owned-and-operated stores. We believe that these efforts are fundamental to our objective of reducing churn and improving the quality of our client base.



- **Maintain strong focus on productivity and efficiency.** We intend to improve the productivity and profitability of our existing operations by realising economies of scale from the growth of our business and from cost savings, in particular through initiatives such as network sharing, consolidation of our IT systems, and the reduction of dealer commissions and churn. In particular, we believe that the proposed purchase of a stake in Euroset will provide opportunities to further the latter goals. We also believe that the substantial investments we have made historically in our network and business create significant headroom to improve our capex efficiency in the future, possibly even through network sharing agreements with other operators, also taking into account the great adaptability of our 3G network to support the new LTE/4G technology. As an organisation, we strive to be fast and adaptive to changes from the outside and plan to continue improving internal processes and capabilities, including the speed of decision-making, readiness to taking calculated risks where appropriate, and collaboration between functions.

## **The Company**

### **History**

Our Russian mobile operations started through CJSC Northwest GSM, which was incorporated on 17 June 1993 and launched operations in 1994 under the “Northwest GSM” brand in and around St. Petersburg. In 2001, we entered our first foreign market, Tajikistan, through CJSC TT Mobile. In March 2002, CJSC Northwest GSM was renamed as OJSC MegaFon. At the beginning of 2002 we also celebrated our first million customers, and reached 2.8 million by the end of the same year.

Between 2003 and 2004, we began expanding the number of Russian macro-regions covered by our network. During that period, we entered the Far East market and developed our business in the Ural and Central macro-regions. In 2004, we became the first company in Europe to launch MMS and the first in the Russian Federation to introduce mobile TV.

In 2005, we launched our own online store and introduced Enhanced Design for Global Evolution (“**EDGE**”) technology; by 2007, our mobile network expanded throughout the Russian Federation, and in October 2007, we launched the first 3G network in the Russian Federation in the city of St. Petersburg.

On 1 July 2009, we merged all of our major operating subsidiaries with and into OJSC MegaFon, so that our principal telecommunications operations are now conducted through a single legal entity throughout all of the Russian Federation.

In 2009, we were selected as the General Mobile Partner of the XXII Winter Olympic and XI Paralympic Games in the Russian Federation, to be held in the city of Sochi in 2014.

In June 2010, we completed the acquisition of Synterra, a company with a fibre-optic network spanning approximately 30,000 kilometres in the Russian Federation and providing various fixed-line and satellite communications services primarily to Governmental and high-end corporate clients. Furthermore, as part of a strategy to create a nationwide integrated telecom business model, between June 2010 and the end of 2011 we acquired several fixed-line regional operators in the Russian Federation: Metrocom, NetByNet, Web Plus, Chebnet Group, Luchshe.net, Nakhodka Telecom and Yugratel. We are in the process of integrating the recently purchased companies into our operations.

In 2010 we became the second ranked mobile operator in the Russian Federation in terms of number of subscribers, which exceeded 56.6 million by the end of 2010.

In March 2011, we were the first among the Big Three to abolish separate tariff systems for WAP mobile internet, simplifying and clarifying our charges for mobile data. In 2011, we also took the lead among Russian operators in significantly reducing European roaming charges for our customers.

In late 2011, we launched the operations of MegaLabs to focus on new product research, development and introduction.

On 23 April 2012 in Novosibirsk, we launched a LTE/4G service through our MVNO agreement with Yota, making us the first of the Big Three operators to provide LTE/4G services in the Russian Federation. Furthermore, on 25 July 2012 we were awarded a nationwide LTE/4G licence which will allow us to develop our own LTE/4G network in the future (which we may do in cooperation with other operators).

In September 2012 we acquired the VAS Media group, which we believe will create valuable synergies with MegaLabs in the value-added services field.



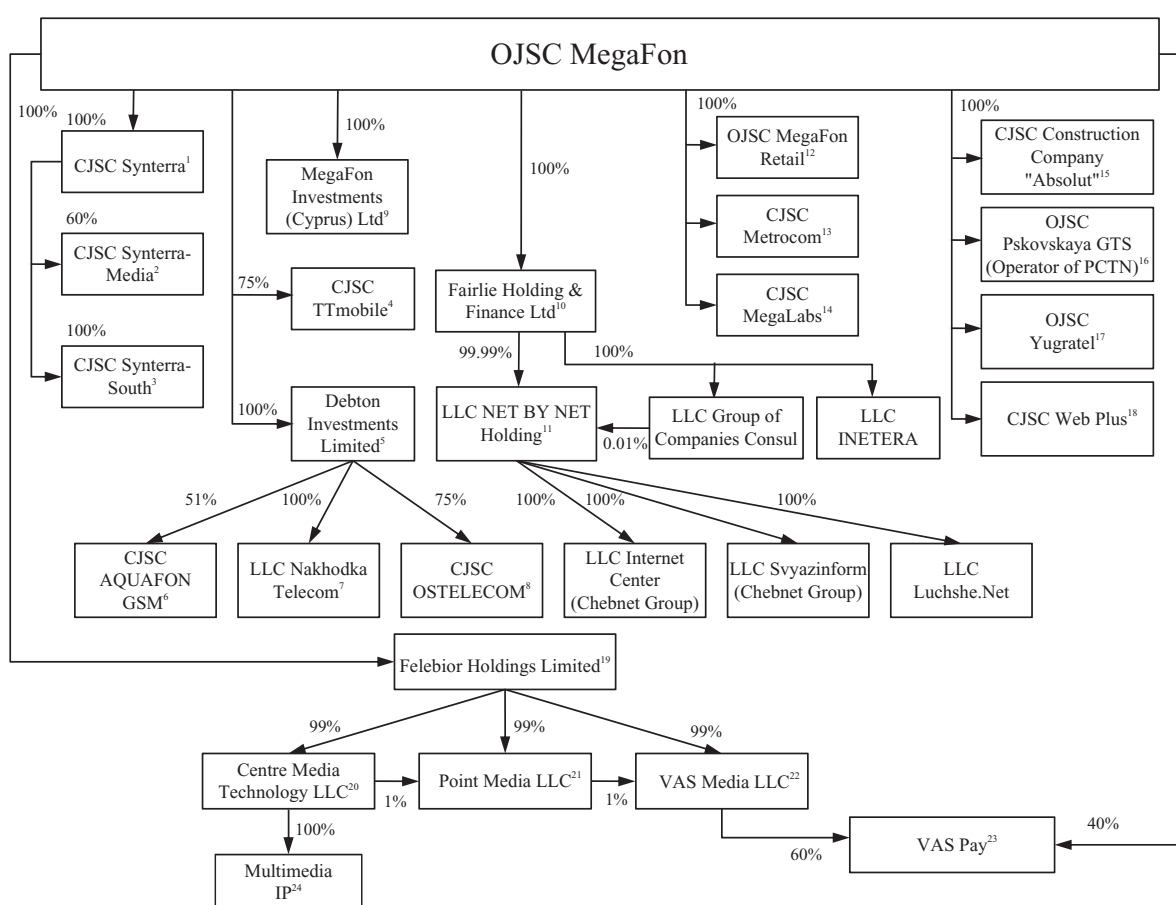
## OJSC MegaFon, Regions and Structure of Our Group

Our corporate group comprises more than 35 subsidiaries.

The parent company of our group is OJSC MegaFon, which operates through eight regional branches: Stolichny (with headquarters in Moscow), North-West (with headquarters in Saint Petersburg), Central (with headquarters in Nizhny Novgorod), Ural (with headquarters in Ekaterinburg), Volga (with headquarters in Samara), South (with headquarters in Krasnodar), Siberia (with headquarters in Novosibirsk) and the Far East (with headquarters in Khabarovsk). All our wireless operations are conducted through OJSC MegaFon.

We also intend for the most part to provide fixed-line communications services through our regional branches (although B2C fixed broadband services, for the time being, will continue to be provided by our subsidiary NetByNet) and, in line with this integration plan, we are in the process of transferring to OJSC MegaFon the fixed-line business operations of the companies we have acquired to allow them to be operated through our branches.

The following chart shows a simplified structure of our Group as of the date hereof with some specific information regarding the operations of various companies which remain separate subsidiaries:



- (1) We purchased CJSC Synterra in June 2010. The majority of its fibre-optic network has been transferred to OJSC MegaFon. A small part of that fibre-optic network continues to be operated by Synterra and its subsidiary Synterra South. We plan to continue the integration of our fixed-line operations with the merger of Synterra into OJSC MegaFon in the near future.
- (2) Synterra-Media carries out media and internet television projects. Using our infrastructure, it provides broadcast services to major media companies, including the First TV Channel and companies arranging major sport and entertaining events. The remaining 40% is owned by CJSC "Media Connect".
- (3) Synterra South operates a part of the fibre-optic network which we acquired when we acquired Synterra.
- (4) CJSC TT Mobile is an operating subsidiary in Tajikistan providing mobile services under the MegaFon brand. CJSC TT Mobile is 25% indirectly owned by the State of Tajikistan.
- (5) Debton Investment Limited is a holding company, through which we own several subsidiaries.
- (6) CJSC Aquafon GSM is an operating subsidiary in Abkhazia. Aquafon's remaining 49% stake is owned by Imar International Corporation (a company owned by Aquafon's management).

- (7) Nakhodka Telecom operates fixed-line networks in the Far East macro-region.
- (8) CJSC Ostelecom is an operating subsidiary in South Ossetia. Ostelecom's remaining 25% stake is owned by the State of South Ossetia.
- (9) MegaFon Investments (Cyprus) Ltd is a special purpose subsidiary currently holding a 14.4% stake in OJSC MegaFon's share capital. Part of our shares that are held by MegaFon Investments (Cyprus) Ltd are being offered in the Offering.
- (10) Fairlie Holding & Finance Ltd, which we acquired in June 2011, is a holding company which holds a 100% interest in various entities that provide broadband internet, IP telephony, IP TV and other multimedia services in the Russian Federation under the NetByNet brand.
- (11) The NetByNet group, acquired in June 2011, has facilitated the Company's entry into the B2C fixed broadband internet market in Moscow and environs and in the Central macro-region, where we did not previously provide fixed broadband internet services.
- (12) MegaFon Retail manages our owned-and-operated retail stores.
- (13) Metrocom operates fixed-line networks located in the city of St. Petersburg (including fibre-optic lines in the city's underground railway system) and environs, and provides communications services to corporate and Governmental clients.
- (14) MegaLabs is our centre for innovative developments and quick-to-market launch of value-added services. Its focus is to bring new products and services to our network through effective partnerships with well-known market participants and teams of young developers.
- (15) CJSC Construction Company "Absolut" owns the building in Moscow where our head office is located.
- (16) Pskov City Telephone Network ("PCTN") is an incumbent operator providing wireline services in the Pskov micro-region. PCTN was recognised as a "natural monopoly" in 2000, which makes it subject to rigorous control by FAS and has delayed its integration in the rest of our business.
- (17) Yugratel, acquired in 2011, is a provider of fixed broadband internet, cable TV and wireline telephony services in the Ural macro-region.
- (18) Web Plus operates fixed-line networks in the Northwest macro-region.
- (19) Felebior Holdings Limited is the holding company of a group of companies ("VAS Media") that we acquired on 11 September 2012. VAS Media is involved in the development of a wide range of VAS services and before the acquisition was already a partner of MegaLabs.
- (20) Centre Media Technology LLC is an aggregator and distributor of digital content that provides various digital-content related solutions in relation to mobile telecommunications and the internet. It has developed various services as a member of projects in relation to the Travu.ru portal.
- (21) Point Media LLC is an aggregator of various location/global positioning-based services.
- (22) VAS Media LLC is a content aggregator. We worked with VAS Media LLC on a number of projects before its acquisition, including Mobile TV Solutions and mobile commerce.
- (23) VAS PAY LLC is an aggregator for the mobile micropayments market incorporated for the purposes of rendering CPA services to large social networks (Odnoklassniki.ru, VKontakte, etc) and other portals.
- (24) Multimedia IP is a provider of Mobile TV solutions.

## Operations

We offer a wide range of voice, data transfer, roaming and value-added services, as well as product bundles and customised business solutions. We have a large and diversified client base, comprising retail, corporate clients, Government clients and other telecom operators.

## Client Base

We are one of the leading universal operators in the Russian Federation, with over 64.7 million overall Subscribers as of 30 September 2012 (of which approximately 63 million are in the Russian Federation)<sup>93</sup>. The following table shows our market share and position in the wireless market as of 30 September 2012 in the macro-regions in which we operate<sup>94</sup>:

<u>Macro-Region</u>	<u>MegaFon's Market Share</u>	<u>MegaFon's Position in the Macro-Region</u>
South .....	27%	2
Volga .....	36%	1
Stolichny .....	27%	3
North-West .....	33%	1
Ural .....	19%	2
Siberia .....	19%	4
Central .....	22%	3
Far East .....	29%	2

<sup>93</sup> Source: Company data.

<sup>94</sup> Source: AC&M Consulting (as per MegaFon macro-regional breakdown).

In addition, we provide mobile services through our subsidiaries in Tajikistan, Abkhazia and South Ossetia. In the period between 30 September 2011 and 30 September 2012 our mobile net additions in the Russian Federation (i.e. the difference in the number of Subscribers between these two dates) was approximately 3.1 million<sup>95</sup>, equal to a 5.1% increase.

Furthermore, we also provide a variety of integrated telecommunication services to numerous corporations, Governmental bodies and telecom operators. At the end of 2011, we had more than 230,000 active agreements with corporate clients and over 23,000 with Governmental clients.

#### *Retail Clients (B2C)*

Private individuals are our largest customer group. As of 30 June 2012, our overall individual customer base consisted of 57.7 million Subscribers (of which 56.1 million are in the Russian Federation), with 3.95 million new B2C Subscribers enrolled in the previous 12 months<sup>96</sup>. B2C clients mainly use wireless services such as mobile voice, data, roaming and VAS (see “—Our Services” below).

In 2011, we conducted an extensive qualitative and quantitative study of the B2C customer segment and segmented it further into eight sub-segments based on customers’ information and communications technology (“ICT”) needs, their barriers to using ICT services, and their spend on ICT. These sub-segments apply across all macro- and micro-regions, but their proportions may differ among the various regions. We plan to utilise these sub-segments to develop more customised services for our clients.

#### *Corporate Clients (B2B)*

The services that we provide to corporate clients (B2B) (which comprise individual entrepreneurs (small office/home office “SoHo”), small and medium-sized enterprises (“SMEs”), and large corporations) focus on the provision of integrated mobile and fixed-line solutions. Corporate clients have access to traditional wireless services such as mobile voice, data, roaming and VAS (including customised value-added services like “SMS-Inform”, “Mobile ATS”, “Office in Your Pocket” and others). In addition, we offer them a wide range of fixed-line services, including data transfer, communications channels and call centres capabilities (see “—Our Services—Fixed-line Voice and Internet Access”).

We offer corporate clients a full range of tariffs for the use of communications services customised to their specific needs and size.

At the end of 2011, we had an 12.7% share of the overall B2B market (taking into account both mobile and fixed-line business)<sup>97</sup>, with approximately 230,000 businesses using our mobile services (comprising 5.2 million Subscribers) and approximately 28,000 businesses taking advantage of our fixed-line services. In 2010, our share of the overall B2B market was equal to 11.9%<sup>98</sup>. During the course of 2011, our corporate client base increased by 34% in terms of number of Subscribers, with the addition of clients such as Uniastrum Bank, BMW and Gazpromneft while major existing clients such as Severstal, Aeroflot, Rossiya Airways, Russian Railways, AvtoVAZ, the Federal Grid Company and Rosneft substantially expanded the range of our services that they use.

#### *Governmental Clients (B2G)*

In the Governmental segment (B2G), we work with Government agencies, local administrations, public non-budgetary funds, and municipal bodies. Following the acquisition of Synterra, we established our position in the Governmental segment. At the end of 2011, our overall market share in the B2G telecommunication sector was approximately 7.1% by revenue<sup>99</sup>, compared to approximately 5.8% at the end of 2010<sup>100</sup>.

The services that we provide to the B2G segment include integrated solutions, fixed-line and mobile telecommunications, data transfer systems, provision and installation of equipment, set-up and maintenance of video conferencing systems, and provision of data processing resources and call centres. The most popular communication services in the public sector today are telephone services, installation and support of virtual

<sup>95</sup> Source: AC&M Consulting.

<sup>96</sup> Source: AC&M Consulting.

<sup>97</sup> Source: Direct Info.

<sup>98</sup> Source: Direct Info.

<sup>99</sup> Source: Direct Info.

<sup>100</sup> Source: Direct Info.

private networks (“VPN”) and internet access. These services often require a higher degree of data protection than those normally employed for our corporate customers, which can be achieved through the use of special data-protection mechanisms, VPN and dedicated lines running through our private networks that are physically separated from public networks.

In 2011, we increased our market position in the Governmental segment. The number of ministries and departments to which we provide communication services doubled. Our largest Government clients include the State Duma, Ministry of Finance, Ministry of Emergency Situations, Ministry of Economic Development, Ministry of Justice, Prosecutor General’s Office, Supreme Arbitration Court, Federal Protection Service, Federal Security Service, Federal Marshals Service, Federal Tax Service and Federal Treasury. As at 30 September 2012, we had approximately 2,000 federal-level B2G clients and approximately 21,000 regional-level B2G clients.

In 2011, we took part in 330 tenders for projects at the federal level, of which we were awarded 152. We are also actively involved in tenders at the regional level; in 2011 we took part in 469 regional tenders, of which we were awarded 288.

We also fulfil state social contracts, providing internet access to schools and disabled children for distance learning, and working actively with educational institutions. For example, as of 30 September 2012 we provided more than 1,200 schools located across the country with internet access. In addition, our disabled children project currently provides over 230 children with internet access so that they can be taught remotely.

#### *Telecom Operators (B2O)*

The operator (or carrier) segment (B2O) covers entities with a licence to provide telecommunications services which use our resources to deliver such services to other users. In this segment, we provide among others, leased lines, voice traffic exchange and data transmission services (VPN and internet traffic exchange), data centre services and roaming services. See “—Our Services—Carrier Services”. Unlike other telecom operators, we do not focus on the provision of voice traffic transit services for carriers.

In 2011, the overall B2O market in the Russian Federation increased by approximately 19.2%<sup>101</sup>, and we believe that the carrier business has good prospects due to the increasing demand for internet bandwidth in conjunction with increasingly heavy content. Our share of IP-transit and leased line services was estimated at 16% at the end of both 2011 and 2010<sup>102</sup>.

Our current B2O customers are leading Russian, CIS and other foreign national carriers, mobile operators and content providers. As of the date hereof, we are in the third place (as opposed to 18<sup>th</sup> place as at the beginning of 2011) in the ranking for IP-connection (a quality parameter that measures the level of a network’s coherence to other independent networks), behind Rostelecom and Transtelecom<sup>103</sup>.

#### *Our Services*

We provide voice, mobile and fixed-line data transfer, roaming and value-added services, as well as business solutions and sale of handsets and other equipment. In addition, we offer the use of our network to many Russian and foreign operators.

As a general rule, we offer all of our services to our entire client base. However, certain services are predominantly or exclusively used only by certain types of clients (e.g., certain business-focused services are mainly provided to the B2B and B2G segment, while the opportunity to lease our lines is reserved exclusively to B2O customers).

#### *Mobile Voice Services*

Our core product is the basic voice service provided through our extensive mobile networks, and this currently represents our primary revenue stream. See “Management’s Discussion and Analysis of Financial Condition and Results of Operations—Key Income Statement Line Items—Revenues—Wireless Revenues from Local

<sup>101</sup> Source: Direct Info.

<sup>102</sup> Source: Direct Info.

<sup>103</sup> Source: www.renesys.com

Subscribers”. We offer these services employing 2G and 3G technology in every micro-region of the Russian Federation. In addition to our basic voice service, we provide our customers with the following services:

- Calling Line Identification Presentation (“**CLIP**”), which is popularly known as “caller ID”, and partial Calling Line Identification Restriction (“**CLIR**”), which gives customers the ability to block their mobile numbers from being displayed on the mobile phones of call recipients. We also offer “Super Caller ID”, a service which can identify a caller even if he/she has subscribed to a CLIR service;
- Call waiting;
- Call forwarding;
- Call blocking;
- Collect calls to other customers in the same macro-region;
- Conference calling;
- Push-to-Talk (a “walkie-talkie” like function that permits customers to communicate with up to 100 other customers simultaneously via 3G/GPRS/EDGE); and
- Video-calling (for 3G customers only).

To receive our services, our Subscribers must have a handset that can be used on our network. New customers who do not own a handset must obtain one either from us or from a third party. As is common practice in the Russian Federation, we generally do not subsidise our users’ purchase of a handset, which substantially lowers our subscriber acquisition costs compared to non-Russian telecommunication operators.

As part of our “Telecommunication Everywhere” programme, between 2010 and 2011 we started providing mobile voice services, wireless data transfer services and other value-added services for passengers on certain flights, trains and boats. See “—Certain Contracts and Projects Relating to the Operation of our Business—Telecommunication Everywhere” below. In addition, we offer voice services to customers located in remote areas without terrestrial cables, utilizing our very small aperture terminal (“**VSAT**”) satellite service.

In 2011, we launched HD Voice networks in Moscow and Sochi. HD Voice delivers greater sound quality by using a wider range of sound frequencies, as well as an advanced voice encoding system. It improves voice recognition and speech intelligibility, conveys nuances of tone and timbre and is better protected from acoustic and ambient noise.

In addition to traditional mobile voice services, we provide confidential mobile communications services (GSM-K), including transfer of technically protected confidential or classified information, to corporate and Governmental customers.

#### *Mobile Data Transfer Services*

The data transfer segment is rapidly growing, with data traffic in the Russian Federation increasing in 2011 by 133% to 261 petabytes<sup>104</sup>. In response to market demand, we have been actively developing our 3G network and building out our fibre-optic backbone and backhaul transmission networks, which have already significantly increased our capability to transfer growing volumes of data at higher transmission rates and at lower cost. Since the beginning of 2009, the monthly volume of data transfer on our network has increased substantially, from 263 terabytes in January 2009 to 20,358 terabytes in September 2012.

Our customers with access to our 3G network (which is operating in all micro-regions of the Russian Federation) can enjoy theoretical data transfer rates of up to 14.4 megabits per second as a result of the high-speed downlink package access (“**HSDPA**”) feature and a high-speed uplink package access (“**HSUPA**”) technology that we deploy in all of our micro-regions. In some micro-regions, where we are launching the evolved high speed package access (“**HSPA+**”), an enhancement of 3G technology, the theoretical data transfer rate can reach up to 21 megabits per second.

Our customers with access to our LTE/4G services (currently provided by virtue of the MVNO agreement entered into with Yota, see “—Certain Contracts and Projects Relating to the Operations of our Business—Yota MVNO Agreement”) can enjoy theoretical transfer download speeds of up to 70 Mbps (in the 15 MHz band).

<sup>104</sup> Source: AC&M Consulting.



These services can be enjoyed by customers with smartphones, tablets, computers, netbooks or other GSM-EDGE, 3G or LTE/4G enabled mobile devices by purchasing one of our data rate plans, which are sold separately or bundled with our voice plans. To receive these services, customers may also purchase a modem with a built-in SIM card from us or select dealers, which they can plug into their computer or netbook. Since the beginning of 2009, we have sold over 10.5 million modems. As at 30 September 2012, clients using modems accounted for approximately 77% of data traffic on our networks. See “—Handsets and Equipment” below.

#### *Value-Added Services*

We offer various value-added services, which provide our customers with a broad range of options for personalising their subscription and receiving information, entertainment and beneficial services. Value-added services may be included in customers’ tariff plans or purchased by customers separately, either on a monthly basis or on a usage basis. In addition, certain value-added services may be provided for free by virtue of being sponsored by advertisers (so-called “freemium” products).

In addition to customary services (such as SMS, MMS, Video-mail and Personal Tone), our value-added services include, *inter alia*:

- Ring Back Tone and Personal Ring Back Tone (allowing customers to purchase tones of their choice to be played, respectively, to callers waiting for their calls to be answered and to the customers themselves as they wait for their outgoing calls to be answered);
- “Multifon”, which enables customers to communicate online (using VOIP).
- Intelligent network services to assist customers in communicating conveniently, including the “mobile party pays” option for conference calls (which allows for a single mobile customer to be charged for all the calls made by the parties to a conference call), and user-generated mobile groups and communities (providing, *inter alia*, special rates for intra-group calling and chatting);
- Location-based services, a broad set of products helping our customers in their day-to-day activities, including maps and navigation, child location control and point of interest searching;
- Information and entertainment services (for instance, information on weather forecasts and currency exchange rates) via dynamically updated data on customers’ handsets;
- Content-providers product access (CPA), a convenient and easy way for our customers to access third-party premium content through mobile handsets;
- Mobile TV solution, a mobile television service launched in 2012 which allows customers to watch live over 100 TV channel programmes on three types of screen: their mobile handsets, their computer/netbook/tablet, and their TV;
- Mobile Payments Service, the result of a strategic partnership with Visa launched in 2012, which allows customers to use their handsets as a virtual credit card to make purchases over the internet, wherever Visa cards are accepted for payment. The funds are debited from the user’s mobile phone account. In addition, we have implemented a pilot project for contactless fare collection (using NFC technology) in the St. Petersburg underground railway system;
- Money Transfers in Retail, a money transfer service started in 2012 in our owned-and-operated stores which allows customers to send/receive money within CIS countries;
- Personal Assistant Service, a dedicated 24/7 concierge service, which helps our clients to receive instant information on a wide variety of topics. These include movie schedules, cultural events, emergency contacts, addresses and location enquiries. In addition, the concierge service can perform a number of tasks for the client, including booking tickets, making restaurant reservations, and arranging emergency assistance;
- Videosurveillance service (a consumer M2M product), which allows remote monitoring of premises and property, children, pets and other objects without having to purchase additional hardware as it works with standard web cameras or IP-cameras and mobile phones; and
- Access to the proprietary Trava.ru portal (an online shop selling fully licensed music, video, game and literary content) available both through the web, and through the ODP (On-Device Portal) application. A large content library is available online through the “freemium” model. In addition, we have introduced a nationwide tariff option of unlimited access to the Trava.ru directory portal for a monthly subscription fee, as well as a “Trava Online” option for modem users in Moscow and environs.

Furthermore, we have introduced value-added services with special attention to our business and Governmental customers:

- Online telephone translation service (allowing customers to use interpreting services during their calls);
- Corporate location based services, which we started providing in 2012, including sanitised geo-data analytics, geo-targeting solutions, and navigation applications for both business and Governmental clients;
- Wireless PBX, a special voice and data VPN for corporate clients;
- Broadcast SMS and MMS capabilities;
- M2M products, adopting technologies that allow both wireless and wired systems to communicate with other devices of the same ability and include technologies that allow data transmission between remote equipment (such as “smart meters” and traffic monitoring systems which were launched in 2012);
- Mobile payment collection services, which allow content providers to receive payments from our customers (a portion of the fee paid by our customer for a call or a text message to a special premium number assigned to a content provider is allocated to such provider);
- Mobile advertising, another product launched in 2012, which incorporates the provision of tailored and targeted advertising through traditional mobile channels (SMS, MMS and unstructured supplementary service data) to customers who have consented to receive such services, and through new web-based and other media channels which have a competitive click-through rate to other advertising channels;
- Cloud computing and IT services (hosting/co-locations, virtual servers and a wide range of XaaS products) which we started offering to the public in 2012; and
- Content distribution network solutions permitting an increase in the speed of data upload and download by creating replica servers in remote locations thereby reducing data transmission distance.

### *Roaming*

We offer roaming services to all our mobile customers. Roaming allows our customers and inbound roamers to receive and make international, long distance and local calls, send and receive SMS and use data services while travelling outside their home network (in the case of our customers, while travelling outside the micro-region where their SIM card was purchased, both within the Russian Federation and internationally).

Our domestic Subscribers can automatically and instantaneously access our domestic roaming service (i.e. roaming between Russian macro-regions). Our Subscribers in both Kavkaz and in the Moscow macro-region can also automatically and instantaneously access the international Customised Applications for Mobile networks Enhanced Logic (“CAMEL”) roaming service, which is currently available in 146 countries and territories where we have CAMEL roaming partners. However, subject to certain exceptions and depending on local regulations, Subscribers elsewhere in the Russian Federation (and Subscribers in Kavkaz and the Moscow macro-region region who intend to use communication services in countries where the CAMEL roaming service is not available), must either specifically request that international roaming be activated for them or ensure that the balance of their personal accounts is above certain thresholds. If our Subscribers do not want to use their mobile phone abroad, they may request deactivation of all international roaming services, including such services which are available by default.

We provide roaming through bilateral agreements with GSM/UMTS and other compatible standard operators. As of 30 September 2012, we had bilateral roaming contracts with companies from 205 countries operating 584 networks. Roaming agreements regulate the relationships between operators, including billing, technical and other procedures. The host operator in the country where the roaming services are provided to the home operator’s customer sends the home operator monthly billing information for the roaming services provided to the home operator’s customers. The home operator pays the host operator directly or via a financial clearing house for the roaming services and charges its own customers. Our customers using roaming are informed in advance by us (through a “BonVoyage” SMS) of the exact rates applicable to roaming services. We also provide inbound roaming services on board ships and aircraft. Outbound roaming services on board ships and aircraft for our customers are also provided by some of our roaming partners. We continually seek to expand our roaming capability and are currently in negotiations with new roaming partners.

We were the first operator among the Big Three who, following the initiative of the Russian Government aimed at lowering roaming charges, renegotiated roaming contracts with a number of operators in Europe with a view to

reducing tariffs and increasing roaming traffic. As a result, starting from 15 December 2011, we significantly reduced prices for our roaming services in 44 European countries, including the European part of the CIS and Turkey, introducing a single Eurotariff for Russian users. The Eurotariff, which was the result of direct agreements with our foreign partners, sets the price for an outgoing call from Europe to the Russian Federation as well as a domestic outgoing call within the host country at 16 rubles per minute (down from between 33 and 86 rubles), an incoming call at 6 rubles per minute (down from between 33 and 56 rubles), an outgoing SMS at 6 rubles (down from between 13 and 19 rubles), while each megabyte costs 50 rubles (down from between 110 and 440 rubles). We believe that our Eurotariff is particularly attractive for our customers not only because of its affordability, but also because, unlike comparable tariffs advertised by our main competitors, it is extremely easy to use as it works through automated operator selection (without the need for any input by our customers).

In addition, we offer various special tariff options that offer special rates or bundles of minutes for domestic or international roaming.

#### *Fixed-line Voice and Internet Access*

We have started providing fixed-line voice and internet access services since the acquisition of Synterra in 2010. We currently provide broadband internet and VPN services to our clients in all of the Russian macro-regions through our extensive fixed-line network (see “—Network and Information Technology—Network—Fixed-line Network”). Directly and through several subsidiaries (see “—The Company—OJSC MegaFon, Regions and Structure of Our Group” above), we offer broadband internet access, including dedicated access to the global internet through our fibre-optic networks, and traditional and high-speed data communications services.

We also provide fixed-line voice services in all of the Russian macro-regions, which comprise, *inter alia*:

- Digital voice communication services, including local, national and international long distance communication services;
- Freephone and tele-voting services;
- Conferencing services; and
- Call centre services, which allow our customers to outsource call centre functions to us.

#### *Carrier Services*

We have been providing carrier services since 2009. We currently provide a range of carrier services, including voice and data transmission services, to foreign and Russian fixed-line and mobile carriers as well as news agencies, financial and entertainment services providers and other content providers. We provide services based on our own and rented networks. The services that we offer include:

- Internet traffic exchange (IP-transit);
- Mobile and fixed voice traffic interconnection (providing local, national and international levels of interconnection);
- Leased lines (local, national and international);
- Satellite solutions;
- Data centre services, including co-location of servers or telecommunication equipment, rental of dedicated servers or virtual servers, XaaS cloud computing, rental of our server capacity, rental of physical space for back-up server placement and hosting centre services as well as granting network access to content providers and facilitating interconnection between various network carriers and provision of VPN services;
- Content delivery network (“CDN”): we currently operate the most extensive CDN in the Russian Federation (by number of hubs)<sup>105</sup>, which is currently being tested commercially; our CDN allows media companies and e-commerce vendors to deliver to their end-users heavy content in a fast and efficient manner;
- Operator-to-operator digital TV services; and
- Cable broadcasting solutions (video signal transmission).

<sup>105</sup> Company data.

Our wireless and fixed-line networks and data centres provide us with the necessary capacity to supply our customers with such services. Currently, we do not purchase IP traffic in the territory of the Russian Federation but operate solely on a partnership basis through peer-to-peer connections. Currently, approximately 150 Gbps of our backbone capacity is contracted by international carriers, while approximately 230 Gbps outbound traffic is allocated within our network for transmission to other carriers both in the Russian Federation and abroad.

### *Handsets and Equipment*

The mobile devices that we sell can be grouped into four broad categories:

- Phones and smartphones;
- Netbooks, tablets and computers;
- Modems and Wi-Fi routers; and
- Other equipment such as MMS frames and 3G cameras.

Since May 2008, we have been promoting and selling a range of customised equipment or alternative mobile devices in our own stores, in other MegaFon branded stores, on our website and through third-party dealer outlets to increase SIM card sales, provide new services and seek leadership in the supply of innovative products. Most of the devices sold permit the purchaser to access mobile data services. In 2011, we offered to our customers more than 20 types of own-brand mobile voice and data transfer equipment on attractive terms.

In 2008 we launched sales of customised modems together with SIM cards. Since the beginning of 2009, we have sold over 11 million such modems, including approximately 2.2 million in the first nine months of 2012. The main buyers are private computer users seeking reliable mobile internet access, especially in those regions of the Russian Federation where the fixed-line broadband network is under developed. In 2011, sales of modems accounted for 14% of our new Subscribers. Since the end of April 2012, we have started selling subsidised LTE/4G-enabled modems. As of 30 September 2012, approximately 92% of the modems sold by us were 3G enabled, while the remaining 8% was LTE/4G enabled. Customers may be offered special data packages or discounts on bundles when they purchase our customised equipment.

In September 2009, we also launched sales of computers with a built in modem and preinstalled SIM card, which customers may purchase from our own stores or from selected dealers. These computers are provided pursuant to an agreement with MIKS and OCS, which are the authorised distributors in the Russian Federation of Lenovo and Acer, respectively.

We offer several lines of branded phones and smartphones. In 2011, we added five new models, including a niche phone for children, the MegaFon C1. We also sell “social phones” with bigger keys and an emergency call button, targeted at senior citizens and the disabled, and mobile handsets devised to be used in extreme conditions.

We launched sales of our first own-brand tablet PC in 2011. Along with Wi-Fi and Bluetooth wireless interfaces, the tablet PC has a built-in 3G module, which provides theoretical data transfer rates of up to 14.4 Mbit/s when connected to our network. It is sold in our retail outlets and our online shop.

We also sell photo frames with SIM cards enabling mobile users to send photos directly to photo frames via MMS, security cameras with built-in SIM cards that transmit images to mobile phones, GPS navigators with built-in SIM cards and routers.

All of these products are sold under the MegaFon brand and accordingly are customised with our logo. They are also provided with operating software customised according to our instructions, so as to offer a friendly interface for our services. The main suppliers of our customised items are Huawei, ZTE and Tekhnoliga. The sales of customised devices in 2010 reached 200,000 units and 378,000 units in 2011. Customised sales represent around 10% of devices sold by our owned-and-operated stores and MegaFon branded stores. Customers who buy products that are customised with our logo tend to have higher ARPU (approximately 50% higher) than those who buy non-customised equipment.

In our owned-and-operated stores, and other MegaFon branded stores we also sell non-MegaFon branded devices supplied to us by internationally reputable equipment providers (such as Samsung, Intel, HTC, Blackberry and Nokia). While we do not have a distribution agreement with Apple, in certain of our owned-and-operated stores we sell Apple products that we purchase in the market.

## **Pricing, Marketing and Customer Service**

### ***Pricing***

Our wireless services are offered on a pre-paid basis or a post-paid basis. While our B2C Subscribers, along with SoHos and SMEs in the B2B segment, are generally offered pre-paid plans (as is common in the Russian market), post-paid plans are offered to other Subscribers. Non-wireless services are generally offered on a post-paid basis, with the exception of B2C broadband internet, which is normally pre-paid.

As of 30 June 2012, over 95.2% of all our Subscribers used pre-paid plans (contributing over 88.6% of our wireless revenues). In the B2B segment, pre-paid plans for Subscribers who are SoHos or SMEs are usually customised with a range of additional value-added services, including specialised customer service, tailored pricing arrangements and access to more complex features such as individual corporate wireless networks.

Post-paid plans which can bundle wireless and non-wireless services are offered to large corporate and Governmental clients. These plans may be highly customised based on a specific client's needs, and various discount rates are available depending on traffic volumes. The pricing of our B2O services is determined by the volume of traffic and intensity of usage of our services by our clients. Various discount rates are available for large users.

Generally, we customise our marketing efforts and pricing policies in each macro-region according to factors such as average income level, the competitive environment and customer needs, all of which vary by macro-region. All our tariffs are quoted in rubles across the Russian Federation.

### ***Pre-Paid Plans***

Pre-paid Subscribers must execute a contract with us and place funds in their account to use our services. They may terminate their contracts at any time. Unlike many other countries, the regulatory framework in the Russian Federation makes it difficult for mobile operators to impose fixed-term contracts on their customers. We therefore do not normally subsidise handsets, as their cost would not be recoverable through a fixed-term contract.

Pre-paid Subscribers generally use services that consist of local and regional airtime and/or access to certain volumes of data transfer plus a broad range of value-added services. They have full access to domestic and, where available, international CAMEL roaming. At their request, they can also have full access to extended international roaming services.

The most basic pre-paid plan that we offer charges based on usage. If our voice customers do not want to pre-pay for packages or pay a subscription fee, they may place funds in their account and they are charged for each minute or second of airtime that they use. We refer to this practice as providing "unbundled minutes". Data tariffs are determined by the volume and speed of data transferred. Customers who do not opt for a package for data transfer services are generally charged per megabyte transferred.

Alternatively, pre-paid Subscribers may purchase "bundled packages" for a monthly fee, paid in advance of each monthly billing cycle, the amount of which varies depending on the amount of airtime and/or data transfer volume that they anticipate using. They may place additional funds in their account to cover charges in excess of the monthly fee and other expenses. In addition to "bundled minutes" and/or "bundled data", these packages can encompass discounted airtime (for instance, discounted prices for calls made during certain off-peak hours, free calls to certain numbers, "bundled SMSs" and other value-added services such as information and entertainment services).

Our pre-paid plans are very flexible. Our Subscribers have the option to purchase as many packages as they wish, and to pay for them on a monthly basis (such as "bundled minutes") or on a daily basis (such as "Video Portal" packages). This is part of a marketing initiative called "your plan", which allows customers to tailor their tariff plans to their specific needs.

In general, pre-paid Subscribers can use our services only if their account balances are positive. They may top-up their accounts and purchase packages by various means including cash, credit card, wire transfer, or mobile payment (i.e. payments made by other Subscribers to their account), and can make such payments at any of our points of sale, at certain retail stores, post offices and bank ATMs and through payment services such as Qiwi, Kiberplat and Web Money (which include a network of self-service payment terminals), in addition to being able



to pay online. We also offer an automatic top up service: when a fixed minimum balance is reached, the participating bank transfers funds from a credit card and automatically credits them to the Subscriber's account. We automatically block the mobile number of pre-paid customers at the point when their account balance falls to zero or has reached the limit granted under the "credit of trust", a limited credit granted to more reliable customers (approximately 3.6% of our current pre-paid Subscribers). See "—Loyalty Programmes and Other Retention Activities".

In general, we face little exposure to credit risk from pre-paid Subscribers. Once we block a pre-paid Subscriber's mobile number, the billing system automatically makes a daily call or sends an SMS reminding the customer of his or her account balance and a recommendation as to a package that the customer may subscribe to based on his or her historical usage patterns. We terminate service to pre-paid Subscribers after 90 days of inactivity.

As noted above, our B2C fixed broadband is generally prepaid. The majority of these customers pay up-front for a tariff package that provides them with an unlimited amount of data at a certain maximum data transfer speed for a certain period of time.

#### *Post-Paid Plans*

As of 30 September 2012, fewer than 5% of our Subscribers used post-paid plans, under which they pay amounts owed to us in arrears on a monthly basis.

We execute a contract with each post-paid plan Subscriber. Under these contracts, the Subscriber is placed on a billing plan under which he or she is billed in arrears, at the end of each monthly billing cycle. The Subscriber may be charged a monthly fee, which is negotiated individually with each post-paid Subscriber according to his or her needs. For this monthly fee, post-paid plan Subscribers receive bundled minutes and/or access to data and may also receive value-added services. After depleting their bundled minutes, post-paid plan customers must pay for additional airtime on a per-minute basis and additional data transfer services depending on the volume and speed of such transfer. Alternatively, if our Subscribers do not want to pay a monthly fee, they will be charged for each minute or second of airtime they use, for the access speed to data they enjoy as well as for value-added services they use, according to individually pre-negotiated tariffs.

Rates for non-wireless services (such as fixed-line voice and internet access or carrier services) are generally highly customised based on the specific client's needs, and subject to various discount rates depending on customers' traffic volumes.

We limit the amount of credit extended to wireless post-paid customers based on criteria such as payment history, home macro-region and past usage. We generally offer our eligible customers credit in an amount equal to the aggregate of their last two monthly invoices or, for the largest federal customers, their last three monthly invoices.

We bill our post-paid plan customers monthly, in arrears, for their network access and usage. They must pay their bills within 30 to 60 days from the billing date, depending on the terms of their contract, or face late payment charges. We block the accounts of post-paid plan customers who exceed their credit limits or fail to pay their bills on time. Because of careful screening (including verification of the customer's payment history and record with the national credit bureau), our delinquency rate from post-paid plan customers has historically been low: as far as post-paid Subscribers are concerned, approximately 5.5% of them do not pay on time. This is in line with historical data points.

#### *Nationwide Tariff Plans and Regional Variations in Tariffs*

We are adopting a unified approach to the product packages that we offer to customers across the Russian Federation, moving towards offering the same services to all our Subscribers. However, it is customary for the pricing of these packages to vary across macro-regions, based on local factors, such as market competition and traffic routing regulations. We launched our first nationwide tariff plan, "First Federal", in 2004. Since then, we have launched several other nationwide plans, such as special rates for outgoing calls within the Russian Federation and student plans. These nationwide plans feature centralised pricing, narrower differences in tariffs between macro-regions and a wider range of bundled value-added services. By introducing these tariff plans, we have sought to simplify our tariffs for all prospective customers in the country, as well as reduce advertising expenses by running nearly identical advertising campaigns across the macro-regions. These plans allow us to

offer national tariff plans that appeal to business customers, high-end individual customers, customers who travel within the Russian Federation and “middle class” customers. Nearly 20% of our Subscribers subscribe to nationwide tariff plans, and we expect this proportion to steadily increase in the near future.

At present, more than 80% of our Subscribers subscribe to tariff plans in which the specific terms in each category vary by macro-region. Regional diversification allows us to provide inexpensive local calls and to maintain higher rates for roaming and long distance calls to other macro-regions within the Russian Federation.

### *Marketing*

Our marketing strategy is driven by a focussed attention to the individualised needs of our customers. We aim to distinguish ourselves from our competitors through the competitiveness of our pricing policies and the high level of customisation and innovation of the products we offer, as well as by providing the best customer experience for our clients. Our advertising campaigns are structured so as to enhance this perception.

We also strive to improve customer retention by closely studying our customers’ preferences. From 2009 we started to use the Analytical Customer Relationship Manager (“**ACRM**”) software developed by Siebel/Oracle, which collects and analyses customer behavioural factors and then uses this information to design automated targeted advertising campaigns via SMS. Our ACRM software provides customer service representatives with customers’ profiles and behaviour, allowing them to offer products that are suitable to each individual customer’s needs. With the help of ACRM, we plan to further refine and improve our B2C segmentation to provide relevant product offers to customers. See “—Operations—Client Base—Retail Clients (B2C)”.

### *Advertising*

Our advertising generally consists of:

- Brand and image advertising and public relations campaigns to position us as a leading universal operator in the Russian Federation and to strengthen the recognisability of the MegaFon brand; and
- Product- and tariff- related advertising to inform customers of specific promotions, new products/tariffs and pricing discounts.

In 2011, we abandoned some traditional communication channels in the B2C segment. We have stopped all marketing activities on the radio and in print and instead prioritised the use of the internet, which targets the promising youth market and, we believe, maximises our advertising efforts and ensures immediate feedback. We also use a combination of television and outdoor advertising, including billboards and signs on buses, kiosks and exhibition halls, to build brand awareness and stimulate demand. Recently, we started using social networks and blogs to promote our products and services.

An essential element of our marketing communications is our motto for the retail market, “The Future Depends on You”, which we have now used for eight years and which, we believe, aptly reflects our core values and desire for innovation, and embodies our approach to serving our customers.

Our direct marketing efforts are aimed generally at retail and corporate clients in the SoHo and SME segment. After the acquisition of Synterra, we modified our communications strategy for the corporate market, and in 2011, the headline “Communicating Ideas and Results” became the basic message for businesses and individual entrepreneurs.

We split our advertising activity into the nationwide, or federal, level, which includes our brand advertising and the promotion, via national media, of federal tariff plans and federal value-added services for mobile services; and the regional level, which includes promotion, via regional media, of regional tariff plans and products. For a discussion on advertising expenses, see “Management’s Discussion and Analysis of Financial Condition and Results of Operations—Key Income Statement Line Items—Sales and Marketing Expenses”.

In 2009, we were granted the status of exclusive General Mobile Partner of the Sochi 2014 Winter Olympic and Paralympic Games and General Mobile Partner of the Russian Olympic teams in 2010, 2012, 2014 and 2016. We believe that this status gives us a great opportunity to increase customer loyalty and strengthen our brand. We opened a representative office in both the “Russian House” at the Vancouver 2010 Winter Olympic Games and the “Russia.Park” at the London 2012 Summer Olympic and Paralympic Games. In addition, we have the right to use various Olympic symbols in our marketing campaigns within the Russian Federation. We plan to construct

all necessary telecommunications infrastructure for the Olympic Games in Sochi in 2014 and thus heighten our reputation, corporate image and brand loyalty, both domestically and internationally. Furthermore, in 2011 our experience in online sales projects nationwide enabled us to become the official operator of the Sochi 2014 online shop (which is otherwise unrelated to MegaFon), giving us the opportunity to create an innovative virtual store in the Russian Federation for the Sochi Olympic and Paralympic Games.

Although we do not rely heavily on sponsorship-based advertising, we do selectively engage in such advertising based on our assessment of its relevance to our target audience. In general, we sponsor sporting, ecological, cultural and social events. In 2010, we became the General Partner of the 2013 World Student Games (Universiade) in Kazan. We have sponsorship contracts with the Russian Football Union for the sponsorship of the national football teams; with the Russian Football Premier League for the sponsorship of their championships; with the Continental Hockey League for the sponsorship of their open ice hockey championships; and with RRF (the Biathlon Union of Russia) for the sponsorship of their competitions. Furthermore, since 2003 we have sponsored a “MegaFon” racing team in various Russian car racing championships and races. In addition, we sponsor music and movie award ceremonies, the “Sport Channel” and various television programmes.

We combine our advertising campaigns with those of telecommunication equipment manufacturers, including Samsung, Nokia and Microsoft. We also closely coordinate our advertising with some of our third-party dealers to both capitalise on the combined volume of joint advertising and ensure the protection of the integrity and image of the MegaFon brand.

Our portal, megafon.ru, had approximately 5 million unique users per month in 2011<sup>106</sup>. By offering content that users find interesting, such as sports news, we manage to effectively market our products and attract new customers through our portal.

#### *Loyalty Programmes and Other Retention Activities*

Our loyalty programmes are designed to retain users of our services in different market segments.

One of our loyalty programmes is “MegaFon-Bonus”, which was launched nationwide in 2005. The time that an average “MegaFon-Bonus” user remains a Subscriber is approximately 25 months, which is over 68% longer than for non-users. Participants collect bonus points by spending money on our telecommunication services or purchasing goods offered during special promotions in our own retail stores. These bonus points can be exchanged for mobile services, such as SMS, MMS, voice-traffic (including roaming) and mobile internet or for discounts towards the purchase of goods in our own retail stores. Another way to collect “MegaFon-Bonus” points has been offered to our Subscribers located in the Moscow, South and Siberia macro-regions. They can receive co-branded Visa credit cards from, depending on the region, Expobank, Citibank or Renaissance Credit, which credit a percentage of all purchases to the user’s mobile phone account, with opportunities to earn additional bonus points. Every month approximately 7.7 million Subscribers (approximately 13% of Subscribers as of 30 September 2012) receive “MegaFon-Bonus” rewards. The penetration level of the programme (which represents the number of customers who realise benefits from the programme during any given year) is approximately 50% of our Subscribers. We also have ongoing partnership programmes with major Russian airlines, and insurance companies and offer joint programmes to our clients. Such joint programmes include a programme with Aeroflot which allows the conversion of bonus points into air miles. Additionally, we enter into short-term partnerships with certain local companies such as fitness clubs, cinemas and retail stores, which grant customers discounts and other benefits in exchange for their “MegaFon-Bonus” points.

Another retention activity that we have employed since October 2007 is the “credit of trust” programme for our pre-paid Subscribers. Our billing systems (see “—Information Technology—Billing” below) automatically rate each customer by reference to predetermined criteria (including the length of time that the customer has been with us, payment history and ARPU) and rank them in clusters. Customers in the so-called “secure clusters” (approximately 3.6% of our current pre-paid Subscribers) are then allowed to receive credit. The amount of credit is approximately one sixth of their monthly expenses. All charges under the credit must be paid within the following billing period, otherwise the customer will be blocked until the payment is received.

#### *Customer Service and Call Centres*

We believe that to attract and retain customers, we must provide a high level of customer service.

<sup>106</sup> Source: Google Analytics.

In each of the macro-regions in which we operate, we have one call centre that provides customer service 24 hours a day, seven days a week. We currently have seven call centres in total and continue our efforts to increase the efficiency of our call centres so as to enable one call centre to provide services to more than one macro-region. Our call centre services are offered in Russian and, in regions where there is demand for customer services to be provided in English and/or local languages, services in these languages are also available. We monitor our call centres' performance closely to ensure the quality of their services. Our call centres use automated interactive voice response and intelligent management software to deal with queries.

Many customers desire to speak with customer service representatives. A system is used which prioritises such calls taking into account the ARPU level of the client, so that customers with higher ARPU wait for a shorter period of time. Special dedicated representatives, who are trained to offer more qualified technical support, deal exclusively with small corporate clients (SoHos and SMEs). A special group of customer service representatives handles customer claims and assists customers who wish to make changes to their services. Our customer service staff also follow up with customers who have discontinued our services to determine the reasons for disconnection and to help us improve our services. Call centres are also important tools for our marketing activities (see “—Marketing” above) and for our sales and distribution network (see “—Sales and Distribution—Call Centres” below).

Our portal, megafon.ru, is set up to facilitate customer interaction with us and allow customers to provide regular feedback. The portal enables customers to send feedback about the quality of service in MegaFon retail outlets. It can give information about the location of the nearest shop and whether any item of equipment is in stock.

In addition to the facilities described above, Governmental customers and large corporate clients can contact their account managers 24 hours a day, seven days a week. They may also contact a call centre, where there is a team dedicated to large corporate and Governmental customers.

In the first half of 2010, in response to an increased number of fraud incidents involving payments for calls or SMS messages to premium-rate numbers assigned to content providers, we introduced a number of initiatives to prevent mobile scams. We have increased the capacity of our fraud control department, which helped to reduce the processing time for customer complaints. Where fraud is committed using premium-rate MMS/SMS numbers, we now have the ability to block such a number within three hours of receiving a complaint. We have begun to apply various additional screening procedures in respect to content providers that use our premium-rate numbers. We have imposed heightened contractual liability on content providers for any fraud incidents. In June 2010, we launched an antifraud internet portal, which allows any visitor to review common fraud schemes and learn how to protect himself or herself against such schemes. Also in June 2010, we introduced simplified procedures for our customers to be informed of the price of a call or SMS to any premium-rate number or to be able to block all calls and SMSs to premium-rate numbers. We reported many fraud incidents to state law enforcement bodies. In some cases, we refunded to our customers payments which were induced by fraud. Implementation of our fraud control initiatives resulted in a 75% decrease in the number of complaints against fraud in June 2010 compared to January 2010.

## **Sales and Distribution**

As of 30 September 2012, our distribution network in the Russian Federation consisted of over 47,000 points of sale.

Our distribution network includes 1,841 owned-and-operated stores, 1,821 third-party points of sale operating solely under the “MegaFon” brand, approximately 16,500 independently-owned multi-brand telecommunications retailers and approximately 27,000 other points of sale, our on-line shop, our direct sales force and our call centre. While our owned-and-operated stores, other MegaFon shops, third-party dealer outlets, on-line shop and call centre mainly focus on selling our products and services to retail clients and small corporate clients (SoHos and SMEs), our direct sales force mainly targets corporate clients, Governmental bodies and other telecom operators.

We focus on the configuration of our distribution network as a key instrument to improve customer retention and lower SAC. In particular, we intend to continue increasing the number of our owned-and-operated stores, which offer higher quality customer service and boost customer loyalty. Our proposed acquisition of a stake in Euroset, the largest retailer of wireless equipment in the Russian Federation is expected to further our strategy of reduction of dealers' commissions, and may reduce our subscriber acquisition costs. We will also continue to aim to expand sales through our portal and in-house direct sales force.

### ***Owned-and-Operated MegaFon Stores***

In the first nine months of 2012, we enrolled 28% of our new Subscribers through our owned-and-operated stores.

As of 30 September 2012, we had 1,841, MegaFon owned-and-operated shops, compared to 1,755 as of 30 June 2012, 1,675 as of 31 March 2012, 1,598 as of 31 December 2011, 1,051 as of 31 December 2010, and 448 as of 31 December 2009. We expect to continue to expand our retail business in the near future, reducing our dependence on third parties. As of the date hereof, all our owned-and-operated stores are under the management of MegaFon Retail (a wholly owned subsidiary established in September 2008). The average number of new Subscribers enrolled each month through our owned-and-operated stores was equal to 760,180 for the nine months ended 30 September 2012. The average ARPU of new Subscribers enrolled through our owned-and-operated stores during the first nine months of 2012 was within the range of 410-430 rubles.

Our owned-and-operated stores function both as sales venues and customer service centres, offering customers a “one-stop shopping” experience. Owned-and-operated stores are generally situated in central business districts, and generally appeal to “middle class” users, high-end users and SMEs. Our customer and sales representatives aim to provide customers with all information necessary to make an informed decision about tariff plans and value-added services, to encourage sales and to provide customer service, including the receipt of payments. We authorise our sales and customer service personnel to take decisions in respect of sales and customer service on their own initiative, within guidelines provided by us. Their salary is partially dependent on the feedback on their performance that we receive from our customers, thus ensuring a high level of customer care.

In addition, in our stores we sell handsets, accessories and other equipment. We also have a large range of MegaFon branded handsets, modems, photo frames and security cameras for sale to customers (see “—Operations—Our Services—Handsets and Equipment” above).

### ***Other MegaFon-branded Outlets***

In view of the growth of our own retail network, the number of MegaFon-branded outlets operated by third parties has decreased at the end of 2011 to 1,900 from 2,201 the previous year, and further decreased to 1,821 as of 30 September 2012. In the first nine months of 2012, 17% of our new Subscribers were enrolled through our monobrand outlets operated by third parties. The average ARPU of new Subscribers enrolled through our monobrand outlets operated by third parties during the first nine months 2012 was within the range of 330-350 rubles.

These MegaFon branded shops sell a full range of products and services aimed at individual clients. These outlets also cater to certain corporate customers, including by providing our basic offers for SoHos and SMEs. Most of our partners are local distributors and they operate in one or several cities. They receive dealer commissions for new Subscribers according to our general compensation scheme for third-party dealers (see “—Third-Party Dealer Network (Multi-brand Telecommunications Retailers and Other Points of Sale)” below), plus an additional bonus for exclusivity ranging from 10,000 to 200,000 rubles per outlet per month.

MegaFon branded outlets typically offer an array of handsets and accessories that they purchase themselves or, much less frequently, obtain from the inventory that we maintain. In addition, they also stock MegaFon branded equipment.

### ***Third-Party Dealer Network (Multi-brand Telecommunications Retailers and Other Points of Sale)***

We have an extensive third-party dealer distribution network, comprising, as of 30 September 2012, approximately 16,500 multi-brand telecommunication outlets and approximately 27,000 other points of sale through which, in the first nine months of 2012, we enrolled approximately 47% of our new Subscribers.

We work with nationwide mobile retailers, as well as independent local partners in select regions. The average ARPU of new Subscribers, was within the range of 370-390 rubles for Subscribers enrolled through nationwide mobile retailers in the first nine months of 2012, while it amounted to 320 rubles for Subscribers enrolled through our independent local partners. Generally, we operate on the basis of revenue sharing agreements which we introduced in 2012 as part of our initiative to reduce churn and SAC. Under our revenue sharing model, we compensate dealers with a specified share of revenues generated by each new customer signed up through the dealer. In certain circumstances, there may be a revenue threshold that must be reached in relation to a specific



customer before dealers become eligible for a share of those revenues. Generally, such share of revenues is calculated on the amount spent by each new Subscriber in the first six months of the new contract. We believe that these policies discourage dealers' opportunistic behaviour and help us to manage our subscriber acquisition costs. Whether a new Subscriber pays in cash, by bank transfer or by credit card, the dealer remits the full amount received to us within three days while we pay the dealer for that new Subscriber after six or twelve months, depending on the terms of our revenue sharing agreement with the dealer.

However, with certain dealers, such as the Russian Post Office, we still operate on the basis of a fixed commission for each customer connected, generally subject to a minimum commission.

We have dealership agreements with a significant number of companies, including Euroset and Svyaznoy, the largest Russian retailers of wireless equipment, with, respectively, approximately 5,252 (of which, approximately 4,639 multi-brand) and 3,189 stores as of 30 September 2012. Our dealers distribute our products and services and often collect cash payments for our services from customers. The dealership arrangements that we sign with independent retailers generally do not restrict our ability to enter into similar arrangements with other dealers, and we continue to increase the number of partners that we execute agreements with to reduce our dependence on any particular dealer. We plan to acquire an interest in Euroset, and as a condition to the completion of this acquisition, we expect to amend our dealership agreement with Euroset to switch to our general revenue sharing model, which we believe may further our initiative to reduce churn and SAC. See "Management's Discussion and Analysis of Financial Condition and Results of Operations—Key Factors Affecting Results of Operations—Acquisitions and Strategic Partnerships—Euroset".

We launched a dealership agreement with the Russian Post Office in August 2009. As of 30 September 2012, the Russian Post Office sold our products and services through more than 24,500 outlets across the Russian Federation.

Finally, we have agreements with kiosks, supermarkets and banks as an alternative distribution channel, particularly for retail market customers.

### ***On-line Shop***

In 2007, we launched our own internet-based "web shop" at [www.shop.megafon.ru](http://www.shop.megafon.ru) to sell our SIM cards. In the following years, we upgraded the software platform of the website and increased the range of products offered on-line, which now also includes handsets, and other equipment and accessories.

In the first nine months of 2012, approximately 148,500 new Subscribers (around 0.7% of all new Subscribers) were being enrolled each month through this distribution channel.

### ***Direct Sales***

As of 30 September 2012, we employed a direct sales force of approximately 320 sales representatives serving the B2B, B2G and B2O market. Our direct sales force engages in two main selling techniques: face-to-face meetings and telemarketing. Face-to-face meetings are generally used to sell advanced services to large enterprises and Governmental bodies. Telemarketing generally focuses on selling such services to SMEs. In the corporate segment, the aim of our direct sales force and account management team is to provide customers with one convenient point of contact for our entire range of mobile and fixed-line services.

In the first nine months of 2012, we enrolled 7% of our new Subscribers through direct sales.

### ***Call Centres***

We also sell our products through our call centres. Over the phone, existing customers can be recommended and sold additional services, or switched to a new tariff plan which may include extra services. Our call centre operators can accept orders from a client, which, for orders that imply physical delivery, the client can then collect at one of our points of sale. For more information, see "—Customer Service and Call Centres" above.

### **Licences**

Our licences are integral to our operations. For a description of the regulatory framework for telecommunications licensing in the Russian Federation, including information about the granting, extension and revocation of

licences, see “Regulation of the Russian Telecommunications Industry—Licensing of Telecommunications Service Providers”. See also “Risk Factors—Regulatory uncertainties could result in our inability to renew our licences on comparable terms or at all” and “—The requirement that licences be re-issued and frequencies be re-allocated in the event of a merger could undermine our ability to consummate acquisitions or mergers”.

### ***2G Licences***

GSM licences were granted to us to operate in our respective service areas at various times over the period from 1994 through 2009. We currently have licences for the provision of GSM telecommunication services throughout the entire territory of the Russian Federation. These expire at varying times between 2013 and 2016.

### ***3G Licences***

On 21 May 2007, we were awarded a ten-year licence for the provision of 3G communications services (using the WCDMA/UMTS standard) throughout the entire territory of the Russian Federation. This licence was granted subject to our meeting certain commitments relating to the installation of base stations supporting 3G standards, and commencement dates for the rendering of 3G telecommunications services in various parts of the Russian Federation, which requires substantial capital commitments (see “Risk Factors—The ongoing uncertainty in global financial markets could materially adversely affect our ability to access capital needed to fund business operations, limiting our operations and resulting in a negative impact on our operating results” and “Management’s Discussion and Analysis of Financial Condition and Results of Operations—Liquidity and Capital Resources—Capital Expenditures”). We have been able to comply with all the licence requirements and, by October 2010, we had base stations supporting 3G standards installed in every micro-region of the Russian Federation.

### ***LTE/4G and MVNO Licences***

On 25 July 2012 we were issued a ten-year licence for the provision of LTE/4G communications services covering the entire territory of the Russian Federation. Under the terms of the licence, we will have to start providing LTE/4G services by no later than 1 June 2013 and, by the end of 2019, LTE/4G services must be available to all communities in the Russian Federation with a population exceeding 50,000 inhabitants. The granting of such LTE/4G licence has been made subject to several other conditions. We have committed to clear certain frequency bandwidth (the cost of which cannot be estimated at present), and we have compensated two competitors for losses associated with termination of their rights to use certain frequencies in Moscow and the Moscow region that have been assigned to us in the amount of 401 million rubles. For possible risks connected to the LTE/4G licence award, see “Risk Factors—Risks relating to our Business and Industry—Any failure to obtain sufficient frequency, or renewals or extensions of our frequency allocations, for our networks, or any order to vacate part of the frequency spectrum we are allocated or that, in any case, we currently use, could disrupt our business”. Such licence is further subject to our meeting substantial capital commitments relating to the rollout of the LTE/4G technology (at least 15,000 million rubles per year, see “Risk Factors—Risks relating to our financial condition—The ongoing uncertainty in global financial markets could materially adversely affect our ability to access capital needed to fund business operations, limiting our operations and resulting in a negative impact on our operating results” and “Management’s Discussion and Analysis of Financial Condition and Results of Operations—Liquidity and Capital Resources—Capital Expenditures”).

On 6 February 2012 we were awarded an LTE/4G licence covering Moscow and environs only, which expires on 6 February 2017. However, LTE/4G services in these areas could not be provided on the basis of such licence until we were awarded a LTE/4G nationwide licence, which we received on 25 July 2012. We started providing services using our TDD LTE network in the city of Moscow in mid-October 2012.

We also hold several MVNO licences and use them to provide our customers with LTE/4G services, by virtue of the MVNO agreement that we entered into with Yota in February 2012. This agreement gives us the capability to provide LTE/4G services to our customers using Yota infrastructure and frequencies, while Yota will be able to use our 2G and 3G infrastructure and frequencies. Through this partnership, as at the date hereof we have provided LTE/4G services to our customers in fourteen major Russian cities (Novosibirsk, Moscow, Sochi, Krasnodar, Samara, Vladivostok, Ufa, Kazan, St. Petersburg, Kostroma, Tula, Vladimir, Yoshkar-Ola and Khabarovsk). By the end of 2012, through our partnership with Yota, we will provide LTE/4G services to more than 40 cities in the Russian Federation. See “—Certain Contracts and Projects Relating to the Operation of our Business—Yota MVNO Agreement”.

### ***Fixed-line Licences***

OJSC MegaFon currently has licences for the provision of fixed-line communications services for all the areas of activity of our operating regional branches. These licences expire at varying times between 2012 and 2022.

### ***Summary of Licences Held***

The following table shows the licences we have been granted at the date hereof and pursuant to which we provide 2G (GSM), 3G, LTE/4G, MVNO, fixed-line and data transfer services. For information about frequency allocation, see “—Network and Information Technology—Network—Mobile Network—Frequency and Numbering Allocation”.

<b>Licence (Services) Type</b>	<b>Territory</b>	<b>Expiration Period</b>
2G (GSM)	Russian Federation	2013-2016
3G	Russian Federation	2017
TDD LTE/4G	Moscow and Moscow region	2017
FDD LTE/4G (data transmission, other than voice data transmission)	Russian Federation	2022
FDD LTE/4G (voice data transmission)	Russian Federation	2022
FDD LTE/4G (telematics services)	Russian Federation	2022
FDD LTE/4G (mobile telephone communications)	Russian Federation	2022
MVNO (based on Yota network)	Russian Federation	2017
Use of frequencies for GSM services on Svalbard (Spitzbergen)	Svalbard (Spitzbergen)	2019
Provision of long-distance and international telephony services	Russian Federation	2013
Provision of local and intra-zone telephone services	Various regions of the Russian Federation	2013-2017
Provision of communications services for cable broadcasting	Various regions of the Russian Federation	2017
Provision of telematic services	Various regions of the Russian Federation	2013-2015
Provision of local communications services, except for payphones and multiuser access devises	Various regions of the Russian Federation	2012-2017
Provision of data transmission services for the purposes of voice communication	Various regions of the Russian Federation	2013-2016
Provision of data transmission services (other than data transfer services for the purposes of voice communication)	Various regions of the Russian Federation	2013-2016
Mobile communications services for private networks	Murmansk region	2014
Provision of communications services via multiuser access devises	Various regions of the Russian Federation	2016
Provision of communications channels services	Various regions of the Russian Federation	2013-2017

Historically, we have not experienced any difficulties renewing our licences. Following our merger with all of our major operating subsidiaries in July 2009, all of our licences were re-issued in a timely fashion and without business interruption. In 2010, 2011 and up to the date hereof, all of our licences that required renewal were promptly re-issued. See “Risk Factors—Risks Relating to our Business and Industry—Regulatory uncertainties could result in our inability to renew our licences on comparable terms or at all”, “—The requirement that

licences be re-issued and frequencies be re-allocated in the event of a merger could undermine our ability to consummate acquisitions or mergers”, and “—Any failure to fulfil the terms of our licences could result in their suspension or termination”.

OJSC MegaFon, Metrocom and Synterra also hold licences necessary to deal with certain types of classified information and to provide services related to protection of such information (including the production of devices for data protection and encryption licences). These licences enable us to provide communications services to various Governmental entities.

### **Network and Information Technology**

We have developed an integrated network infrastructure providing high-capacity transmission capabilities and extensive coverage throughout the Russian Federation.

Like our customers, we are “technologically agnostic” and ready to pursue whichever technological innovation might be available to offer our clients the opportunity to communicate effectively everywhere. Pursuant to this approach, and given that fixed-line infrastructures represent the most efficient way to transport great quantities of data, including those that our clients eventually receive wirelessly, we have greatly expanded our broadband fixed-line network, a fundamental prerequisite to ensure the absolute mobility of our customers. In furtherance of this approach, we are currently striving to ensure complete integration between our mobile and fixed infrastructure. Currently, our IP network is one of the most extensive in the Russian Federation, with a peering interconnection capacity of more than 400 Gbps.

Unlike many telecommunication companies in non-Russian markets, we own the vast majority of our fibre-optic infrastructure, except for the base transceiver station sites which are typically rented.

### ***Network***

#### ***Mobile Network***

The primary elements of our mobile network are transceivers, base stations, radio network controllers, mobile switching centres and media gateways, which are connected by microwave links and fibre-optic lines. Before 2007, our network had principally employed technology based upon the GSM standard. In 2007, we began to deploy 3G networks, using WCDMA/UMTS technology. In October 2007 we put into operation our first 3G network in St. Petersburg and environs, and have since constructed the largest 3G network in the Russian Federation. We currently provide 3G communications services in each micro-region of the Russian Federation (as required under our licence to provide 3G services).

As of 30 September 2012, our radio network consisted of 58,904 base stations, of which 27,621 were 3G enabled base stations. As of the same date, we also operated 661 base station controllers, of which 136 were 3G radio network controllers, 99 mobile switching centres and 151 media gateways. We plan to continue to increase our radio network, in particular our 3G and LTE/4G networks in the near future. For a discussion on capital expenditures, see “Management’s Discussion and Analysis of Financial Condition and Results of Operations—Liquidity and Capital Resources—Capital Expenditures”. Our mobile network has demonstrated to be highly adaptable to transition to and support new technologies. As of 31 December 2011, 78% of our 2G base stations were used also for placement of 3G technology and we believe that our 3G infrastructure will significantly support the roll-out of our LTE/4G network.

#### ***2G.***

Our GSM networks are “dual band” networks, operating in two frequency bands – the lower 900 MHz band and the higher 1800 MHz band. In general, there is no difference in quality between GSM-900 and GSM-1800 services, although the lower-frequency 900 MHz signals propagate further than 1800 MHz signals. As a result, reaching an equal footprint of geographic coverage requires fewer 900 MHz base stations than 1800 MHz base stations. However, GSM-1800 base stations are more efficient at relieving capacity constraints in high traffic areas. Accordingly, we have combined GSM-900 and GSM-1800 infrastructure in a unified network. We have been allocated frequencies in both 900 MHz and 1800 MHz bands and use both GSM-900 and GSM-1800 equipment.

We also implemented EDGE capability throughout our GSM networks as an interim solution before the rollout of our 3G networks. EDGE is an enhancement to the basic GSM network, which provides faster data speeds than the previous GSM technology. EDGE is now being supplanted by 3G technology in our networks.

We currently continue to develop our 2G network. We installed 2,415 new base stations in 2011 and an additional 2,019 in the first nine months of 2012, bringing their total number to 31,283 as of 30 September 2012, with coverage of 92% of the population of the Russian Federation. As of 30 September 2012, 81% of our 2G base stations were located in the European part of the Russian Federation. We intend to maintain this level of 2G network coverage, while also increasing the capacity and reliability of our 2G network and improving access to communications in remote areas and along major national highways.

### *3G.*

Our 3G network, using WCDMA/UMTS technology, along with the HSDPA/HSUPA and HSPA+ enhancements described below, provides much faster download speeds and much more efficient use of radio spectrum than GSM, thereby increasing our network capacity and allowing customers access to a greater range of services and applications, such as simultaneous use of speech and data services, sending video images and accessing the internet using their handsets, at theoretical transmission speeds of up to 21 Mbps.

3G may be used with HSDPA and HSUPA features, which enable faster data transfers and increased capacity. All of our 3G network equipment is HSDPA and HSUPA enabled.

HSPA+, an enhanced version of the HSDPA/HSUPA features, further increases network capacity by increasing theoretical download speed up to 21 Mbps (from approximately 14 Mbps without it). We have started using HSPA+ technology in all macro-regions and most of our 3G base stations support advanced HSPA+ technology. We also use next generation network (“NGN”) technology in our switching centres to support 3G and packet interfaces. Since September 2009, we had NGN technology at all our switching centres that support 3G. Furthermore, in 2011, we began building base stations using the latest UMTS-900 technology in the Moscow environs. The overall average data transfer rate available to customers on UMTS-900 in 2011 was around 5 Mbit/s, while the average data transfer rate available at peak times was around 1.4 Mbit/s. This speed of mobile access allows our wireless business to successfully compete with fixed-line broadband providers.

As of 30 September 2012, our 3G network included 27,621 base stations, of which 2,774 were built in the first nine months of 2012 and 5,985 in 2011. As of 30 September 2012, around 72% of the Russian population has access to our 3G network. As of 30 September 2012, 83% of our 3G base stations were located in the European part of the Russian Federation. We continue to develop our 3G network and we expect it to expand to over 28,000 base stations by the end of 2012, connecting approximately 78% of the Russian population.

### *LTE/4G.*

Like other mobile operators, we are monitoring the next generation of wireless technology closely, specifically LTE standard or 4G technology, for deployment on our networks. The LTE/4G standard has almost two times higher maximum spectrum efficiency than 3G, is more flexible and can provide data transmission services at theoretical download speed of up to 70 Mbps (in the 15 MHz band). On 25 July 2012 we were issued a licence for the provision of LTE/4G communication services throughout the entire territory of the Russian Federation.

We are currently creating our own test areas for the deployment of LTE/4G technology and, having been awarded a nationwide LTE/4G licence, we plan to build and launch the commercial operation of our own LTE/4G network in the near future (possibly in cooperation with other operators). See “—Licences—LTE/4G and MVNO Licences” above. The main technological advantage of our LTE/4G network is its compatibility with 2G and 3G technology. This means that owners of LTE/4G mobile devices will automatically be able to receive services from our 2G and 3G networks should they be unable to connect to our LTE/4G network.

We are also currently providing LTE/4G services to our Subscribers in certain cities through a partnership with Yota. See “—Certain Contracts and Projects Relating to the Operation of our Business—Yota MVNO Agreement”.

### *Network Equipment Suppliers.*

Both GSM and 3G technologies are based on an “open architecture”, which means that equipment from one supplier is interoperable with that of another supplier to allow expansion of the network. Several major suppliers currently offer GSM and 3G mobile equipment, and the market for the supply of such equipment is competitive. In 2010, we organised a tender among all major producers of GSM and 3G equipment to select a supplier. We currently purchase switching and other network equipment through non-exclusive framework agreements from



two major suppliers: Nokia Siemens Networks Oy. and Huawei Tech. Investment Co. Ltd. We generally designate one or two suppliers for each macro-region and seek to minimise the mixing of equipment from different producers within a single macro-region, which reduces operational complexity and improves network stability. The areas that correspond to each supplier are as follows:

- 2G Networks:
  - Nokia Siemens Networks Oy.: North West, Moscow, South, Centre and Volga.
  - Huawei Tech. Investment Co. Ltd.: Siberia, Far East and Ural.
- 3G Networks:
  - Nokia Siemens Network Oy.: North West, Moscow, South and Centre.
  - Huawei Tech. Investment Co. Ltd.: North West, Siberia, Far East, Ural and Volga.

The equipment necessary to support HSPA+ technology and NGN technology is supplied to us by Huawei. Our LTE/4G network in Moscow and Sochi has been built with equipment supplied by Nokia Siemens Networks Oy. We expect equipment for future developments of our LTE/4G network to be acquired through competitive tenders.

#### *Frequency and Numbering Allocation.*

We have been allocated radio frequency ranges from 2x5 MHz to 2x15.2 MHz depending on specific micro-regions (except for Moscow and environs where we have been allocated 2x2.8 MHz) in the 900 MHz band (so-called Primary-GSM) and radio frequency ranges from 2x14.6 MHz to 2x29.4 MHz depending on specific micro-regions in the 1800 MHz band. In Moscow and environs we have also been allocated 2x10 MHz in the extended 900 MHz band (so-called Extended-GSM) that is also used for UMTS-900 channels. In 58 out of the 83 micro-regions, the State Radio Frequency Commission has also allocated us around 2x1.6 MHz in the extended 900 MHz band; and in one region, 2x0.4 MHz in the same frequency range. In the Krasnodar micro-region we have been allocated 2x10 MHz in the extended 900 MHz band for the Sochi Olympic and Paralympic Games until the end of 2016. In addition, we have been allocated radio frequency ranges of 2x15 MHz for frequency division duplex and 1x5 MHz for time division duplex for our 3G/UMTS networks allocated to us everywhere in the Russian Federation. 3G frequency range allocation in Moscow and environs and in Komsomolsk-on-Amur (a city with a population of approximately 260,000 inhabitants as of 1 January 2012) was conditional upon completion of the conversion of military and other Governmental networks using the 3G frequency bands to different frequency bands. In December 2009, the conversion process was partially completed in Moscow and environs. However, as of the date hereof, we have been assigned these frequencies subject to certain restrictions. The area in the Moscow region within which 3G operators are currently not permitted to use the 2100 MHz 3G frequency band amounts to approximately 11,000 square kilometres. This area is, however, covered by our 3G network in the 900 MHz frequency band and by our 2G network, which we are currently strengthening. With the exception of that portion of the Moscow region and the city of Komsomolsk-on-Amur, we believe that we have been allocated adequate radio frequency spectrum (see “Risk Factors—Risks Relating to our Business and Industry—Any failure to obtain sufficient frequency, or renewals or extensions of our frequency allocations, for our networks could disrupt our business”). As far as the LTE/4G rollout is concerned, we have been allocated radio frequency range 25 MHz for TDD LTE/4G network in Moscow and environs (2570-2595 MHz). Upon the completion of certain bandwidth clearance operations, we will be allocated radio frequency range 2x10 MHz in the 2530-2540/2650-2660 MHz band, 2x7.5 MHz in 806 – 813.5/847 – 854.5 MHz and 2x7.5MHz in the 742.5-750/783.5-791 MHz band nationwide. See “—Licences—LTE/4G and MVNO Licences” above.

We have been assigned all of the numbers under the nationwide mobile phone calling prefixes of +7-92x and +7-93x, which means that these numbers may not be allocated to any other operator. This amounts to a total of 200 million numbers. These numbers are known as “federal numbers”. Of this 200 million total, we have applied for and been allocated over 112 million numbers. Currently, we use these allocated federal numbers mostly as active customer numbers or numbers reserved for new SIM cards to be issued in the near future. The remaining approximately 88 million unallocated numbers are reserved for us, and we will be applying for formal allocation of further numbers on an as-needed basis. Generally, we believe that our numbering capacity is sufficient for at least the next two years. In addition, we have been allocated over 3 million additional numbers (known as “local numbers”), which are available for both our fixed-line customers, and also for our mobile customers as an additional number. We are currently using approximately 57% of these local numbers. In the past, we never experienced any material difficulties in obtaining additional number capacity.

### *Fixed-line Network*

In 2004, we began the construction of our own local and long distance fixed-line infrastructure across the Russian Federation to increase the capacity of our network and improve the speed and quality of data transmission.

In the period from 2004 through 2011, we constructed (organically and through acquisitions) an extensive fibre optic network covering, as of 30 September 2012, a total of 131,030 km of fibre-optic backbone and backhaul transmission. In particular, as of 30 September 2012, our backbone network spanned 103,871 kilometres. Our well developed fixed-line network enables us to provide services (both for our own data traffic and for the traffic of other telecom operators) at competitive rates. In 2011, we built a total of more than 20,000 kilometres of backbone and urban fibre-optic lines, and increased the total capacity of the European portion of our backbone network to an average combined throughput of up to 0.9 Tbps.

We have installed wavelength-division multiplexing (“**DWDM**”) technology equipment in the vast majority of our fibre-optic lines. DWDM technology allows simultaneous transmission of multiple information channels through optical fibre – at different frequencies. As a result of implementation of DWDM technology the fibre-optic network capacity increases by more than one hundred times (up to 40 Gbit/s per optical channel). By the end of 2012, we plan to introduce 100Gbit/s DWDM multiplexing technology, incorporating coherent transponders. We expect that this will allow us to increase the capacity of our backbone network to 8 Tbps in the future.

Our fixed-line network consists of three main sections, last-mile/access, backhaul and backbone.

*Last-mile/access Network.* By “last mile/access” we refer to the part of the network that connects our backhaul network to the end user’s property, and further, onto the end user’s equipment. Our fixed-line last-mile network usually consists of our own fibre-optic which branches off from the backhaul network to a fixed-line node by the kerb, and then proceeds further on to a particular building. Wireless (microwave) or satellite technology can also be employed to cover the “last mile”. We also occasionally lease cables and channels owned by other operators. To connect the building to the end user’s premises, we use fibre, copper or coaxial cables.

*Backhaul Network.* By backhaul network we refer to a local fibre-optic link that aggregates traffic from various metropolitan areas, and connects this traffic to the backbone. These links are fast replacing the traditional microwave transmission connecting mobile infrastructure (base stations and switches) to accommodate the increasing volume of mobile broadband data. Our backhaul fixed-line network as of 30 September 2012 comprised 27,159 kilometres of fibre-optic cables. We continue to invest in construction of backhaul fibre-optic lines. As of 30 September 2012, 53% of our base stations located in cities and 8% of other base stations were interconnected through fibre-optic lines.

*Backbone Network.* The backbone network is a central conduit designed to transfer large amounts of network traffic at high speeds between regions within the Russian Federation and abroad. Our backbone infrastructure, which is built out of fibre-optic cable, as of 30 September 2012 covered a total of 103,871 kilometres. Active development of backbone infrastructure enables us to not only meet customers' traffic flow needs, but also to reduce the cost of data transfer due to higher traffic volume throughput obtained by applying modern optical multiplexing technology. In 2009, we launched a fibre-optic communication line Big Ring ("FOCL Big Ring"), uniting three macro-regions of the Russian Federation through a single backbone network. Our FOCL Big Ring is approximately 5,000 kilometres long and connects mobile switching centres in most of the major cities of the European part of the Russian Federation. We plan to construct a similar backbone network connecting the micro-regions of the South (to enable the highest quality of communication during the 2014 Winter Olympic and Paralympic Games), the Eastern part of Siberia and the Far East. In 2011 we particularly focussed on improving our backbone network in the Ural, Siberia and Far East macro-regions. The following map shows (in green) the extension of our backbone network:



Our fixed-line network has been greatly expanded by the acquisitions we carried out in the last two years. When we acquired Synterra in June 2010, we acquired a fibre-optic network covering a total of approximately 30,000 kilometres. In addition, the acquisition of Metrocom in October 2010 has provided us with a 2,000 kilometre fibre-optic network in St Petersburg and environs, including fibre-optic lines in the St. Petersburg underground railway system. The NetByNet fibre-optic network, acquired in June 2011, is located mainly in the Moscow and Centre macro-regions, and covers a total of 400 kilometres. In December 2011, we also purchased Yugratel, which added 1,997 kilometres to our fibre-optic network in the Ural macro-region. We are now carrying out the integration into our network of all of the networks we have acquired. In 2011, we created a single network control and management centre for the fibre-optic network of MegaFon and Synterra and we expect to complete the integration of all of our backbone networks by 2013. In addition, we actively cooperate with the other Big Three operators and Rostelecom in a variety of projects for the construction of additional fibre optic lines, which may result in a degree of network sharing.

We arrange competitive tenders to select suppliers of equipment for our fibre-optic, wireless and satellite lines and other fixed-line infrastructure needs. As of the date hereof, Huawei is our primary supplier of multiplexing equipment.

#### *Network Procurement and Maintenance*

The process of establishing a base station encompasses a variety of tasks: we must comply with site-specific requirements for engineering and design, lease the required space, obtain all necessary Governmental permits and, finally, construct the facility and install the equipment. Our radio network planning software, developed by Aircom Ltd. (UK), can create digital cellular coverage maps of our macro-regions, taking into account the peculiarities of both rural and urban landscapes, including the reflection of radio waves from buildings. These software tools enable us to plan base station sites without the need for numerous field trips and on-site testing, saving us considerable time and money in our network build-out.

Base station site contracts set forth the conditions under which we lease space for our base stations and other network equipment. These agreements are generally of a short duration, up to five years, and in the past have generally been renewed. Under these agreements, we have the right to use premises located in attics or on top floors of buildings for base stations and space on roofs for antennae. In areas where a suitable base station site is unavailable, we construct towers to accommodate base station antennae. We anticipate that we will generally be able to continue using our existing GSM-900, GSM-1800 and 3G base station sites and to co-locate additional 3G or LTE/4G base stations at these sites.

Construction of the fibre-optic network requires us to obtain a number of permits and approvals. If it is technically possible and commercially feasible to use an existing cable conduit that is owned by a third party, we need permission from the owner of the conduit (typically, an incumbent fixed-line operator) to lay a fibre-optic cable. In cases where there are no cable conduits of an acceptable quality that may be used by us, we will need to construct a new cable conduit for our fibre-optic network. Prior to commencement of construction of a cable conduit we are required to prepare project design documentation, procure its approval by state authorities and obtain a construction permit. Upon completion of construction work, the cable conduit must be accepted by state authorities. Even though we are not required to obtain rights to use the land over a cable conduit to operate our fibre-optic network, we still need to obtain such rights to use the land to perform construction works, whether it be through ownership, lease or “public easement”. In the past, we have experienced difficulties in obtaining rights to use land from private owners, and we may continue to experience similar difficulties in the future. See “Risk Factors—Risks Relating to our Business and Industry—Any failure to build-out network infrastructure or failure to comply with all applicable laws and regulations on ownership title or lease rights or to obtain all necessary approvals and permits necessary for the launch and operation of our base stations, data centres or fibre-optic lines could negatively affect our business; furthermore, changes in regulation on cable placement could make us incur significant additional costs”.

Roscomnadzor grants permits to operate base stations, fibre-optic lines and other network elements and permits to use radio frequencies. In order to receive permits we are required to meet certain technical, technological and sanitary requirements and obtain certain certifications for materials and equipment that we use.

#### *Network Quality Control*

In order to provide quality service to our customers, our Global Network Operations Centre (“GNOC”), staffed 24 hours a day and seven days a week, performs daily network integrity checks and responds to network disruptions. We use a standardised grading system for monitoring network quality and regularly conduct technical audits and surveys to maintain our network infrastructure and quality of service.

Through our operation and maintenance centres located in the main city of each macro-region and reporting to our GNOC, we control and monitor the performance of our network and our call completion rate. We use our monitoring systems to optimise our network and to locate and identify the cause of failures or problems and also to analyse our network performance and obtain network statistics. We have agreements with our suppliers for technical support services that allow us to obtain their assistance in troubleshooting and correcting problems with our network 24 hours per day, seven days per week.

We use the following measures of network quality:

- Dropped call ratio, which is the ratio of calls ended for reasons other than the customer’s initiative to all calls, as calculated during peak hours. An acceptable level is less than 5%.
- Grade of service, which is the ratio of blocked call setups to all call attempts, as calculated during peak hours. An acceptable level is less than 5%.
- Speech quality, which is the ratio of bit errors to total transmitted bits, as calculated during peak hours. An acceptable level is less than 6%.
- Network overload, which is the ratio of the number of cells with a grade of service of more than 2% to the total number of cells in the network, as calculated during peak hours. An acceptable level is less than 5%.
- Data session blocking rate, which is the ratio of the number of blocked attempts to establish a data session to the total number of data session establishment attempts. An acceptable level is less than 5%.
- Data session drop rate, which is the ratio of the number of dropped data sessions to the total number of established data sessions. An acceptable level is less than 5%.

The acceptable levels set out above are based on established international practice, our experience, and various marketing investigations. We aim for levels that are better than those described above, although in a few regions, our quality may not always meet such standards. However, we believe our network quality is generally in line with accepted Russian industry practice.

In case of emergency our GNOC immediately notifies relevant state authorities and coordinates urgent network repair to ensure that the network remains fully operative; our GNOC also coordinates the process of informing the population (through SMS) of calamities or other emergencies, at the request of state authorities.

In relation to fixed-line services, we use together with network monitoring systems (NMS) special statistical measurement equipment and service quality devices to monitor and measure the quality of our fixed-line network, including passive and active probe-based solutions. We also undertake quality measurements on backbone lines to control common technological parameters. In addition, we use special hardware-software complexes to support service level agreements with our fixed-line clients.

### *Satellite Communications Infrastructure*

Our telecommunications services provided by satellite are based on VSAT technology. As of 30 September 2012, we had more than 12,000 VSAT terminals throughout the entire territory of the Russian Federation. We lease capacity on seven satellites—Express AM3, Express AM22, and Express AM33 (all owned by RSCC), Intelsat-17, Intelsat-18, and Intelsat-906 (owned by Intelsat Ltd) and Yamal-200 (owned by Gazprom Space Systems). They operate in the C and KU private frequency range with a total transmission capacity of 755 MHz, which we believe is adequate for our current needs. The equipment that we use to provide satellite communications services is mainly supplied by Gilat, Hughes and iDirect.

### *Data Centres*

We currently have 18 data centres, and plan to open more in the future. A data centre is a telecommunications node securing high-speed interconnection between various networks, including our regional networks and networks of other operators. In addition, a data centre is a point of connection to the entire network for various content providers. Also, a data centre's physical space is designed for placement of various IT equipment, including our own servers as well as back-up or VPN servers of our clients; a data centre's server capacity may be a reliable data storage facility for us and our customers. Data centres are designed to prevent connection failures in case of emergencies, unfavourable weather conditions or power shortages. In October 2010, we officially opened our largest data centre with a total area of approximately 7,000 square metres in Samara. The design of this centre was the first in the Russian Federation to be awarded the Tier 3 certification under Uptime Institute Standards. We have also recently opened a new data centre in Dmitrov (in the Moscow region), and plan to open a data centre in the St. Petersburg macro-region by 2013.

### ***Information Technology***

#### *IT Systems*

MegaFon's IT systems are tightly integrated into all aspects of our business, which enables the accomplishment of a wide range of business tasks, and comprise, *inter alia* (and in addition to billing, which is described more in detail in “—Billing” below), the following key areas:

- Customer relationship management;
- Online services, client self-service;
- Interconnection (i.e. the linking of our network with external networks);
- BI (business intelligence, business analysis platforms), data stores; and
- Enterprise resource planning, controlling, finance and HR.

The systems are housed in MegaFon's own data centres and computer rooms in each macro-region so as to meet regional needs and take into account local specifics. The infrastructure designed for providing service support to internal users and customers is deployed in the Samara data centre, which has the capability to provide cloud services both for internal purposes and for our customers.



We continue to invest in the improvement of our IT systems. In 2011, we focused in particular on the improvement of our corporate Contact Centre operations. We launched an operator performance evaluation system and a workload optimisation system. Development of the corporate knowledge store (BI Platform) enabled us to analyse and generate key performance indicators under federal marketing projects and our own efficiency improvement projects with minimal involvement from our regional branches.

In 2011, we continued the deployment of SAP products and solutions. SAP HR modules served as the basis for unifying our methods for managing personnel resources, payroll calculations and business travel. The installation of the SAP GRC Process Control, which took place in 2011, enabled us to secure a convenient and efficient instrument for monitoring compliance with procedures and tracking changes in business processes. In particular, the new system simplified compliance with control procedures ensuring the reliability of financial statements in line with international standards.

The development of our IT systems aims at raising our efficiency levels. We are currently undertaking a large document processing project involving the adoption of bar coding, scanning, recognition and digital signing technologies. An intellectual library is being developed, which will be integrated with the ERP system and will enable us to eventually stop manual data processing. This will also allow for faster business processes and a more transparent service provision mechanism. In addition, we believe that the employment of virtualisation and cloud computing services, which are already widely used by us, together with the implementation of server equipment unification projects, may significantly contribute to increasing our efficiency.

### *Billing*

We operate convergent billing systems and service platforms at data centres in each macro-region (except the Moscow and Central macro-regions, which have recently unified their billing systems). The accuracy and flexibility of our billing systems are crucial to provide efficient and responsive customer service, and also permit us to generate accurate and timely customer data for our marketing activities.

Our convergent billing system, which was developed by Peter-Service (a member of the AF Telecom Group), provides service management and billing for all our customers. In the future, we plan to integrate our billing systems across macro-regions, thus resulting in a more uniform architecture. In 2012 this process was started by the merge of the billing systems of the Moscow and Central macro-regions. A release-based scheme is used for development purposes, where changes to the system are released together after being unified and compatibility tested, to ensure consistency and reliability of the system. We believe that the flexibility of the billing system and our ability to promptly involve its developers in the implementation of our commercial initiatives gives us a competitive advantage.

We continuously develop our systems to keep up with growth in our client base, increases in the geographical scope of our network and the development of new services. We endeavour to maintain centralised control of our systems; nevertheless, IT specialists from our branches are encouraged to work together with Peter-Service to provide input based on local experience. In order to ensure the highest reliability, regular tests and trials are run in our Moscow competence centre.

## **Certain Contracts and Projects Relating to the Operation of our Business**

### *Interconnection Agreements*

Mobile operators must interconnect with other carriers (local fixed-line, long distance and international) to gain access to their networks and allow their customers to communicate with customers of other operators (and vice versa). Each of these relationships is governed by an interconnection agreement, which typically involves a traffic usage charge for calls, which varies depending on the destination and duration of the call.

To provide our customers with domestic and long distance services, we have our own domestic and long distance network. We also have over 60 interconnection agreements (both at domestic and federal levels) in effect with Russian fixed-line and mobile operators, such as OJSC Rostelecom and its regional affiliates, MTS, VimpelCom, Tele2, CJSC TransTeleCom and OJSC MTT. We have interconnection agreements with all of our mobile competitors, and also with various regional fixed-line carriers in the Russian Federation. To provide our customers with international services, we have interconnection agreements with most major international carriers and we have international nodes in Frankfurt, Amsterdam, Stockholm, London and Hong Kong. We believe that our international nodes provide our clients with a reliable infrastructure for international communication and

transfer of data, while at the same time optimising the costs associated with such services. We prefer to directly interconnect with international carriers, without using the interconnection services offered by other Russian operators. In addition, we place importance on being able to connect directly with CIS countries.

### ***DREAM***

In the first half of 2013 we are planning to launch the DREAM (Diverse Route for European and Asian Markets) project.

DREAM will consist of two fibre-optic routes which will be laid between our point of presence in Frankfurt and China via Kazakhstan. These will be universal lines, and so they will be able to transport all forms of data traffic. DREAM will be one of the shortest and, we believe, most secure international transit routes connecting Europe and the growing East Asia region.

The Europe-Asia data transmission market is currently growing<sup>107</sup>. At the same time, current underwater routes have suffered a number of difficulties in the past, including as a result of earthquakes, which can result in closures for a number of weeks. Terrestrial routes such as DREAM provide alternatives to these underwater routes.

### ***Baltic Highway***

In September 2012, we, together with Latvian carrier Lattelecom and German carrier Deutsche Telekom, launched the “Baltic Highway”, the shortest traffic route from Russia to Europe via the Baltic States. The Baltic Highway consists of fibre-optic cables laid out between Moscow and Frankfurt. This route provides high quality data transmission, ensuring greater reliability and minimum time delay for our clients. The implementation of DWDM technology allows data transmission of up to \*10 Gbps along the route. It also provides an alternative to the existing transit route via the Scandinavian countries, thus also improving the efficiency of this already-existing communication channel.

### ***MegaLabs***

In 2011, we created MegaLabs as an incubation centre for innovative developments and launch of value-added services, including content and media, financial services, cloud solutions, M2M technologies, and advertising services. MegaLabs aims to respond to increasing competition from alternative ICT platforms to help us capture emerging opportunities in new ICT markets.

MegaLabs focuses on in-house and partnership-based product development and adoption. In many cases, it is expected to do this in collaboration with well-known market participants and teams of developers from the Russian Federation and abroad.

We believe that, due to its nature and size, MegaLabs will be a more agile participant in the VAS market than OJSC MegaFon could be, and is therefore better placed to exploit opportunities provided by this promising sector. We also believe that dedicating a separate organisation to new product development will significantly shorten the time to market for new products and reduce the cost of their introduction.

In the near future we also plan to merge VAS Media, a group of companies that we acquired in the second half of 2012, into MegaLabs. VAS Media is involved in the development of a wide range of VAS services (including payment, geo-positioning and mobile e-commerce services) and before the acquisition was already a partner of MegaLabs on a variety of projects (such as Mobile TV Solution). We believe that the synergies between VAS Media and MegaLabs will help MegaLabs to become a more competitive player in the VAS market and accelerate the development, implementation and launch of new services by MegaLabs.

### ***XXII Winter Olympic and XI Paralympic Games, Sochi 2014***

We have been selected as the exclusive General Mobile Partner of the XXII Winter Olympic and XI Paralympic Games, which will be held in Sochi in 2014. In connection with this award, we are developing a 3G network in Sochi, covering all Olympic venues and supporting video calls and mobile internet. In addition, we have also been granted frequencies to build an experimental LTE/4G test zone for the Olympic site, which is currently being tested. We have also been granted the status of General Mobile Partner of the Russian Olympic teams in 2010, 2012, 2014 and 2016.

<sup>107</sup> Source: AC&M Consulting.

In addition, in 2011 our experience in online sales projects nationwide enabled us to become the official operator of the Sochi 2014 online shop (which is otherwise not connected to MegaFon), giving us the opportunity to create an innovative virtual store in the Russian Federation for the Olympic and Paralympic Games in Sochi.

### ***Yota MVNO Agreement***

In February 2012, we entered into a mutual MVNO agreement with Yota for the use of its LTE/4G network in the Russian Federation. Under the agreement, we will be able to provide LTE/4G services to our clients using Yota network and frequencies, and Yota will be able to use our network and frequencies to provide 2G and 3G voice and data services to its clients. The agreement has a five-year duration, with an automatic renewal option for additional five years. Each party can terminate the agreement unilaterally subject to three years' notice.

The main objective of this MVNO agreement is to provide our customers with early access to the latest technologies and services by leveraging the existing Yota LTE/4G network (Yota was the first company to be awarded LTE/4G licences in the Russian Federation) while at the same time limiting our own capital investment. Through the Yota partnership, as of the date hereof we provide LTE/4G services to our customers in fourteen major Russian cities (Novosibirsk, Moscow, Sochi, Krasnodar, Samara, Vladivostok, Ufa, Kazan, St. Petersburg, Kostroma, Tula, Vladimir, Yoshkar-Ola and Khabarovsk). By the end of 2012, through our MVNO agreement with Yota, we will provide LTE/4G services to more than 40 cities in the Russian Federation, covering a population of approximately 36.8 million.

Notwithstanding this agreement, Yota remains one of our competitors; see “Risk Factors—Risks Relating to our Business and Industry—We face intense competition”.

On 27 April 2012, the shareholders of AF Telecom and the shareholders of Yota Holding (Cyprus) Limited (“**Yota Holding**”) entered into a joint venture agreement (the “**Shareholder JVA**”) which came into effect on 5 July 2012 according to which their shareholdings in AF Telecom and Yota respectively, were contributed to a newly incorporated joint venture company, Garsdale. As a result of this transaction, as of 5 July 2012, Yota has become one of our related parties. See “Principal and Selling Shareholders—Changes in Shareholding Structure and Ultimate Beneficial Owners—AF Telecom Shareholder Arrangements” below. As a condition for the approval of this joint venture, FAS has prescribed that Yota must make its LTE/4G network and frequencies available on the basis of the MVNO model to other telecommunications operators on non-discriminatory terms.

### ***Euroset***

#### ***Euroset Acquisition***

On 28 September 2012, Lefbord Investments Limited (“**Lefbord**”) entered into an agreement to acquire a 50% stake in Euroset, the biggest wireless equipment retailer in the Russian Federation. The remaining 50% of Euroset will be owned by VimpelCom, one of our competitors.

Lefbord is currently wholly-owned by Garsdale, which is our controlling shareholder. Before the completion of such acquisition by Lefbord, we expect to enter into agreements to subscribe for shares in Lefbord representing a 50% stake of its capital. Pursuant to an agreement to be entered into by us, MICL and Garsdale as to the governance of Lefbord, we will also undertake to purchase, one year from the closing of the Euroset acquisition (with the possibility for this obligation to be deferred for two more years, upon agreement of the parties), Garsdale's interest in Lefbord. We are currently negotiating an agreement to be entered into by us, VimpelCom, Garsdale, Euroset Holding N.V. and Lefbord with respect to the governance of Euroset.

The details of the Euroset transaction have not yet been finally agreed and they could depart, potentially materially and adversely to us, from the description of the transaction set out in the Prospectus. The execution of the Euroset transaction is subject to the satisfaction of a number of conditions, including obtaining FAS approval for the transaction. For more information, see “Management's Discussion and Analysis of Financial Condition and Results of Operations—Key Factors Affecting our Results of Operations—Acquisitions and Strategic Partnerships—Euroset” and “Risk Factors—Risks Relating to our Business and Industry—The return on, and benefits from, our recent investment in Euroset might be affected by disagreements among Euroset shareholders”.

We expect that if this acquisition is completed, it will allow our products to be more prominently marketed in Euroset's outlets and we believe may help us to reduce our churn rate. We further believe that we may be able to benefit from synergies related to the sale of handsets, for which Euroset is a leading market participant in the Russian Federation. Moreover, the purchase of handsets on a joint basis with Euroset could lower our costs in respect of handset sale activities. Furthermore, the entry into a new dealership agreement with Euroset based on our new revenue sharing model is one of the conditions to the completion of the Euroset acquisition. We believe that this new agreement may allow us to reduce our SAC.

### *Euroset Business*

Euroset is a leading retailer of telecommunication and media devices and services in Russia, predominantly operating under the "Euroset" brand which is one of the strongest Russian retail brands. As of 30 September 2012, Euroset had a retail network of 5,252 outlets in Russia and 81 outlets in Belarus. According to J'son & Partners Consulting, Euroset had a 29% market share in the Russian retail mobile telephone handset sector, based on the number of mobile telephone handsets sold in 2010.

The telecommunication and media devices that Euroset sells are primarily sourced from leading original equipment manufacturers, including Samsung, Nokia and LG, mobile operators (such as VimpleCom and MTS) providing Apple handsets, as well as other manufacturers and distributors. In 2011, Euroset had more than 280 suppliers, including approximately 25 suppliers of mobile telephone handsets. The telecommunication services that Euroset sells are primarily those of the three major Russian mobile telecommunications operators—MegaFon, MTS and VimpelCom—though it also sells the services of other mobile operators. Euroset generally sells these services on a commission basis (including telecommunication tariff plans and ongoing account top-up services). Euroset also offers financial and payment services of third-party providers, such as instant money transfers, loan repayments, utilities payments and other services, and sells third-party insurance and consumer banking products. In addition, Euroset provides in-house services, which comprise product repair services and extended repair warranties.

As part of its retail network, Euroset operated 529 "Beeline" branded outlets as of 30 September 2012, which exclusively offer Beeline telecommunication services as well as a range of telecommunication and media devices similar to those offered at Euroset's standard type of "Euroset" branded outlets. Euroset operates these outlets under an arrangement with VimpelCom, a company controlled by the VimpelCom group which is an owner of the "Beeline" brand and one of the principal beneficial shareholders of Euroset as at the date of this Prospectus. VimpelCom is expected to retain a 50% stake in Euroset following completion of the Euroset Acquisition.

Euroset operates through a Dutch holding company and various subsidiaries in Russia and Belarus. Euroset leases the premises of substantially all of its outlets. Most leased premises are subject to short-term leases of less than twelve months. Euroset has a logistics system of eight major distribution centres with an aggregate area of 34,056 sq.m. as well as a number of smaller distribution centres. The average number of employees of Euroset in 2011 was 23,638.

### *Telecommunication Everywhere*

Through our "Telecommunications Everywhere" programme we provide telecommunication services in technically challenging situations, such as on board aircraft, boats and trains.

#### *Aircraft*

In 2010, we installed equipment to provide mobile telecommunications such as mobile GPRS-internet, SMS and MMS services on a single Aeroflot aircraft. The new service was launched commercially in March 2011, and was available to all passengers flying this aircraft who are customers of Russian and international mobile operators with which we have roaming agreements. The project proved to be appealing to customers and, by late 2011, we installed the same equipment on two other Aeroflot aircrafts.

In 2012, we intend to launch these services on several of Aeroflot's long-range Airbus A330s, and we plan to introduce in-flight Wi-Fi capabilities in the near future.

#### *Boats*

In 2011, we successfully completed a project to provide telecommunication services to boats in very extreme environments, such as the Nadezhda icebreaker, which carries expeditions of scientists to the Arctic region. We also plan to develop telecommunication services onboard commercial cruise liners.

### *Trains*

In late 2011, we signed a memorandum of cooperation with Russian Railways on providing voice and Wi-Fi services for rail passengers. The agreement covers all of Russian Railways high-speed and long-distance trains. The majority of the planned base stations along the Buslovskaya-St Petersburg-Moscow-Nizhny-Novgorod route have already been installed and the equipment is currently being tested. This infrastructure is also planned to be used from 2013 onwards to provide telecommunication services to passengers travelling on Federal Passenger Company services.

Furthermore, in late 2010, we signed a memorandum of cooperation on developing telecommunications infrastructure and services with Aeroexpress, which operates the rail links between Moscow and its airports (Vnukovo, Domodedovo and Sheremetyevo). Full 3G coverage along the track to Sheremetyevo has already been achieved. In early 2013, we intend to launch high-speed access on Aeroexpress trains commercially.

### ***Partnership with Utilities***

In 2011, we entered into separate agreements with MRSK Holding and the Federal Grid, under which we will have the ability to expand our fibre-optic network by using the two utilities' pre-existing infrastructure. As a result, new networks will be developed in the Central, Northwest, Volga, Siberia, South, Ural and Far East macro-regions. The first major joint project with MRSK Holding will be the construction of a fibre-optic network in North Ossetia (Alania) in 2012, while the project with Federal Grid, which involves using electricity pylons to route cables for the development of our backbone network in Siberia and Far East, should be completed by 2013.

### ***MeteoFon***

In 2011, we launched MeteoFon, a project to create a network of automatic meteorological stations in the Russian Federation, in conjunction with those owned by the Russian Federal Service on Hydrometeorology and Environment Monitoring (Rosgidromet).

So far, we have installed approximately 150 weather stations on our base stations in various regions of the Russian Federation, and have plans to install more. The weather stations can analyse weather conditions every five minutes and information is transmitted through our network. We believe that MeteoFon will give institutions and individuals more reliable weather information, and that the resultant information can be used to prevent emergencies (fires, floods, etc) and provide forecasts for sporting and other official events. MeteoFon is already in use at Olympic venues in Sochi.

### **Intellectual Property**

We rely on a combination of trademarks, patents, domain name registration, mass media registration and contractual restrictions to protect our technologies, brand names, logos, marketing designs and internet domain names. We have registered a large number of trademarks with the Russian Patent and Trademark Office, of which the following are the most important:

The most important trademarks registered in the name of OJSC MegaFon:

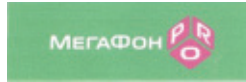
- MEGAFON in Cyrillic characters, both alone and with our logo:





The trademark “MEGAFON” in Latin characters is owned by CJSC Telecominvest, a member of the AF Telecom Group. We use it under the terms of a licensing agreement. See “Transactions with Related Parties”.

- MEGAFON PRO in Cyrillic and Latin characters:



- MEGALITE in Cyrillic characters

**МЕГАЛАЙТ**

- MEGASYNC in Latin characters with our logo:



- MEGAFON—INTERNET in Cyrillic characters with the logo:



- ZAMENI GUDOK (“replace the ring” in Russian), in Cyrillic characters:

**ЗАМЕНИ ГУДОК**

- PROSTO DLYA OBSHENIYA (“just for communication”), in Cyrillic characters:



- GREEN ZONE, in Latin characters:

**Green zone**

- «BUDUSHCHEE ZAVISIT OT TEBYA», in Cyrillic characters, accompanied by our logo and company name:

Будущее  
зависит от тебя



- We use the English version of the above trademark, “The future depends on you”. It is, however, currently not registered.
- “PeterStar” (a trademark under which fixed-line services are offered to B2C customers) in Cyrillic and Latin characters:



- A four-pointed star with/without the company name:



- Trademarks relating to MegaLabs:

**MEGALABS**

**МЕГАЛАБС**

**MegaLabs**

**МегаЛабс**

**MegaLabs**

The following trademarks are registered in the name of Synterra CJSC:

- “Global-Teleport” in Cyrillic characters with logo:



- “Synterra” in Cyrillic and Latin characters:

**СИНТЕРРА**

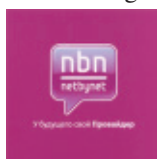
**SYNTERRA**

- “S”—logo:



The following trademarks are registered in the name of NetByNet Holding LLC:

- “NBN” logo with the headline “*The future has its own provider*” (in Russian) is used by NetByNet according to a licence agreement signed in 2008.



The following trademarks are registered in the name of OJSC Yugratel:

- “Yugratel” in Cyrillic characters with logo (in different colours):



We have also registered a large number of internet domain names, of which the more important ones are MEGAFON.RU, MEGAFON.SU, MEGAFON.COM, MEGAFON.TEL, MEGAFONPRO.COM, MEGAFONPRO.RU, SYNTERRA.RU, PETERSTAR.RU, MEGALABS.RU.

In addition to the above we have registered some inventions and utility models and received relevant patents, including several relating to SMS/MMS advertising and to systems for the notification of emergency situations, in the name of OJSC MegaFon.

As the communication medium that channels proprietary content to our subscribers, we only deal with content providers who can give a representation that their content does not infringe on other third parties' intellectual property rights. All content providers agree to indemnify us against expenses incurred as a result of any third party claims for damages caused by infringement of their intellectual property rights. With respect to our content, such as our video and music libraries, we apply for the necessary permissions from holders of intellectual property rights before providing access to such content to our customers.

### **Real Estate Property**

We operate primarily from leased premises, although we own real estate property in more than 50 cities in the Russian Federation. The real estate property that we own comprises office property, key switching centres, client service centres and data centres, with a total area of more than 150,000 square metres. In addition to the above, we lease real estate property with a total area of more than 220,000 square metres. We expect to lease or acquire additional space for offices, customer service centres and technical facilities depending on our needs, availability and cost. We believe that our properties are adequate for our current needs and that additional space will be available as needed. We have also acquired land lots on which we are planning to construct our data centres.

### **Insurance**

We carry property insurance from Ingosstrakh, a prominent Russian insurance company. Under the relevant insurance contract, Ingosstrakh insures us against damage or destruction of our property as a result of any sudden and accidental impact (with the exceptions set out in the contract) and also against reasonable costs that we incur in the process of saving property during a covered event, such as in connection with extinguishing fires. Our insurance contract with Ingosstrakh covers theft and burglary, and also covers property destruction and damage up to an amount of 300 million rubles as a result of an act of terror and up to an amount of 1,250 million rubles as a result of national disturbances or lockouts. We insure most of our property, plant and equipment.

Generally, Ingosstrakh insures our property at depreciated book value with a deductible of 30,000 rubles per event for moveable property (including base stations, switching equipment and transcoders) in operation or in storage, in transit or in the process of installation and 150,000 rubles per event for immovable property (including buildings, IT equipment and furniture) in operation or in the process of installation.

We carry a certain number of other insurance agreements with other insurance companies that were entered into prior to the general policy described above, which expire in 2012-2013. Furthermore, AlfaStrakhovanie provides us with medical and health insurance for our employees.

We also carry directors' and officers' liability insurance from OJSC Sogaz, which is re-insured by a number of major international carriers, subject to certain exclusions.

We do not, however, have any "key man" insurance. We also do not carry business interruption insurance.

### **Environmental and Safety Matters**

We have had no material issues related to environmental or safety matters for as long as we have been in operation and no occasion to implement our emergency recovery procedures except in relation to some damage to our base stations and other equipment in Chechnya as a result of terrorist attacks (see "Risk Factors—Risks Relating to the Political Environment in the Russian Federation—Ethnic and other conflicts create an uncertain operating environment that could hinder our long-term planning ability and decrease the value of investments in the Russian Federation").

We abide by the applicable laws and environmental regulations regarding environmental and safety matters. We have also implemented our own internal regulations and guidelines aimed at minimizing the risks involved in certain types of work, such as working with electrical equipment and vehicles or working at height. In addition, regular audits of every OJSC MegaFon department are conducted to ensure that safety obligations are being fulfilled, guidelines adequately followed, and higher-risk work organised.

### **Social Responsibility**

We are involved in a wide range of social and cultural projects. Overall, we play an active role in social projects to support sport, the disabled, children and various state initiatives.

We are one of the largest sponsors of sports development in the Russian Federation. For years, we have been supporting popular types of sport in the Russian Federation at various levels. We sponsor major organisations such as the Russian Ice Hockey Federation, the Continental Hockey League, and the Russian Football Union. We also sponsor the national biathlon team. In addition, we are also General Partner and the official mobile service provider to the XXII Winter Olympic Games and XI Paralympic Winter Games in 2014 in Sochi, as well as the XXVII World Summer Universiade, taking place in 2013 in Kazan.

We founded the “Future depends on you” football tournament in 2005. It is an event for teams of children from orphanages across the Russian Federation. A total of 200 orphanages and over 5,000 children have taken part in the games over the last six years. The annual event is held in May and the winners of the 22 teams play the final matches in Sochi. The overall championship winners are awarded a trip to London to visit and train at the Arsenal FC training ground.

We support sports for the physically impaired, including sponsorship of the Russian national sledge-hockey team. Furthermore, we are working to make all our owned-and-operated shops entirely wheelchair-accessible.

We also sponsor a variety of cultural events, such as the “New Wave” music festival, and the Moscow International Film Festival.

## **Litigation**

### ***Claims of Breach of Anti-Competition Laws***

#### *Tatarstan Case*

In June 2011, we along with MTS, VimpelCom and Smarts were held liable by the Tatarstan division of FAS for violating antimonopoly laws on competition by charging our subscribers higher fees for calls to fixed operators than for calls to other mobile operators. We appealed this decision to the Tatarstan Arbitrazh Court, which confirmed FAS’s decision on 18 January 2012. We appealed this decision on 5 March 2012 to the 11th Arbitrazh Appellate Court, but on 28 May 2012 our appeal was dismissed. On 3 August 2012, we further appealed the resolution of the 11th Arbitrazh Appellate Court before the Federal Arbitrazh Court of Povolzhie District, but on 11 September 2012 our appeal was dismissed. We presently intend to appeal this further before the Supreme Arbitrazh Court. Furthermore, based on its decision of June 2011, on 25 May 2012 the Tatarstan division of FAS imposed on us a fine in the amount of 26.9 million roubles. We appealed this decision to the Moscow Arbitrazh Court, but on 11 October 2012 our appeal was dismissed. We appealed the decision of the Moscow Arbitrazh Court before the 9th Arbitrazh Appellate Court on 29 October 2012. The hearing on the case has not been scheduled yet. If our appeals are unsuccessful, we might be liable to pay an administrative fine in the amount of 26.9 million roubles. In any event, we have already reduced our fees for calls to fixed operators in Tatarstan. See the fourth paragraph of “Risk Factors—Risks Relating to our Business and Industry—Risks Relating to our Business and Industry—A finding by FAS that we have acted in contravention of antimonopoly legislation could have a material adverse effect on our business, financial condition and results of operation”.

#### *Price-Fixing*

On 27 March 2012, OJSC MegaFon received a request from FAS to explain the reason for differences in prices for mobile radio telephone communication and internet access services in Moscow and St. Petersburg, as well as in the Moscow, Chelyabinsk and Bryansk regions. If the reasons for these differences were to be judged unsatisfactory, we might be subject to fines ranging from 1% to 15% of our total proceeds derived from the regions where such alleged offences have been committed. As both: (i) the time period during which the alleged offences were carried out; and (ii) the “regions” in relation to which our proceeds should be calculated (and utilised as benchmarks to quantify any possible fine) have not yet been determined by FAS, it is not possible to give an indication of the amount of the possible fine. See the fourth paragraph of “Risk Factors—Risks Relating to our Business and Industry—A finding by FAS that we have acted in contravention of antimonopoly legislation could have a material adverse effect on our business, financial condition and results of operation”.

#### *Omsk Region*

On 12 April 2012, OJSC MegaFon received a request from the Omsk division of FAS to provide information on qualitative and price parameters, as well as to give an economic justification for the price applied to 3G-modems sold by us in the years 2010 to 2012. If the reasons for the setting up of such prices were to be judged unreasonable, we might be subject to fines ranging from 1% to 15% of the our total proceeds derived from the

regions where such alleged offences have been committed. As both: (i) the time period during which the alleged offences were carried out; and (ii) the “regions” in relation to which our proceeds should be calculated (and utilised as benchmarks to quantify any possible fine) have not yet been determined by FAS, it is not possible to give an indication of the amount of the possible fine. See the fourth paragraph of “Risk Factors—Risks Relating to our Business and Industry—A finding by FAS that we have acted in contravention of antimonopoly legislation could have a material adverse effect on our business, financial condition and results of operation”.

#### *Content Providers’ Services*

On 29 February 2012, the Saint-Petersburg Division of FAS initiated proceedings against us, MTS and VimpelCom to investigate alleged violation of the antimonopoly legislation related to granting our subscribers with access to information-and-reference and entertainment services of content providers. On 15 March 2012, we received a request from the Saint-Petersburg Division of FAS to provide certain documents and information related to the subject matter of this investigation. On 23 October 2012, FAS passed this investigation to its federal division and scheduled a hearing to consider the case for 26 November 2012. If FAS found us liable for this alleged violation of the antimonopoly legislation, we might be subject to fines ranging from 1% to 15% of our total proceeds derived from the regions where such alleged offences have been committed. As both: (i) the time period during which the alleged offences were carried out; and (ii) the “regions” in relation to which our proceeds should be calculated (and utilised as benchmarks to quantify any possible fine) have not yet been determined by FAS, it is not possible to give an indication of the amount of the possible fine; we are thus not currently able to quantify the financial impact that this may have on us. See the fourth paragraph of “Risk Factors—Risks Relating to our Business and Industry—A finding by FAS that we have acted in contravention of antimonopoly legislation could have a material adverse effect on our business, financial condition and results of operation”.

#### *Synterra Tax Case*

On 28 February 2012, the 9th Arbitrazh Appellate Court, overruling the decision of the court of first instance, has ruled that Synterra had incorrectly accounted for the amortisation of certain telecommunication equipment, including cable and fibre-optic lines in its financial statements for the period from 1 January 2007 until 31 December 2008. In particular, the tribunal has ruled that such equipment should have been amortised according to a lower amortisation factor than the one that Synterra employed, and that therefore Synterra’s profits for the years 2007-2008 have been incorrectly stated.

We appealed this decision, and on 11 May 2012, the Federal Arbitrazh Court of Moscow District (Cassation instance) reversed the decision of the 9th Arbitrazh Appeal Court in our favour. On 22 May 2012, this decision was further appealed by the tax authorities before the Supreme Arbitrazh Court, following which the case was passed for consideration to the Presidium of the Supreme Arbitrazh Court on 15 August 2012; the hearing is scheduled to take place on 20 November 2012. If the decision of Federal Arbitrazh Court of Moscow District (Cassation instance) were to be overturned, we could incur tax fines up to an amount of 172.7 million rubles. See “Risk Factors—Risks Relating to the Russian Federation—Our tax burden may become greater than the estimated amount that has been paid or accrued on our balance sheet, as Russian tax authorities have often been arbitrary and aggressive in their interpretation of Russian tax laws which are often highly unclear, contradictory and subject to varying interpretation by different tax authorities”.

#### *Potential Litigation in Relation to the Synterra Purchase*

In 2010, we completed the acquisition of 100% of the issued share capital of Synterra. The consideration for the acquisition included deferred and contingent consideration in the notional amount of up to U.S.\$110 million (equivalent to 3,418 million rubles at the exchange rate as at 2 June 2010). U.S.\$90 million of the deferred and contingent consideration bears interest at the rate of 2.75% per annum, while the remaining U.S.\$20 million is interest free. As at 30 September 2012, our remaining liability for deferred and contingent consideration outstanding in respect of the acquisition, including certain related accrued interest, was U.S.\$92.0 million (equivalent to 2,845 million rubles at the exchange rate as at 30 September 2012), of which U.S.\$44.8 million (equivalent to 1,385 million rubles at the exchange rate as at 30 September 2012) is unconditional and payable on or prior to the third anniversary of the closing of the acquisition, while the remaining balance is subject to satisfaction of certain conditions and possible retentions as set out in the acquisition documents. U.S.\$74 million of the deferred and contingent consideration bears interest at the rate of 2.75% per annum, while the remaining U.S.\$18 million of the deferred and contingent consideration is interest free. There is disagreement among the parties as to the actual amount of contingent consideration that is to be paid by us because of currently unresolved set-off claims.



### *Summa Telecom Case*

Summa Telecom, part of the Summa Group, was originally granted certain frequencies within the 2.5–2.7 GHz band in order to provide networks based on WiMAX Mobile technology in 2006. In 2007, Summa Telecom requested that the SRFC reallocate these frequencies to it on other terms including permission to use other types of equipment. Without rendering any decision on this request, in 2010 the SRFC reversed its 2006 decision allocating frequencies to Summa Telecom on the grounds that it failed to build the networks within the agreed timeframe. Later, pursuant to the SRFC Decision, the SRFC specifically rejected the 2007 request of Summa Telecom and reassigned some of the affected frequencies to Yota. It also recommended that the remaining frequencies be reassigned to other operators by way of a tender. On the basis of this recommendation, in July 2012 Roscomnadzor included these frequencies in the list of frequencies to be distributed in the LTE/4G tender and subsequently reassigned such frequencies to Rostelecom and MTS as part of the tender.

Summa Telecom recently challenged the refusal of the SRFC in September 2011 to grant its request of 2007. Summa Telecom's claim was granted at first instance by the Moscow Arbitrazh Court and was then appealed to the 9th Arbitrazh Appellate Court which joined us as a "third party" to these proceedings, because the court believed the decision in the case might affect our rights and obligations (we were not involved in the proceedings at first instance, since these frequencies were not allocated to us). On 1 November 2012, the 9th Arbitrazh Appellate Court reversed the decision of the Moscow Arbitrazh Court. The resolution of the 9th Arbitrazh Appellate Court can be appealed by Summa Telecom to the Federal Arbitrazh Court of the Moscow District within two months from the date of this resolution. If Summa Telecom decides to appeal the resolution of the 9th Arbitrazh Appellate Court and its appeal is successful, this might affect our ability to provide LTE/4G services to our customers through the MVNO agreement we have in place with Yota. In addition, while none of the frequencies challenged by Summa Telecom were distributed to us as a result of the LTE/4G tender, if Summa Telecom decides to challenge the results of such tender because some frequencies in the affected bandwidth were distributed to certain other operators as a result of this tender (which would require additional, separate proceedings on its part), and if such challenge is successful and the results of the LTE/4G tender are partially or wholly invalidated, this could adversely affect our ability to provide LTE/4G services. See Risk Factors—Risks Relating to our Business and Industry—Any failure to obtain sufficient frequency, or renewals or extensions of our frequency allocations, for our networks, or any order to vacate part of the frequency spectrum we are allocated or that, in any case, we currently use, could disrupt our business". Given the uncertainties related to the Summa Telecom case, it is not possible at present to quantify the financial impact that this case might have on us.

### *Kosmos-TV and Kaskad-TV Case*

In December 2011, certain provisions of the SRFC Decision, under which some frequencies in the bandwidth 2.5-2.7 GHz were recommended to be distributed as part of the LTE/4G tender (and pursuant to which some of such frequencies were directly assigned to us, Yota and MTS), were challenged by CJSC Kosmos-TV and CJSC Kaskad-TV in the Moscow Arbitrazh Court. The court has also joined us as a "third party" to this claim. Later, the parties to these proceedings agreed to enter into a settlement agreement according to which the SRFC, among other things, would require that each of the claimants would be compensated for the loss of the challenged frequencies—and ultimately this was one of the conditions imposed on the winners of the LTE/4G tender, including us, that made the settlement of the dispute possible. See "Business—Licences—LTE/4G and MVNO Licences". However the settlement agreement has not been yet approved by the court and therefore (as provided by Russian law) is not effective yet. A court hearing expected to grant such approval was held on 11 October 2012, at which time the proceedings were suspended until a final decision is reached regarding a claim (which was not advanced against us, and in which we have not been involved even as a "third party" to date) challenging certain provisions of the SRFC Decision initiated by LLC EROS, a small regional broadband operator, because LLC EROS' claims might affect the claims of CJSC Kosmos-TV and CJSC Kaskad-TV and therefore approval of the settlement agreement cannot be granted until completion of the LLC EROS case. On 31 October 2012, the Moscow Arbitrazh Court announced the operative part of its decision to dismiss the claim of LLC EROS in its entirety. We are unable to assess the effect of the settlement of the proceedings initiated by CJSC Kosmos-TV and CJSC Kaskad-TV being delayed or even blocked by any resolution of the proceedings initiated by LLC EROS in case LLC EROS appeals the decision of the Moscow Arbitrazh Court, and any impact that this might have on the results of the LTE/4G tender. See Risk Factors—Risks Relating to our Business and Industry—"Any failure to obtain sufficient frequency, or renewals or extensions of our frequency allocations, for our networks, or any order to vacate part of the frequency spectrum we are allocated or that, in any case, we currently use, could disrupt our business". Given the uncertainties related to the Kosmos-TV and Kaskad-TV case, we are not currently able to quantify the financial impact, if any, that this may have on us.

### *SMS-Transmission Case*

On 7 February 2012, the Department of the Federal Service on Customers' Rights Protection and Human Well-Being Surveillance for Tver Region ("**Tver Department of Rospotrebnadzor**") filed a claim to the Zamoskvoretsky District Court of Moscow seeking to prevent us from charging our subscribers in relation to SMS transmission when the SMS in question has not actually been received by its addressee. The Tver Department of Rospotrebnadzor argues that charging subscribers for an outgoing SMS regardless of whether such SMS is actually delivered is illegal and that the subscribers' accounts should be charged only upon confirmation from the addressee's handset of receipt of the relevant SMS. The first hearing in this case is scheduled for 5 December 2012. Given the uncertainties related to this case, we are not currently able to quantify the financial impact, if any, that this may have on us.

## REGULATION OF THE RUSSIAN TELECOMMUNICATIONS INDUSTRY

In this Prospectus, summaries of Russian laws and regulations are qualified by reference to the entire Russian language text of such laws and regulations, although such text is not incorporated by reference herein.

### **The Telecommunications Law**

In the Russian Federation, the Federal Government (including the bodies which it controls and coordinates) regulates the telecommunications industry. The Telecommunications Law, which became effective on 1 January 2004 and replaced a 1995 law regulating the same subject matter, is the principal law regulating the Russian telecommunications industry. The Russian Government has adopted numerous decrees and regulations that establish the legal framework envisaged by the Telecommunications Law and it remains subject to frequent change. Regulations enacted prior to the Telecommunications Law continue to apply insofar as they do not conflict with the Telecommunications Law. All of this creates significant uncertainty as to the state of regulation of the telecommunications industry in the Russian Federation.

The Telecommunications Law describes the institutional framework for the Federal Government's role in regulating the telecommunications industry. For our business, the most important aspects of the Telecommunications Law are those that authorise the Federal Government agencies to:

- Licence telecommunication service providers;
- Allocate radio frequencies;
- Allocate numbering capacity;
- Certify telecommunications equipment;
- Ensure fair competition and freedom of pricing; and
- Oversee operators' compliance with the terms of their licences and Russian law.

In order to launch operations, a Russian telecommunications company must complete a multi-stage process, which includes, among other things:

- Obtain a decision from the State Commission on Radio Frequencies on allocation of frequencies within a specified band and a decision from Roscomnadzor on the assignment of these frequencies to the particular operator;
- Obtain a licence from Roscomnadzor to provide telecommunication services;
- Obtain authorisation to put into operation communications facilities;
- Register its radio electronic devices (“**REDS**”) and high frequency equipment with Roscomnadzor; and
- Obtain a decision on allocation of numbering capacity from the Federal Communication Agency.

Under the Telecommunications Law, all telecommunications service providers have access to the Unified Telecommunications Network (“**UTN**”), a centrally managed complex of telecommunications networks owned by different Russian companies and Government agencies. Each service provider can connect its network to the UTN if the provider complies with applicable laws and the conditions set forth in its operating licence. The execution of an interconnection agreement is required.

### **Regulatory Authorities**

Several Government agencies participate in the regulation and supervision of the Russian telecommunications industry. These agencies, whose functions are not always clearly defined, form a complex, multi-tiered system of regulation and supervision that is subject to frequent revision.

#### *Ministry of Communications and Mass Media*

The Ministry of Communications and Mass Media (the “**Ministry of Communication**”) is the ministry charged with the regulation of the Russian telecommunications industry. It has replaced the Ministry of Information Technologies and Telecommunications, which was re-organised in May 2008. The Ministry of Communications has authority to set policy and adopt regulations implementing the Telecommunications Law and other federal laws in a number of areas, including:

- Requirements applicable to telecommunication networks and their design, construction, reconstruction and operation;

- Requirements applicable to numbering (i.e. general requirements dealing with, for example, the codes that are used in specific geographical areas) and use of frequencies; and
- Requirements applicable to telecommunications services.

The Ministry of Communications oversees Roscomnadzor and the Federal Communication Agency. In addition, the State Commission on Radio Frequencies operates under the Ministry of Communications, with the State Commission on Radio Frequencies receiving organisational and technical support from the Ministry of Communications.

### ***Roscomnadzor***

Regulation of the Russian Government No. 228 “On the Federal Service for Supervision in the Sphere of Communication, Information Technologies and Mass Communications” dated 16 March 2009, as amended (the “**Regulation No. 228**”), governs Roscomnadzor. Roscomnadzor is a federal executive body charged with the functions of control and supervision in the area of information technologies and communication. Roscomnadzor’s main responsibilities include the following:

- Monitoring operators’ compliance with applicable regulations, the terms of their licences and the terms of use of frequencies allocated to them;
- Issuing licences for activities in the area of telecommunications and, in certain cases, organising tenders with respect to communications licences;
- Based on decisions of the State Commission on Radio Frequencies to allocate frequencies, assigning frequencies and registering such allocations;
- Registering REDs and high-frequency equipment;
- Examining REDs to assess their compatibility with other REDs;
- Maintaining a register of issued licences and a register of operators occupying a significant position within the public telecommunications network;
- Supervising activity related to the processing of personal data; and
- Monitoring operators’ compliance with the requirements applicable to telecommunications networks and their design, construction, reconstruction and operation.

### ***Federal Communication Agency***

Regulation of the Russian Government No. 320 “On the Federal Telecommunications Agency” dated 30 June 2004, as amended, governs the Federal Communication Agency. The Federal Communication Agency is a federal executive Governmental body performing the functions of managing state property and providing state services in relation to communication. The Federal Communication Agency’s main responsibilities include the following:

- Deciding on allocation of numbering capacity;
- Organising the certification system in relation to communications (see further “—Other Requirements Applicable to Telecommunications Operators—Equipment Certification” below); and
- Maintaining a register of equipment certificates.

### ***State Commission on Radio Frequencies***

Regulation of the Russian Government No. 336 “On State Commission on Radio Frequencies” dated 2 July 2004, as amended (“**Regulation No. 336**”), governs the State Commission on Radio Frequencies. The State Commission on Radio Frequencies is an inter-agency coordination body operating under the Ministry of Communications which is responsible for regulating the use of radio frequency spectrum in the Russian Federation. The main responsibilities of the State Commission on Radio Frequencies include the following:

- Developing state policy in the sphere of frequency allocation and use;
- Deciding on allocation of radio frequency bands and determining the terms of use for radio frequency bands; and
- Determining the radio frequency spectrum available for provision of telecommunication services.

### ***Other Agencies***

In addition to the agencies mentioned above, the work of several other agencies impacts the telecommunications sector. The Federal Security Service is primarily responsible for maintaining and ensuring the security of networks for the Russian Government. The Federal Security Service also has jurisdiction over encryption devices, which include some commonly used digital wireless handsets. The Ministry of Health Protection has some control over the location of telecommunications equipment. The Federal Supervisory Service for Protection of Consumer Rights and Human Well-Being protects consumer rights, including consumers of telecommunications services. The Federal Supervisory Service for the Use of Nature regulates companies' environmental compliance. The Federal Tariff Service imposes certain tariffs in the sphere of telecommunications. Lastly, the Federal Antimonopoly Service supervises competition regulation.

### **Licensing of Telecommunications Service Providers**

#### ***Licence Issuance***

Legal entities and individual entrepreneurs must hold a licence to render commercial telecommunications services. The Telecommunications Law sets out in general terms the procedures and conditions for the issuance and cancellation of such licences, while the specific terms are determined by the regulations adopted thereunder. Under the Telecommunications Law, the Russian Government may determine and annually review the list of telecommunications activities that are subject to licensing. A list of such activities was adopted by the Government in February 2005, and subsequently amended in December 2005, September 2007 and January 2008. The list currently includes, *inter alia*, mobile telecommunication services, local communications services, (except for payphones and multiuser access devices), long-distance and international telephony services, intra-zone telephone services, data transfer services (other than data transfer services for the purposes of voice communication), telematic communication services and certain other services.

Under the Telecommunications Law and Regulation No. 228, Roscomnadzor is authorised to issue licences for the provision of telecommunications services. A single entity may hold multiple licences to conduct different telecommunications services. Roscomnadzor can issue licences for terms of between three and 25 years taking in account, among other things, the requested term and the term of that entity's frequency band allocations. Government officials have broad discretion with respect to licence issuance.

Roscomnadzor issues licences either after reviewing applications from prospective licensees or after holding a competitive auction or tender. The Telecommunications Law requires an auction or a tender only if the number of telecommunications operators that can provide services in a particular geographic area is limited by constraints on radio frequency availability or network access, including numbering capacity.

Licensees are obliged to pay an upfront fee of 2,600 rubles (as specified in the Tax Code of the Russian Federation). This amount applies irrespective of the region covered by a licence.

Additionally, under the Telecommunications Law, operators must make quarterly payments of 1.2% of revenue generated by the provision of telecommunications services (net of taxes paid by customers, e.g. VAT) to the "universal services fund", which is then used to subsidise the losses of telecommunications operators that provide public telephone services and public access to the internet in remote regions of the Russian Federation. Our payment obligation towards this fund for the year 2011 was 2,339 million rubles.

Licences may contain any number of licensing conditions established by the Government that the licensee must comply with, including a date by which provision of services must begin, the extension of the licensed territory and certain technical requirements for connection of the licensee's network to other telecommunications networks, and requirements in relation to capital expenditure. A licence also usually requires that the licensee meets certain requirements with respect to the quality of services provided to customers. These requirements may vary in accordance with the services provided.

#### ***Licence Renewal and Re-issuance***

Telecommunications operators may apply to Roscomnadzor to renew licences before their expiration for the same term as the licence was originally issued, or any other term which does not exceed 25 years. The application for renewal of a licence should be filed not later than two months and not earlier than six months before its expiration. Roscomnadzor can reject an application for renewal if it finds that the licensee has violated the terms of the licence and failed to cure such violation.



Additionally, under the Telecommunications Law, in the case of corporate re-organisations (such as mergers) the successor entity does not acquire the licences of its predecessor automatically, but instead must apply to Roscomnadzor to have such licences reissued in its name. Such an application must be accompanied by certain documents (such as charter documents, certificate of registration and documents confirming the transfer of telecommunication networks and facilities) and the successor entity must pay an application fee. While experience to date suggests that the licences of a merged entity are normally re-issued to the successor entity, there can be no assurance that Roscomnadzor will continue to follow this practice. See “Risk Factors—Risks Relating to our Business and Industry—The requirement that licences be re-issued and frequencies be re-allocated in the event of a merger could undermine our ability to consummate acquisitions or mergers”. As of the date of this Prospectus, as far as we are aware we have not suffered any refusals to renew our licences.

### ***Licence Suspension***

Roscomnadzor can suspend a licence if:

- The licensee violates applicable laws or the terms of the licence, where those violations may infringe upon, or cause harm to: the rights, lawful interests, or life and health of individuals; the state (including the communication needs of Governmental authorities); the needs of the country’s defence, state security or law enforcement; and, in addition to causing such harm, the licensee fails to comply with Roscomnadzor’s instructions to cure any such violations; or
- The State Commission for Radio Frequencies withdraws the licensee’s radio frequency allocation if such withdrawal results in the inability to provide telecommunication services.

Roscomnadzor may issue a written warning of a possible licence suspension if a licensee stops providing services for over three months or if violations of law or licence terms come to its attention. These warnings must set forth a reasonable period, not exceeding six months, during which the licensee may cure the violation that resulted in the warning. If the licensee cures the violation within this period, the licence remains valid. If the violation is not cured within this period, Roscomnadzor may then suspend the licence and apply to a court to revoke the licence.

### ***Licence Revocation and Cancellation***

The Telecommunications Law provides for revocation of licences under certain circumstances. A court may revoke a licence on the basis of a claim filed by either Roscomnadzor or any other interested party in the following cases:

- The documents that served as the basis for issuing the licence contained inaccurate information;
- The licensee failed to cure the violations that triggered the suspension of the licence; or
- If the licence was issued in an auction or tender, the licensee failed to perform the obligations it had undertaken as a condition of participating in the auction or tender.

Additionally, Roscomnadzor may cancel a licence without a court order if the licensee so requests or if the licensee is wound up. Any such cancellation can be appealed in court.

## **Other Requirements Applicable to Telecommunications Operators**

### ***Allocation of Radio Frequency***

Under the Telecommunications Law, wireless telecommunications operators must, in addition to securing a licence, apply for radio frequencies in order to operate their networks.

Pursuant to Regulation No. 336, the State Commission on Radio Frequencies, an inter-agency body, regulates the use of radio frequencies in the Russian Federation and decides on the allocation of radio frequencies to operators. The State Commission on Radio Frequencies’ responsibilities also include developing federal policies on the allocation and use of radio frequencies, and ensuring efficient and appropriate use of radio frequencies in the interests of all users and with consideration for Government needs and priorities. Once the State Commission on Radio Frequencies has made a decision on allocation, Roscomnadzor assigns and registers the allocated frequencies.

These agencies allocate frequencies for a maximum term of ten years, which users may apply to extend. Under the Telecommunications Law, these agencies may change frequency allocations for reasons relating to national

defence, national security and similar purposes. In such cases, the licensee is compensated for the resulting losses. Furthermore, Roscomnadzor may suspend or terminate frequency allocations for several reasons, including the user's failure to comply with the conditions of the frequency allocation.

In addition, frequencies assigned to a company that merges into another company do not automatically pass to the successor company, which instead must apply for the frequencies to be re-allocated and permission to use the frequencies re-issued. See "Risk Factors—Risks Relating to our Business and Industry—The requirement that licences be re-issued and frequencies be re-allocated in the event of a merger could undermine our ability to consummate acquisitions or mergers".

The Telecommunications Law requires that users of radio frequencies make upfront and recurring annual payments for the use of the radio frequency spectrum. The Resolution of the Russian Government No. 171 "On Determination of Amount of One-Time and Annual Payment for Use of Frequency Spectrum in the Russian Federation and Procedure for Collecting Such Payment" dated 16 March 2011, as amended, introduces the general rules for determining the amount of such payments and the payment procedure, and the Decree of the Ministry of Communications No. 164 "On Approval of Procedure for Calculating the One-Time and Annual Fee for Use of Frequency Spectrum in the Russian Federation" dated 30 June 2011, as amended, sets the methods for calculating the amount of such payments. See also "Risk Factors—Risks Relating to our Business and Industry—We may be subject to substantial increases in fees for use of frequency spectrum under the terms of some of our licences".

### ***Allocation of Numbering Capacity***

The Russian Government also allocates numbering capacity. Resolution of the Russian Government No. 350 "On Approval of Rules for Allocation and Use of Numbering Capacity of the Unified Telecommunications Network in the Russian Federation", dated 13 July 2004, as amended, specifies the procedures for allocating numbering capacity and the use of numbering resources under the Telecommunications Law.

The Federal Communication Agency allocates and controls the use of numbering capacity. Russian law also sets forth various grounds for the withdrawal of numbering capacity, including termination of the user's licence, failure to use the allocated numbering capacity within two years of allocation and violations in the use of numbering capacity.

The Telecommunications Law requires that operators must pay fees for the allocation of numbering capacity. The level of these fees is established by Russian tax legislation.

### ***Equipment Certification***

The Federal Communication Agency is in charge of the certification system for the telecommunications industry. By virtue of this authority, it authorises certification bodies and specialised testing laboratories involved in the certification of equipment for the telecommunication industry. Authorised specialised laboratories test certain telecommunications network equipment and, based on the results of these tests, certification bodies certify whether the equipment complies with specific technical requirements. The Federal Communication Agency then registers (and publishes details of) the equipment certificate. The list of telecommunications equipment subject to mandatory certification is set forth in Resolution of the Russian Government No. 532 "On Approval of List of Telecommunications Equipment Subject to Mandatory Certification" dated 25 June 2009. In addition, the design, production, distribution and maintenance of encryption devices, which includes some commonly used digital wireless handsets, requires both a licence and equipment certification from the Federal Security Service.

Lastly, Russian wireless operators must register their REDs and high-frequency equipment with Roscomnadzor. The list of REDs that are subject to such registration was approved by Resolution of the Russian Government No. 539 "On Procedure for the Registration of Radio-Electronic Equipment and High-Frequency Devices" dated 12 October 2004, as amended. If the use of a RED involves the allocation of a radio frequency, this registration is valid for the term of the frequency allocation. Registration of REDs and high-frequency equipment that does not involve the use of radio frequencies is valid for ten years. In each case, the term is renewable (upon users' request).

## **Fair Competition Provisions**

### ***Tariff Regulation***

The Telecommunications Law deems any fixed-line public telecommunications network operator that, together with its affiliates, commands a specified percentage, currently 25%, of traffic or installed capacity in a given geographic area, or throughout the Russian Federation, as an operator occupying a significant position within the public telecommunications network. The Russian Government regulates the interconnection prices charged by these operators. Although the Telecommunications Law requires regulatory agencies to promote competition among wireless operators, regulations in respect of operators occupying a substantial position within the public telecommunications network currently do not apply to wireless operators, which are free to set their own tariffs. See “Risk Factors—Risks Relating to the Legal and Regulatory Environment in the Russian Federation—Risks relating to our business—If we or any of our existing or future subsidiaries is recognised as an operator occupying a “substantial position” or a natural monopoly, we might be subject to price regulations and this may adversely affect our business, financial condition and results of operations”.

In addition, operators that are natural monopolies (for instance as a result of being the sole provider of a particular technology or service in a region) are also subject to price regulation in the areas of traffic and data transfer. The legal basis for federal regulation of natural monopolies, including those in the telecommunications market, and Governmental control over tariffs and certain activities of natural monopolies is established in Federal Law No. 147-FZ “On Natural Monopolies” (the “**Natural Monopolies Law**”) dated 17 August 1995, as amended. In addition, the Natural Monopolies Law provides for the types of transactions for which a regulated entity must obtain prior FAS approval and establishes the general principle that entities recognised as natural monopolies must not refuse to provide regulated services to certain types of consumers.

The Federal Tariff Service is responsible for maintaining the Register of Natural Monopolies whose tariffs are regulated by the state. A telecommunications operator may be included in this register following a decision by the Federal Tariff Service based on analyses of the operator’s activities and the market conditions.

One of our subsidiaries, Pskovskaya GTS, is classified as both a significant operator and a natural monopoly. As a result, its tariffs are regulated by the state.

### ***Mandatory Interconnection at the Local Switch***

Under Russian law, operators that qualify as operators occupying a significant position within the public telecommunications network may not refuse to provide interconnections and may not discriminate between operators. However, in practice, regional public telecommunications network operators may discriminate by delaying interconnection to some operators and charging more favourable interconnection rates to local wireless operators. See “Risk Factors—Risks Relating to our Business and Industry—Telecommunications operators with whom we interconnect may not adhere to the terms of our interconnection agreements or may limit access to their network capacity”.

### ***Antitrust Regulation***

On 8 April 2009, FAS classified MegaFon as a company holding a dominant position in the market of mobile communication services with a market share of over 25%.

Under the Competition Law, a person with a dominant position in a particular market is prohibited from engaging in the following activities: (a) fixing and maintaining excessively high or excessively low prices; (b) withdrawing goods or services from circulation resulting in price increases; (c) imposing terms unfavourable to a counterparty or irrelevant to the subject-matter of the agreement; (d) reducing or terminating production of goods or provision of services for reasons that are not economic or technological in nature, where demand for the goods or services exists, so long as the goods or services can be produced/provided at a profit; (e) refusing to enter into an agreement with particular buyers or customers for reasons that are not economic or technological in nature, where the goods or services can be produced or supplied; (f) fixing differing prices (tariffs) for the same goods or services for reasons that are not economic or technological in nature; (g) creating discriminatory conditions; (h) creating barriers to entry into or exit from a particular market; (i) violating legal requirements relating to pricing; or (j) carrying out any other activities that result or may result in the prevention, limitation or elimination of competition and/or the infringement of interests of other persons.

FAS is authorised to issue binding instructions ordering the dominant entity to terminate any abuse, as well as to transfer the profits obtained as a result of the illegal conduct to federal funds (i.e. by fining the relevant operator). FAS can also order, through a court procedure, the spinning-off or splitting-up of the business operations of a legal entity that abuses a dominant position more than twice in a three-year period.

In addition to the above limitations applicable to entities holding a dominant position, the Competition Law provides for a merger control regime, which includes the requirement for pre-closing approvals by FAS, in the following circumstances:

- (i) (A) acquisition of voting shares in a joint stock company resulting in ownership of more than 25%, 50% and 75% of voting shares of a Russian joint stock company (or 1/3, 1/2 and 2/3 participation interest in a Russian limited liability company) or more than 50% of voting shares of a foreign company; or  
(B) acquisition of core production and/or intangible assets if the balance sheet value of such assets exceeds 20% of the total balance sheet value of the core production and intangible assets of the target; or  
(C) obtaining rights to determine the terms of business of an entity or to exercise powers of its executive body,  
provided that the combined asset value of the acquirer and the target (together on a consolidated basis) and/or the annual revenues of such acquirer and the target (together on a consolidated basis) exceed certain statutory thresholds or the acquirer, the target or any person within their respective groups are included in the Register of Persons Having a Market Share in Excess of 35% in a Particular Commodity Market or Having a Dominant Position in a Particular Commodity Market (the “FAS Register”);
- (ii) mergers and consolidations of companies, if the combined value of their assets (each on a consolidated basis) or annual revenues (each on a consolidated basis) exceed certain statutory thresholds; or if one of these companies is included in FAS Register; or
- (iii) creation of a company, if its share capital is paid for by shares or core production and/or intangible assets of another company as specified in (i) above, provided that the combined value of the assets of the founders and the entities whose shares or assets are contributed to the share capital of the newly created company (each on a consolidated basis), or their total annual revenues, exceed certain statutory thresholds; or if the company whose shares or assets are contributed to the share capital of the newly founded company is included in the FAS Register.

The Competition Law establishes a 30-day review period for pre-closing approval of such transactions. The review period may be extended for a further two months if FAS determines that the prospective transaction might restrict competition with respect to a particular market. The Competition Law provides for mandatory post-transaction notification to the antimonopoly authorities if the aggregate asset value or total annual revenues of the acquirer and the target exceed certain statutory thresholds.

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 FAS, FAS may bring a court claim to invalidate the transaction provided that the transaction has led or may lead to the restriction of competition, for example, as it has strengthened a dominant position in the relevant market.

More generally, Russian legislation provides for civil, administrative and criminal liability when antimonopoly legislation is violated.

### **Government Surveillance Systems**

Third parties may tap telecommunications only in cases provided for by law and pursuant to a court order. Federal Law No. 144-FZ, dated 12 August 1995, “On Operational-Investigative Activities”, as amended, created a surveillance system, known as SORM, which is operated partly by the Federal Security Service.

In 1997, the former Ministry of Communications and the Federal Security Service reached an agreement concerning the implementation of SORM in the telecommunications industry. SORM requires that telecommunications operators ensure that the electronic traffic on their networks can be monitored by the Government. The relevant requirements are currently set out in the Order of the Ministry of Communications No. 6 “On Approval of Requirements for Telecommunications Networks for Conducting Investigation Activities. Part I. General Requirements” dated 16 January 2008 and in the Order of the Ministry of Communications No. 73 “On Approval of Requirements for Telecommunications Networks for Conducting Investigation

Activities. Part II. The Requirements for Data Communication Networks” dated 27 May 2010. SORM also requires telecommunications operators to finance the cost of any additional equipment needed to make their systems compliant with SORM. Currently, we are in compliance with Russian law requirements related to SORM and, accordingly, certain Government agencies are able to monitor electronic traffic on our network.

### **Internet Regulation**

Currently, there is no comprehensive regulatory framework directly applicable to internet-related services or to internet content. Existing regulations are fragmented and vague. In order to provide internet access, an operator must obtain a licence for telematic communication services from Roscomnadzor. Such a licence includes regulation or the licensee’s access to global and regional telecommunication and information networks, including the internet, and services for e-mail transmission. A licence for telecommunication services for data transmission (other than transmission of voice data) is also required for internet-related services. The general rules of the Telecommunications Law governing licence issuance, suspension, revocation and cancellation apply to these types of licences. Additionally, the press has reported that there have been some discussions in the Russian Parliament on the possibility of passing legislation regulating internet content but these discussions have not yet resulted in adoption of any relevant statutes.

### **Foreign Strategic Investments Law**

Under the Foreign Strategic Investments Law, we qualify as a strategic company, since we were classified by FAS as a company holding a dominant position in the market of mobile communication services in the territory of the Russian Federation, with a market share of over 25% as well as because we offer services involving the use of cryptographic technologies. The Foreign Strategic Investments Law provides for certain restrictions on acquisition of shares in a strategic company by foreign investors, foreign states or international organisations, or by entities controlled by them. The law applies to all agreements that lead to the acquisition of control over a strategic company by a foreign investor, regardless of where these agreements were entered into.

In particular, the Foreign Strategic Investments Law requires the Russian Government’s approval for any direct or indirect acquisition by a foreign investor (or any entity controlled by a foreign investor) of control over a Russian strategic company. If a foreign entity acquires 5% or more of the shares in a strategic company, it must notify the Governmental Committee for Control over Foreign Investments in the Russian Federation (the “**Governmental Committee**”) in writing and provide information and documents relating to the transaction.

“Control” is broadly defined by the Foreign Strategic Investments Law as: (i) the ability, directly or indirectly (including, *inter alia*, by means of ownership, trust management agreement, joint activity agreement, mandate agreement or other transactions), to control more than 50% of the voting shares comprising the charter capital of a strategic entity; (ii) the right to direct business decisions taken by the strategic entity, for example under a shareholders’ agreement; (iii) the right to appoint the sole manager or more than 50% of the Board of Directors (or the management board) of the strategic entity; or (iv) the right to serve as a management company for the strategic entity. In addition, 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 that 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 ability determine the decisions of the strategic company.

If a foreign entity obtains control over a strategic company due to a change in the proportion of the votes in the strategic company available to the foreign entry by virtue of (i) buyback or transfer of shares in a strategic company, (ii) distribution of treasury shares in the strategic company among its shareholders, (iii) conversion of preferred stock into ordinary stock or (iv) any other reason, the foreign entity must file an application to the Governmental Committee within three months of obtaining control.

Prior approval is required for transactions aimed at the acquisition by a foreign state, international organisation or an organisation controlled by any of them (except for certain international organisations, the list of which was introduced by the Decree of the Russian Government No. 119-R dated 3 February 2012), if such a transaction results in direct or indirect control over more than 25% of the votes represented by the shares in a strategic company or other ability to block decisions of the management bodies of such entity. At the same time, transactions aimed at the acquisition of control by a foreign state, international organisation or an organisation controlled by any of them over a Russian strategic company are prohibited under the Foreign Strategic Investments Law.



The Foreign Strategic Investments 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 Company if the counterparties to the deal are under the control of the Russian Federation or under the control of Russian individuals who are tax residents of the Russian Federation and who do not have citizenship of other countries.

Transactions where control is obtained over a strategic company in violation of the Foreign Strategic Investments Law are considered to be void under Russian law. Moreover, FAS may file a claim seeking to: (i) deprive a foreign investor of its right to vote at shareholders' meetings; or (ii) invalidate the decisions of the management bodies of such strategic company and invalidate the transactions entered into by such strategic company after control on such a company was acquired by a foreign investor.

If a foreign investor does not receive an approval after obtaining control over a strategic company, it must dispose of the strategic company's shares so as to bring its shareholding into compliance with the requirements of the Foreign Strategic Investments Law within three months of approval being refused. If a foreign investor fails to do so, an authorised state body may initiate court proceedings in order to deprive the foreign investor of its right to vote at shareholders' meetings. Similarly, if a foreign investor breaches, or systematically fails to comply with, obligations which are imposed on it in connection with an approval for the acquisition of control, an authorised state body may initiate court proceedings in order to deprive the foreign investor of its right to vote at shareholders' meetings.

### **Privacy and Personal Data Protection Regulation**

We are subject to Russian laws regarding privacy and the protection of our subscribers' personal data. Russian data protection legislation requires, as a general principle, that an individual must consent to the collection and processing of his/her personal data and must provide this consent before the data is used, except in certain cases provided for by the law. Consent must be given in writing and signed or evidenced in cases and according to the requirements prescribed by relevant laws and regulations. Further, any failure by us to protect our users' privacy and data may result in an administrative fine of between 5,000 and 10,000 rubles. However, federal law provides certain exceptions. For example, on 10 August 2010 amendments to the Federal Law "On Enforcement Proceedings" and the Federal Law "On Court Bailiffs" entered into force, pursuant to which bailiffs have received the right to request personal data if it is necessary for the purposes of enforcement proceedings. Pursuant to these amendments, on 11 May 2011 we, VimpelCom and MTS entered into an agreement with the Federal Bailiff Service, according to which, upon a request of the state authority, we will provide them with certain personal data with respect to our subscribers who, pursuant to a definitive judgment, have been determined to owe the state authority money.

In July 2011, amendments to the personal data protection law aimed at increasing regulatory oversight over data protection were introduced. According to these amendments, we are now directly liable for the actions of third parties to whom we forward personal data for processing. We are also obliged to publish our data protection policies and use certified information protection facilities. In May 2012 the Federal Security Service of the Russian Federation prepared and published a draft regulation of the Government of the Russian Federation which is intended to detail new standards to be implemented under the law. Once adopted, the relevant regulation will introduce security levels for different types of personal data and detail the standards of protection for each level. In addition, in May 2012 the Ministry of Economic Development and Trade of the Russian Federation prepared and published a draft law to be introduced to the State Duma on behalf of the Government of the Russian Federation proposing (i) to increase administrative fines for violations of regulations on the processing of personal data to up to 2% of total income for the past year; (ii) extend the statute of limitation for administrative proceedings for the above violation from three months to one year; and (iii) grant Roscomnadzor powers to initiate administrative proceedings on the grounds of the above violation and consider respective cases. See "Risk factors—Risks Relating to our Business and Industry—Any failure to comply with laws on protection of subscribers' personal data as well as security breaches of our subscriber database could result in adverse publicity, as well as civil and criminal proceedings which could negatively impact our business".

## MANAGEMENT AND CORPORATE GOVERNANCE

### Governance Bodies

In accordance with the Joint Stock Companies Law and OJSC MegaFon's charter, OJSC MegaFon's principal governance bodies are the General Shareholders' Meeting, the Board of Directors, the Management Board and the General Director. Also, we have a number of committees of the Board of Directors with specialised functions. In addition, we are required to maintain a Revision Commission as a matter of Russian law.

### *General Shareholders' Meetings*

#### *Powers of the General Shareholders' Meeting*

The powers of a General Shareholders' Meeting are set forth in the Joint Stock Companies Law and in our Charter. A General Shareholders' Meeting may not decide issues that are not included in the list of its powers under the Joint Stock Companies Law and the Charter. Among others, the shareholders have the power to decide on:

- amendments to the Charter;
- the re-organisation or liquidation of the company and the appointment of the liquidation commission, and approval of interim and final liquidation balances;
- election of members of the Board of Directors and early termination of the tenure of the Board of Directors, approval of the amount of remuneration payable to members of the Board of Directors and/or the procedure for reimbursement of expenses to members of the Board of Directors;
- determining the number, nominal value and class/type of the authorised shares and the rights attached to such shares;
- increasing share capital by increasing the nominal value of shares or issuing additional shares;
- decreasing share capital by decreasing the nominal value of shares or reducing the number of shares, including by way of share repurchases or cancellations;
- the appointment and early termination of the tenure of the General Director and members of the Management Board and determination of the term of office of the General Director;
- the appointment and early termination of the tenure of the members of the Revision Commission and approval of the amount of remuneration and compensation payable to the members of the Revision Commission;
- the appointment of the external auditor;
- the approval of certain interested party transactions and major transactions;
- distribution of profits, including approval of dividends (provided that, under the Dividend Policy, the amount of any dividend cannot exceed the amount recommended by the Board of Directors);
- redemption of issued shares in circumstances provided for by the Joint Stock Companies Law;
- participation in financial and industrial groups, associations and other types of commercial organisations;
- approval of annual reports and financial statements;
- splitting and consolidation of our share capital;
- determining General Shareholders' Meeting procedure;
- approval of certain internal documents and regulations; and
- any other matter which, according to the Joint Stock Companies Law and the Charter, is within the powers of the General Shareholders' Meeting.

#### *Voting and Quorum*

Voting at a General Shareholders' Meeting is generally based on the principle of one vote per ordinary share, with the exception of the election of the Board of Directors, which is carried through cumulative voting. Decisions are generally passed by a majority vote of the ordinary shares present at a General Shareholders'

Meeting. However, Russian law requires a three-quarter majority vote of the ordinary shares present at a General Shareholders' Meeting to approve, *inter alia*, the following:

- charter amendments;
- re-organisation or liquidation of the Company and the appointment of the liquidation commission, and approval of interim and final liquidation balances;
- major transactions involving assets in excess of 50% of the balance sheet value of the assets of the company;
- determination of the number, nominal value and type of authorised shares and the rights attached to such shares;
- repurchase of issued shares in cases provided for by the Joint Stock Companies Law;
- any issuance of shares or securities convertible into ordinary shares by closed subscription;
- issuance by open subscription of ordinary shares or securities convertible into ordinary shares, in each case, constituting more than 25% of the number of ordinary shares outstanding at the time;
- decrease of share capital by means of change of the nominal value of shares;
- application to the FSFM with request to be exempted from disclosure obligations provided for by the laws of the Russian Federation.

The quorum requirement for our General Shareholders' Meeting is met if shareholders' (or their representatives) accounting for more than 50% of the issued ordinary shares are present. If the 50% quorum requirement is not met, another General Shareholders' Meeting with the same agenda may (and, in case of an annual General Shareholders' Meeting, must) be scheduled and the quorum requirement will be satisfied if shareholders' (or their representatives) accounting for at least 30% of the issued ordinary shares are present at that meeting.

The Board of Directors must convene the annual General Shareholders' Meeting between 1 March and 30 June of each year, and the agenda must include the following items:

- election of the members of the Board of Directors;
- approval of the annual report and the annual financial statements, including the balance sheet and profit and loss statement;
- approval of distribution of profits, including approval of annual dividends (if any);
- election of the Management Board;
- approval of an independent auditor; and
- election of the members of the Revision Commission.

A shareholder or group of shareholders owning in the aggregate at least 2% of the issued ordinary shares may introduce proposals for the agenda of the annual General Shareholders' Meeting and may nominate candidates for the Board of Directors and the Revision Commission. According to the Charter, any agenda proposals or nominations must be provided to the company no later than 30 days after the preceding financial year-end.

Under the Joint Stock Companies Law, certain shareholders' resolutions relating to a company's re-organisation, an increase or decrease of share capital or a splitting or consolidation of shares may provide that they only remain valid for a specific period of time (the "**Validity Period**"). However, in the event such shareholders' resolutions are not acted upon within the Validity Period and/or the effective Validity Period for such resolutions has expired, such resolutions become null and void; and subject to provisions of the Joint Stock Companies Law, are no longer enforceable.

Extraordinary General Shareholders' Meetings may be called by the Board of Directors on its own initiative, or at the request of the Revision Commission, the independent auditor or a shareholder or group of shareholders owning in the aggregate at least 10% of the issued ordinary shares as of the date of the request.

A General Shareholders' Meeting may be held in a form of a meeting or by absentee ballot. In a meeting, the adoption of resolutions is carried out through the attendance of the shareholders or their authorised representatives for the purpose of discussing and voting on issues of the agenda. However, shareholders can also participate in a meeting that is physically convened without personally attending the meeting provided that the ballot is mailed to shareholders in advance, and such ballot is completed and mailed back to the Company by the shareholder. In addition, General Shareholders' Meeting can also be held by absentee ballot, where the company collects ballots completed and mailed to it by its shareholders; in such cases no physical meeting is held.

The following issues cannot be decided by a General Shareholders' Meeting by absentee ballot:

- election of the members of the Board of Directors;
- election of the Revision Commission;
- approval of the independent auditor; and
- approval of the annual report, the annual financial statements, including balance sheet, profit and loss statement, and any distribution of profits, including approval of annual dividends (if any).

### *Notice and Participation*

Under the Joint Stock Companies Law, all shareholders entitled to participate in a General Shareholders' Meeting must be notified of the meeting, whether the meeting is to be held in a form of a meeting or by absentee ballot, not less than 20 days prior to the date of the meeting, and such notification shall specify the agenda for the meeting. Such notice period is extended to 30 days if the agenda of the meeting contains an item on re-organisation, or if the meeting is the annual shareholders' meeting of a company listed on a Russian stock exchange (as the charter of such a company is required to provide for such extended notice period). However, if the meeting in question is an extraordinary General Shareholders' Meeting to elect the Board of Directors or to approve any re-organisation in the form of a merger, spin-off or demerger, shareholders must be notified at least 70 days prior to the date of such a meeting. Only those items that were set out in the agenda sent to shareholders may be voted upon at a General Shareholders' Meeting. A General Shareholders' Meeting is not entitled to change its agenda.

The list of persons entitled to participate in a General Shareholders' Meeting is to be compiled on the basis of data in our shareholders' register on the date determined by the Board of Directors, which date shall neither be earlier than the date of adoption of the resolution to hold a General Shareholders' Meeting nor more than 50 days before the date of the meeting (or, in the case of an extraordinary General Shareholders' Meeting to elect the Board of Directors, not more than 85 days before the date of such General Shareholders' Meeting).

Shareholders may exercise their right to participate in a General Shareholders' Meeting by:

- personal attendance;
- attendance of a duly authorised representative (by proxy);
- absentee ballot; or
- delegating the right to fill out the absentee ballot to a duly authorised representative.

### ***Board of Directors***

#### *Composition of the Board of Directors*

The Board of Directors is responsible for general management matters, with the exception of those matters that are designated by law and OJSC MegaFon's charter as being the exclusive responsibility of the General Shareholders' Meeting.

The Joint Stock Companies Law requires at least a five-member Board of Directors for all joint stock companies, at least a seven member Board of Directors for a joint stock company with more than 1,000 holders of ordinary shares, and at least a nine member Board of Directors for a joint stock company with more than 10,000 holders of ordinary shares. According to our Charter, our Board of Directors consists of seven members. Only natural persons (as opposed to legal entities) are entitled to sit on the Board of Directors. Members of the Board of Directors are not required to be our shareholders. Our Charter prohibits members of our Board of Directors from acquiring shares, participatory interests or other securities in competitors, as well as prohibiting them from being elected to the management bodies of our competitors, without prior written consent from the Board of Directors.

The Charter provides that the entire Board of Directors must be elected at each annual General Shareholders' Meeting and that the Board of Directors is elected through cumulative voting. Under cumulative voting, each shareholder may cast an aggregate number of votes equal to the number of shares held by such shareholder multiplied by the number of persons on the Board of Directors, and each shareholder may give all such votes to one candidate or distribute them among two or more candidates. Thus, in our case, a shareholder will be able to guarantee the election of a director for, approximately, every 12.5% plus one share that it owns. Our current

Board of Directors was elected at the General Shareholders' Meeting on 24 May 2012. Pursuant to the Voting Agreement, AF Telecom has nominated three candidates to the Board of Directors and the TeliaSonera Group has nominated three candidates to the Board of Directors. It is intended that, as long as it retains 25% plus one share in our share capital, the TeliaSonera Group will also have two representatives on the board following the Offering, which may be more than provided to TeliaSonera Group by virtue of its shareholding under Russian law. See "Risk Factors—Risks Relating to our Recent Shareholder Re-organisation—Disagreements among our shareholders might hinder the timely management of OJSC MegaFon". We understand that the current intention of our shareholders is that in due course following the Offering, in addition to TeliaSonera Group's two representatives, our Board of Directors will consist of three AF Telecom representatives and two independent non-executive directors. Each of TeliaSonera and AF Telecom will have the right to nominate one of these independent directors.

A majority vote of a General Shareholders' Meeting may at any time remove the directors as a group before the expiration of their term, without cause. Our regulation on the Board of Directors also entitles members of the Board of Directors to voluntarily resign in which case the Board of Directors must convene a General Shareholders' Meeting for election of the new Board of Directors. Directors may be re-elected an unlimited number of times.

The Board of Directors elects the Chairman of the Board of Directors from its members and has the right to remove its chairman at any time. However, our General Director may not be elected as the chairman of the Board of Directors. The chairman of our Board of Directors organises its work, calls and presides over meetings of the Board of Directors and performs other functions provided for by Russian law, the Charter and our internal documents. The chairman of our Board of Directors also has the casting vote in the case of a tied vote.

#### *Powers of the Board of Directors*

The Joint Stock Companies Law generally prohibits the Board of Directors from acting on issues that fall within the exclusive authority of a General Shareholders' Meeting. Our Board of Directors has the power to perform the general management of the company, and to decide, among other things, the following issues:

- determination of our business priorities and developmental strategy;
- approval of our budget and significant amendments thereto;
- convening annual and extraordinary General Shareholders' Meetings, except in certain circumstances specified in the Joint Stock Companies Law;
- approval of the agenda of a General Shareholders' Meeting with a right to include additional questions in the agenda at its own discretion and determination of the record date which establishes the shareholders that are entitled to participate in a General Shareholders' Meeting;
- placement of bonds and other securities, in cases specified in the Joint Stock Companies Law;
- determination of the price of property and securities to be placed or repurchased, as provided for by the Joint Stock Companies Law;
- repurchase of shares, bonds and other securities in certain cases provided for by the Joint Stock Companies Law;
- determination of the amount of remuneration and compensation payable to our General Director and approval of the employment agreement with the General Director;
- recommendations to the General Shareholders' Meeting on the amount of remuneration and compensation to be paid to members of our Revision Commission;
- determination of the fees payable for the services of an independent auditor;
- recommendations to the General Shareholders' Meeting on the amount of any dividend payable on shares and the payment procedure thereof;
- the use of our reserve fund and other funds;
- approval of our internal documents (other than the Dividend Policy), except for those documents whose approval falls within the competence of the shareholders or our General Director;
- the creation and liquidation of branches and representative offices;



- approval of major and interested party transactions in the cases provided for by the Joint Stock Companies Law;
- submission for consideration by the General Shareholders' Meeting of major transactions (i.e. matters involving assets with a value of 25% to 50% of the value of our assets) where no consensus has been reached with regard to the approval thereof by our Board of Directors;
- approval of transactions with respect to any acquisition, disposal or option to dispose, directly or indirectly, of property (including property rights) the value of which (including an aggregate value of property which is the subject of a number of related transactions) or the amount of liabilities to be assumed by us under such transactions (or group of transactions) is over U.S.\$50,000,000 except when approval of such transactions falls within the competence of the General Shareholders' Meeting or is subject to approval by the Board of Directors as a major or interested party transaction;
- amending or cancelling the Dividend Policy;
- consideration and approval of the General Director's reports on current state of business;
- appointment of our share registrar;
- appointment and early termination of the heads of our branches upon the General Director's recommendation;
- approval of our participation (or termination of such participation) in other organisations except when it falls within the competence of the General Shareholders' Meeting;
- approval of decisions on share issuances and reports on the results of such share issuances; and
- any other matter which, according to the Joint Stock Companies Law and the Charter, is within the competence of the Board of Directors.

#### *Meetings: Voting and Quorum*

The Board of Directors meets as needed, and generally once a month, although it usually does not meet in August.

The Charter provides that a meeting of the Board of Directors generally has a quorum if at least half of the elected members of the Board of Directors are present at the meeting or have filed their voting ballots in case of absentee voting. Generally, a majority vote of the directors present at the meeting is required to adopt a decision.

Certain decisions require either the unanimous vote of all members of the Board of Directors (for example, major transactions with a value of 25% or more but equal to or less than 50% of our assets as reported under RAS must be approved unanimously by the Board or by a simple majority of the shareholders; major transactions with a value of more than 50% of our assets as reported under RAS must be approved by three quarters of the shareholders: for further details, see "Description of Share Capital and Certain Requirements of Russian Law—Certain Requirements of Russian Legislation—Major Transactions") or a majority vote of the disinterested and independent directors (for example, related-party transactions with a value of less than 2% of our assets must be approved by a majority of disinterested directors of the Board or, alternatively, if the number of disinterested directors renders the meeting inquorate, must be referred to disinterested shareholders for approval, and any related-party transactions with a value of 2% or more of our assets must be referred to our shareholders: for further details, see "Description of Share Capital and Certain Requirements of Russian Law—Certain Requirements of Russian Legislation—Interested Party Transactions").

In addition, some decisions require a three-quarter majority vote of the members of the Board of Directors. Any decision on the amendment or cancellation of the Dividend Policy requires the approval of at least six members of the Board of Directors.

#### *Members of the Board of Directors*

The name, qualifications and certain other information for each member of the Board of Directors of OJSC MegaFon are set forth below. The business address of each such person in his or her capacity as a director of OJSC MegaFon is 30 Kadashevskaya Embankment, Moscow, 115035, Russian Federation.

The Director listed below as an independent director has been determined to be independent by the Board of Directors in accordance with the U.K. Corporate Governance Code, as if it applied for this purpose.

<u>Name</u>	<u>Position</u>	<u>Date of Election</u>	<u>Expiry of Term</u>
Sergey Soldatenkov	Chairman, Director	May 2012	May 2013
Cecilia Edstrom	Director	May 2012	May 2013
David Erixon	Director	May 2012	May 2013
Tero Kivisaari	Director	May 2012	May 2013
Lars Nyberg	Director	May 2012	May 2013
Jan Rudberg	Independent Director	May 2012	May 2013
Vladimir Streshinsky	Director	May 2012	May 2013

- Sergey Soldatenkov* has been a member of the Board of Directors of OJSC MegaFon since May 2012. Mr Soldatenkov is a member of the Remuneration Committee. He was General Director of OJSC MegaFon from April 2003 to April 2012. He was previously the Vice President of United Company GROS, a role he held from 2002 to 2003. Prior to that, from 2000 to 2002, he was the Deputy CEO for Commercial Affairs, acting CEO, and then CEO at Petersburg Telephone Networks (since re-organised as North-West Telecom). From 1999 to 2000, he was the Deputy CEO of CJSC Telecominvest and from 1994 to 1999, he headed Delta Telecom. He has served as a member of the Board of Directors of CJSC North West GSM, our predecessor. He was also a member of the Board of Directors at CJSC Telecominvest, from 1997 to June 2012. Mr Soldatenkov holds a degree in Radio Engineering from the Leningrad Institute of Aviation Instruments. Mr Soldatenkov was nominated for appointment by AF Telecom.
- Cecilia Edström* has been a member of the Board of Directors of OJSC MegaFon since May 2012. Ms Edstrom is a member of the Audit Committee. She has been Senior Vice President and Head of Intergroup Communications and Strategy of TeliaSonera since May 2008. Previously, she was Senior Vice President and Head of Corporate Relations at Scania AB, where she held a number of senior positions since 1995. She started her career in corporate finance at SEB in 1989. She is also a member of the board of BE Group AB. Ms Edström holds a Bachelor of Science in Finance and Business Administration. Ms Edström was nominated for appointment by the TeliaSonera Group.
- David Erixon* has been a member of the Board of Directors of OJSC MegaFon since May 2012. He is a member of the Remuneration Committee and the Finance and Strategy Committee. Previously, he was Vice-President of Products and Consumer Experience at Yota Group and Global Brand Director at Vodafone Plc. Mr Erixon studied Media & Communication Science at Gothenburg University in Sweden and Information Systems at Kingston University in London. Mr Erixon is the co-founder of internationally renowned digital school Hyper Island and the design agency Doberman (based in Scandinavia). He is also the founder and currently a director and business advisor of David Erixon Limited. Mr Erixon was formally proposed by AF Telecom and the TeliaSonera Group.
- Tero Kivisaari* has been a member of the Board of Directors of OJSC MegaFon since April 2008. He is also a member of the Finance and Strategy Committee. Since May 2007 he has served as the President of TeliaSonera Eurasia, where he was previously Chief Financial Officer and Vice President. In September 2012 he was also appointed President of Mobility Services of TeliaSonera AB. Mr Kivisaari holds degrees from Helsinki University of Technology and Helsinki School of Economics and Business Administration. Mr Kivisaari was nominated for appointment by the TeliaSonera Group.
- Lars Nyberg* has been a member of the Board of Directors of OJSC MegaFon since May 2012. He is also Chairman of the Remuneration Committee. He has been President and Chief Executive Officer of TeliaSonera since 2007. He has been a member of the Board of Directors of DataCard Corporation since 2005 and of Autoliv Inc. since 2004 (where he has also served as Chairman since December 2011). Mr Nyberg has also been a member of the Board of Directors of the University of Stockholm since 2006, SNS since 2006, and the World Childhood Foundation since 2007. Until 2007, he was a member of the Board of Directors of Snap-On Tools Inc. and Micronic Laser Systems, and Chairman of the Board of Directors of IBS (International Business Systems). Previously, he held various managerial positions in Philips. Mr Nyberg graduated with a Bachelor of Science in Business Administration from Stockholm University. Mr Nyberg was nominated for appointment by the TeliaSonera Group.
- Jan Rudberg* has been a member of the Board of Directors of OJSC MegaFon since June 2010. He has been a Corporate Advisor since 2003 and is also Chairman of Hogia AB. He was previously the Executive Vice President of Telia AB, CEO of Tele2 AB, Executive Vice President of Nordbanken AB, CEO of Enator AB and CEO of Ericsson Information Systems Nordic. He founded Next Generation Broadcasting AB and was a

member of the Board of Directors until 2011. Mr Rudberg is a graduate of the Gothenburg School of Business Administration. He is also Chairman of the Audit Committee. Mr Rudberg was formally proposed by AF Telecom and TeliaSonera Group and is considered to be an independent director by OJSC MegaFon.

- *Vladimir Streshinsky* has been a member of the Board of Directors of OJSC MegaFon since June 2008. He is also Chairman of the Finance and Strategy Committee. He was the CEO of CJSC Telecominvest until July 2012, and is currently a director at the Kommersant publishing house, CJSC Telecominvest, Mail.ru Group Limited, LLC “Gamma RV”, UTH Russia Limited, New Media Technologies Capital Partners Limited and Garsdale Services Investment Limited. He is also the CEO of USM Advisors LLC and Garsdale Services Investment Limited, and a financial advisor at Metalloinvest Trading AG. In the period from 2006 to 2008 he was responsible for the formation of Metalloinvest, and has previously been a member of the Board of Directors of Metalloinvest Holding Company. From 2008 to 2010 and in 2007, he served as member of the Board of Directors of Coalco Development Limited. From 2008 to 2009, Mr Streshinsky was General Director of Coalco LLC. From 2000 to 2010 he was Executive Director and from 2010 to 2011 financial advisor at Coalco AG. In addition, from 2006 to 2007 he was Chief Executive Officer of CJSC “Gazmetal”. Mr Streshinsky graduated from the Moscow Institute of Physics and Technology in 1992. Mr Streshinsky was nominated for appointment by AF Telecom.

## ***Management Board***

### *Details of the Management Board*

The Management Board is a collegiate executive body responsible for our day-to-day management. Our regulation on the Management Board provides that the number of members of the Management Board is determined by the General Shareholders’ Meeting. The members of the Management Board shall be elected annually, and their powers shall be terminated, by the General Shareholders’ Meeting upon recommendation of the General Director. Currently, the Management Board consists of thirteen members. Under the Joint Stock Companies Law, not more than 25% of the members of the Board of Directors may serve as members of the Management Board. The authority of the Management Board includes, among other things:

- determination of the short-term objectives of our business policy;
- discussing our draft budget and exercising control over the execution of our budget;
- coordination and control over the business of the branches, representative offices and other autonomous subdivisions; and
- supervision of our Government relations, including ensuring compliance with Russian law and the timely production of information at the request of competent authorities.

Under our Management Board regulations, resolutions of the Management Board are taken by a majority vote of members of the Management Board present at the meeting.

The Management Board meets regularly. The General Director acts as the Chairman of the Management Board.

### *Members of the Management Board*

The name, qualifications and certain other information for each member of the management board are set forth below. The business address of each such person is 30 Kadashevskaya Embankment, Moscow, 115035, Russian Federation.

<u>Name</u>	<u>Position</u>	<u>Date of Election</u>	<u>Expiry of Term</u>
Ivan Tavrín	Chief Executive Officer	October 2012	May 2013
Evgeny Chermashentsev	Director, Corporate Business	October 2012	May 2013
Mikhail Dubin	Executive Director, Consumer Business	October 2012	May 2013
Valery Ermakov	Director, Regional Operations	October 2012	May 2013
Stanislav Frolov	Director, Kavkaz Operations	October 2012	May 2013

<u>Name</u>	<u>Position</u>	<u>Date of Election</u>	<u>Expiry of Term</u>
Anait Gasparian . . . . .	Director, Corporate Development	October 2012	May 2013
Alexander Grigoriev . . . . .	Director, Volga Operations	October 2012	May 2013
Pavel Korchagin . . . . .	Director, Central Operations	October 2012	May 2013
Konstantin Likhodedov . . .	Director, Stolichny Operations	October 2012	May 2013
Eduard Ostrovsky . . . . .	Advisor, Special Programs and Relations with State Authorities.	October 2012	May 2013
Alexey Semenov . . . . .	Director, North-West Operations	October 2012	May 2013
Anna Serebryanikova . . . . .	Director, Legal Affairs and Government Relations	October 2012	May 2013
Igor Shirokov . . . . .	Director, Infrastructure	October 2012	May 2013
Alexei Tyutin . . . . .	Director, Siberia Operations	October 2012	May 2013
Valery Velichko . . . . .	Director, Ural Operations	October 2012	May 2013
Gevork Vermishyan . . . . .	Chief Financial Officer	October 2012	May 2013
Yuri Zhuravel . . . . .	Director, Far East Operations	October 2012	May 2013

- *Ivan Tavrín* has been a member of the Management Board since 7 March 2012. He was First Deputy CEO of OJSC MegaFon until 20 April 2012 when he became the General Director and CEO of OJSC MegaFon. He graduated from Moscow State Institute for International Relations in 1998 with a diploma in law. Between August 2009 and January 2012, he was President of UTH Russia Limited, which he currently controls 50% of (the other 50% being controlled indirectly by Mr Alisher Usmanov). He has previously been the President of CJSC TV Service and CJSC Media-1 Management”, as well as a shareholder of Fairlie Holding & Finance Limited (the holding company for the NetByNet group of companies) from December 2009 to June 2011. Mr Tavrín is currently a director of MO-TV Holdings Limited, UTH Russia Limited, Media-One Holdings Limited, Mail.ru Group Limited and Kommersant Publishing House CJSC.
- *Evgeny Chermashentsev* has been a member of the Management Board since October 2012. He joined OJSC MegaFon in May 2012 as Adviser to the CEO and has been Director of Corporate Business of OJSC MegaFon and a CEO of CJSC Synterra since August 2012. From 2009 to 2012, he was General Director of LLC Vyberí Radio. From 2008 to 2009 he was also Director for Regional Development of Media 1 Management CJSC and worked in the field of management of media assets. From 2006 to 2007 he was General Director and Director for Development of RMG Media LLC. Mr Chermashentsev graduated from Saratov State University which was renamed Chernyshevsky Saratov State University in 1999.
- *Mikhail Dubín* has been a member of the Management Board since November 2010. In October 2012 he was appointed as Executive Director of Consumer Business. He joined OJSC MegaFon in July 2010 as the First Deputy General Director for Strategic Development. From 2009 to 2010, he was the Deputy General Director for OJSC AF Telecom Holding and CJSC Telecominvest. From 1999 to 2007, he was at Sberbank in various positions dealing with project finance for telecommunications. Mr Dubín holds a degree in International Economics from the State Academy of Finance and a degree and a doctorate in Economics.
- *Valeriy Ermakov* has been a member of the Management Board since June 2009. In October 2012 he was appointed as Director of Regional Operations; prior to that he served as the Chief Operating Officer of OJSC MegaFon. From 2001 to 2009 he served as General Director of OJSC MSS-Povolzhie, at the time one of OJSC MegaFon’s operating subsidiaries. Mr Ermakov is also a Chairman of CJSC TT-mobile and a director of CJSC Aquafon-GSM. Mr Ermakov had previously spent six years at OJSC Tambov Telecommunications, attaining the position of Deputy General Director. Mr Ermakov graduated from the Tambov Institute of Chemical Machinery with a degree in Radio Engineering, Design and Production.

- *Stanislav Frolov* has been a member of the Management Board since October 2012. Mr Frolov joined the Head Office of OJSC MegaFon in 2012, and has been Director of Kavkaz Operations of OJSC MegaFon since September 2012. From 2011 to 2012 he was General Director of LLC Eurostroy, in which role he was the Technical supervisor over construction of telecommunication sites. In 2011 he also acted as Managing Director of Corporation for Development of the North Caucasus. From 2009 to 2010 he was Director of Federal State Unitary Enterprise (FSUE) Rostechinventarization, Federal Technical Inventory Bureau (TIB). In 2007 he was Deputy Head of the Department for Registration of Title to Land Plots in the Federal Registration Service Department for Moscow. Mr Frolov graduated from Voronezh State University in 1999 and from the All-Russian Extramural Institute of Finance and Economics in 2007.
- *Anait Gasparian* has been a member of the Management Board since October 2012. She was appointed as Director of Corporate Development at OJSC MegaFon in April 2012. From 2010 to 2012, she was the Director for Corporate Development for media holding UTH Russia. In 2009 she was Projects Lead on Operational Effectiveness in MC Euroset. From 2007 to 2008, she was at Renaissance Capital in a role dealing with Investment Banking, Consumer & Retail Group. Ms Gasparian holds a degree in Economics from the Saint-Petersburg State University.
- *Alexander Grigoriev* has been a member of the Management Board since June 2011 and is Director of Volga Operations. He joined OJSC MegaFon in April 2003 as Head of the IT Group of the Technical Operation Department of the Ulyanovsk office of MegaFon. In September 2005, he was transferred to the Central Office of the Volga Branch of MegaFon in the city of Samara to the position of Deputy Chief of the IT Department. In March 2009, he was appointed Chief of the IT Department, and a year thereafter, he was appointed as a First Deputy Director of the Volga Branch of MegaFon. Mr Grigoriev graduated from the Ulyanovsk State Technical University specialising in Computing Machines, Integrated Systems and Networks, and also holds a Masters degree in Dataware and Software of Automated Systems.
- *Pavel Korchagin* has been a member of the Management Board since November 2011 and is Director of Central Operations. From 2002 to 2003, he held the position of Technical Director followed by General Director of Volgograd Mobile CJSC. He became the Technical Director at Mobicom-Centre CJSC in 2003 and was appointed as First Deputy General Director of Mobicom-Centre CJSC in April 2007. After the re-organisation of MegaFon, he became the First Deputy General Director of the Central Branch of MegaFon beginning in July 2009. He was appointed as Director of the Central Branch in September 2011. Mr Korchagin had previously, from 1986 to 1992, been an engineer and research scientist in the Scientific and Research Institute for Special Purpose Machine Building in Moscow. From 1993 to 2002, he was a senior engineer and, later, the Head of the Department for Informatics and Automation of Bank Operations of Sberbank in Volgograd. Mr Korchagin graduated from the Bauman Moscow State Technical University with a degree in Automated Systems.
- *Konstantin Likhodedov* has been a member of the Management Board since October 2012 and is Director of Stolichny Operations. He joined OJSC MegaFon in June 2012. From January to May 2012 he acted as CEO of Disney Channel. From 2009 to 2011 he was CEO of 7TV. From August 2008 until August 2009 he was CEO of "Vyber Radio". In 2008 he was Deputy CEO of Channel MTV. In 2007 he acted as Deputy CEO of Channel TV3. Mr Likhodedov graduated from the Saint-Petersburg State University specialising in Economics.
- *Eduard Ostrovsky* has been a member of the Management Board since August 2002. In October 2012 he was appointed as Advisor on Special Programs and Relations with State Authorities. From June 2006 until October 2012, Mr Ostrovsky served as Deputy CEO for Government Relations and Implementation of Special Programmes. From 2002 to 2006, he acted as OJSC MegaFon's Deputy CEO for the Federal Subsystem of Confidential Mobile GSM Communication. From 1993 until 2002, he served as Deputy Communications Minister, Deputy Chairman of the State Telecommunications Committee, and Deputy Communications and Information Minister. Mr Ostrovsky graduated from the Ordzhonikidze Military College in Ulyanovsk and from the Military Communications Academy with a degree in Military Communications.
- *Alexey Semenov* has been a member of the Management Board since October 2012 and Director of North-West Operations since August 2012. From 2009 to 2012 he was Executive director of CJSC «TT mobile», a subsidiary of OJSC MegaFon in Tajikistan. From 2008 to 2009 he was Director of the additional office of the Mary El Republic of the Republic of Tatarstan branch office of OJSC "MCS-Povolzhie". Mr Semenov graduated from the State Economic Academy of Samara.
- *Anna Serebryanikova* has been a member of the Management Board since January 2009. She was appointed to the position of Director of Legal Affairs and Government Relations in October 2012. Previously, from



September 2008, she acted as General Counsel of OJSC MegaFon. She has also served as Corporate Secretary since 2007. She joined MegaFon in 2006 and became adviser to the General Director on international legal affairs. From 2004 to 2006 she was a lawyer at J. P. Galmond & Co. From 1998 to 2004, she was a senior legal consultant and head of department at the Non-Profit Foundation for Restructuring Enterprises under the Finance Ministry. Ms Serebryanikova graduated with honours from the Law faculty of Moscow State University and holds a Masters of Law degree from Manchester University.

- *Igor Shirokov* has been a member of the Management Board since October 2012. He joined OJSC MegaFon in June 2012 as Director of Infrastructure. From 2011 to present he has been Chairman of the Board of LLC Prominvest, which provides housing and community services. From 2010 to 2012 he acted as CEO of telecommunications company LLC «SpetsRadioService». From 2000 to 2004 and from 2005 to 2010 he was a CEO of LLC “KORUS Consulting”. Mr Shirokov graduated from Saint-Petersburg State University of Civil Aviation.
- *Alexei Tyutin* has been a member of the Management Board since June 2009 and is Director of Siberia Operations. He was appointed as General Director of CJSC Mobicom-Novosibirsk, OJSC MegaFon’s operating subsidiary in Siberia in April 2009. He joined OJSC MSS-Povolzhie in December 2001 as the head of the Corporate Finance department, and became Deputy General Director for Commercial Affairs at Mobicom-Novosibirsk, a subsidiary of OJSC MegaFon in Siberia, in 2004. Mr Tyutin holds degrees in Industrial and Civil Construction from the Mikoyan Kuibyshev Institute of Engineering and Construction and in Economic and Social Planning from the Samara Institute of Economics.
- *Valery Velichko* has been a member of the Management Board since June 2011 and is Director of Ural Operations. Previously, he was Deputy Director and Director of Security there. From 2006 to 2009, he was Director of Security at Urals GSM. Mr Velichko is a graduate of the Dzerzhinsky Higher Institute of Border Defence and the Ministry of Internal Affairs’ Special Police School in Bryansk.
- *Gevork Vermishyan* has been a member of the Management Board since November 2011. He was appointed as Chief Financial Officer of OJSC MegaFon in July 2011. From 2002 to 2007, he was at LUKOIL OJSC where he was promoted from the position of analyst to Deputy Head of Corporate Borrowings. From 2007 to July 2011, he was the Head of Corporate Debt at AFK Sistema. Mr Vermishyan graduated from the Financial University under the Government of the Russian Federation in the faculty of International Economic Relations.
- *Yuri Zhuravel* has been a member of the Management Board since June 2009 and is Director of Far East Operations. He was appointed as General Director of CJSC Mobicom-Khabarovsk, OJSC MegaFon’s operating subsidiary in the Far East region in October 2005. He joined MegaFon in 2003 as the Director of the Vladivostok Branch of CJSC Mobicom-Khabarovsk and subsequently became its First Deputy CEO in 2005. Mr Zhuravel graduated from the Red Banner Military Institute. He also holds an MBA degree from Salve Regina University, Rhode Island in the United States.

### **General Director**

Our General Director, Ivan Tavrin, is our chief executive officer and chairman of the Management Board, and is in charge of our day-to-day activities. The General Director exercises executive authority over all our activities, except for issues assigned to the exclusive authority of the General Shareholders’ Meeting, Board of Directors and the Management Board. Under the Charter, the General Shareholders’ Meeting elects the General Director, determines the term of his or her office and may at any time resolve to terminate his or her powers. The General Director acts on our behalf without a power of attorney; he/she may also be held liable for losses we experience.

Under the Charter, the powers of the General Director include, among other things, the following:

- operational management of our activities;
- development and submission to the Board of Directors of annual working plans, annual balance sheets, profit and loss accounts and other reporting documents;
- ensuring implementation of decisions of the General Shareholders’ Meetings and the Board of Directors,
- Approval of the estimated costs of preparing and conducting General Shareholders’ Meetings;
- submission of our budget and amendments thereto for approval by the Board of Directors;
- submission of reports on the current state of the budget, as well as the annual report, to the Board of Directors;

- providing the Board of Directors with information on our financial standing, performance of priority programmes, transactions and decisions that may significantly influence our operations;
- providing the Revision Commission and independent auditor with all necessary information on our financial and business activities;
- entering into transactions on our behalf, disposal of our property within the limits set out in his or her labour contract and/or Russian law except when it falls within the competence of the General Shareholders' Meeting or the Board of Directors;
- acting on our behalf without the need to obtain specific authorisation, representing us vis-à-vis public authorities, organisations, legal entities and third parties in general, opening bank accounts, and executing powers of attorney;
- coordination of work of our departments, and approval of administrative and organisation structure and staff schedules;
- execution of labour contracts with our employees, approval of employee benefit and compensation policy as well as approval of regulations on bonuses payable to our employees;
- approval of all our internal documents except when it falls within the competence of the General Shareholders' Meeting or the Board of Directors; and
- making decisions and issuing orders, regulations and other documents within his or her competence.

### *Committees of the Board of Directors*

We have also established the following committees of the Board of Directors:

#### *Audit Committee*

Our Audit Committee, consisting of three members who are also directors of OJSC MegaFon, oversees our financial reporting activity. The committee reviews, on an independent basis, the financial information provided by our management as well as the systems of internal controls that concern financial and accounting compliance. The committee also supervises our auditing, accounting and financial reporting processes more generally. The annual shareholders' meeting elects members of the Audit Committee until the next annual shareholders' meeting.

The current members of the Audit Committee are:

- Jan Rudberg (Chairman);
- Cecilia Edstrom; and
- Vladimir Streshinsky.

#### *Finance and Strategy Committee*

Our Finance and Strategy Committee, consisting of three members who are also directors of OJSC MegaFon, oversees our investment activity. The committee reviews and participates in the preparation of business and investment plans and acquisition processes relating to us and our subsidiaries. The committee also oversees compliance with company policies, procedures and practices. The annual shareholders' meeting elects members of the Finance and Strategy Committee until the next annual General Shareholders' Meeting.

The current members of the Finance and Strategy Committee are:

- Vladimir Streshinsky (Chairman);
- David Erixon; and
- Tero Kivisaari.

#### *Remuneration Committee*

Our Remuneration Committee, consisting of three members who are also directors of OJSC MegaFon, oversees our remuneration and human resources activity. The committee advises the Board of Directors on determining

base salary and other compensation for the General Director and the officers reporting directly to the General Director, and on establishing performance targets for top management and variable pay schemes for other employees. The committee also reviews our personnel policy and human resources processes including those relating to recruitment and benchmarking. The annual shareholders' meeting elects members of the Remuneration Committee until the next annual General Shareholders' Meeting

The current members of the Remuneration Committee are:

- Lars Nyberg (Chairman);
- Sergey Soldatenkov; and
- David Erixon.

### ***Revision Commission***

The principal duties of the Revision Commission are to ensure that our operations comply with applicable laws and our financial accounts under RAS do not contain any material misstatements. Our Revision Commission consists of three members.

The Revision Commission's role is mainly limited to reporting to the Board of Directors and our shareholders with respect to our RAS annual financial statements. In particular, opinions of the Revision Commission are provided to our shareholders before and during each annual General Shareholders' Meeting.

At the General Shareholders' Meeting members of the Revision Commission are elected for a term of one year. Members of the Board of Directors, Management Board and the General Director may not serve on the Revision Commission.

The Revision Commission is a statutory commission whose establishment is required under the Joint Stock Companies Law and is different from an audit committee of the Board of Directors for the purposes of the U.K. Combined Code. Accordingly, the scope of the authority of the Revision Commission under Russian law is significantly narrower than that of an audited committee under the U.K. Combined Code.

The current members of the Revision Commission are:

- *Pavel Kaplun (Chairman)*, Head of investment and analytical department at USM Advisors LLC;
- *Olli Ranta*, Finance Director at TeliaSonera Eurasia; and
- *Yuri Zheimo*, OJSC MegaFon's Director for Internal Audit.

### **Service and Employment Contracts**

We do not enter into service contracts with the members of our Board of Directors.

The members of our Management Board have entered into employment contracts with OJSC MegaFon, which set forth their compensation and contain standard terms and conditions (including as to severance and other benefits typically granted) in compliance with Russian law.

Other than certain payments representing rights accrued under the Long-Term Incentive Program, no benefits are payable upon termination to the members of the Board of Directors or the Management Board.

### **Compensation**

In 2011, the aggregate amount of remuneration paid (including contingent or deferred compensation), and benefits in kind granted, to the members of the Board of Directors and Management Board for services in all capacities provided to us was 767.7 million rubles.

### ***Long-term Incentive Program 2008***

In April 2008 our Board of Directors approved a long-term motivation and retention programme for certain key executive and senior level employees under which the parties selected to participate are awarded phantom share options. Under all grants, the value ascribed to the full package of phantom share options for which options may be awarded is 1.1% of the value of OJSC MegaFon, which in turn is calculated as six times operating income before depreciation and amortisation, reduced by debt, net of cash and cash equivalents, short-term investments

and long-term deposits. The awarded share options vest every two years over a four-year period and are contingent upon the recipient's continuing employment with OJSC MegaFon (however, in certain circumstances, individuals who cease to be employed by us during the four-year period may retain the right to phantom shares previously accrued) and an increase in the value of OJSC MegaFon. The phantom share options are settled in cash upon vesting. Phantom share options have been awarded under the 2008, 2009, 2010 and 2011 grants in an aggregate amount of 17.479 million phantom share options.

### ***Long-term Incentive Program 2012***

On 29 October 2012, our Board of Directors approved a long-term motivation and retention programme for certain key executive and senior level employees under which the parties selected to participate are awarded phantom share options. In the aggregate, the value ascribed to the full package of phantom share options for which options may be awarded is 1.1% of the share capital of OJSC MegaFon (equal to 7,000,000 phantom shares) at the base price of U.S.\$17.86 per share. The plan has a three-year duration and the awarded share options shall vest in April/May 2014 and 2015 and settle in cash upon vesting. Payments shall be made on the basis of the difference between the base price and the weighted average price of the GDRs in the period between 15 January and 15 March of the relevant year of vesting. Vesting of the options is contingent upon the recipient's continuing employment with OJSC MegaFon (however, in certain circumstances, individuals who cease to be employed by us during the three-year period may retain the right to phantom shares previously accrued).

### ***Ivan Tavrín's Long-term Incentive Plan***

Mr Tavrín has agreed to purchase from our subsidiary, MICL, a 1.25% interest (7,750,000 shares as at the date hereof) in us at the Offer Price within 30 days of Admission. Mr. Tavrín will also be given an option to buy up to a further 1.25% interest in us on each of his employment anniversary dates in May 2013, May 2014 and May 2015 (also at the Offer Price). The options can be exercised, in whole or in part, on those dates or subsequently. Any unexercised portion of the options will continue to be capable of being exercised in whole or in part until they lapse in May 2017. Their exercise will be subject to certain conditions as follows:

- Mr Tavrín's continued employment with us;
- Mr Tavrín holding at least a 1.25% interest in us on the relevant exercise date.

The strike price of the options will be subject to potential adjustment at the discretion of our Board of Directors in case we declare a special dividend or a dividend that materially exceeds the contemplated dividend policy. Mr Tavrín will agree not to hold more than 5% of our authorized share capital at any time prior to May 2017.

### **Management Shareholdings**

No members of the Board of Directors or the Management of OJSC MegaFon owned any of our ordinary shares as at the date hereof. As far as we are aware, no members of the Board of Directors or the Management Board of OJSC MegaFon intend to subscribe for Securities in the Offering.

### **Employees**

As of 31 December 2009, 2010 and 2011, and 30 September 2012, we had 20,367, 27,487, 33,163 and 33,678 full-time employees working for our company and our subsidiaries, respectively. The growth in the number of our employees is mostly a result of our organic growth.

The following table breaks down, as of 31 December 2009, 2010 and 2011, and as of 30 September 2012, the number of full-time employees working for our company in different functional areas:

<b>Function</b>	<b>As of 31 December</b>			<b>As of 30 September</b>
	<b>2011</b>	<b>2010</b>	<b>2009</b>	<b>2012</b>
Management .....	255	204	177	253
Commercial .....	18,241	15,106	10,105	19,227
IT .....	1,857	1,198	939	1,341
Technical Development .....	5,457	4,171	3,517	5,390
Accounting and Finance .....	1,345	1,737	1,345	1,840
Administration .....	1,529	1,426	1,314	1,224
HR .....	567	406	250	553
Other areas .....	3,901	3,239	2,720	3,850
<b>Total</b> .....	<b>33,163</b>	<b>27,487</b>	<b>20,367</b>	<b>33,678</b>

We do not offer any pension schemes to our employees. However, we offer bonuses to our employees based on the achievement of business targets and individual targets.

We have not experienced any work stoppages and consider relations with our employees to be good. Fewer than 1% of our employees are members of trade unions.

### **Conflicts of Interest**

Some of our directors and the shareholders that nominated them have a range of business relationships outside the context of their relationship with us that could influence their decisions. Cecilia Edstrom, Tero Kivisaari and Lars Nyberg were nominated by TeliaSonera Group and hold various positions within the TeliaSonera Group. Vladimir Streshinsky was nominated by AF Telecom, and holds various positions within the AF Telecom Group and other entities that are affiliates of Mr Alisher Usmanov. Ivan Tavrinn holds certain positions within the AF Telecom Group and other entities that are affiliates of Mr Alisher Usmanov. As a result of the individuals named immediately above holding positions within such entities, a potential conflict of interest may arise (i) between their duties owed to us and their duties owed to such entities, and (ii) between their duties owed to us and their private interests arising from the positions they hold within such entities.

Other than as set out immediately above, there are no actual or potential conflicts of interest between the duties that any member of the Board of Directors or the Management Board owes to OJSC MegaFon and such member's private interests or other duties.

### **Litigation**

Subject to the exception noted below, at the date hereof, none of the members of our Board of Directors or our Management, for 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 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.

The exception noted above is that as a result of us being found administratively liable for a breach of antimonopoly laws relating to our pricing for roaming services (see “Risk Factors—Risks relating to our Business and Industry—Changes to the regulations concerning roaming tariffs may adversely affect our business”), our then General Director, Sergey Soldatenkov, was held administratively liable as a result of his position as Chairman of the Management Board which established the pricing for these roaming services and was fined 20,000 rubles. We are currently appealing this finding of administrative liability.



In September 2012, the anti-corruption unit of the Swedish Prosecuting Authorities initiated an investigation, and the Swedish police collected information from the TeliaSonera Group regarding its investment in Uzbekistan and in connection with its acquisition of Ucell and related 3G licence, frequencies and number series in 2007. The investigation relates to allegations of corruption and money laundering in respect of payments by an affiliate of the TeliaSonera Group to the company from whom the TeliaSonera Group acquired its interests in such 3G licence, frequencies and number series in 2007. In this work of collecting information, the Swedish police have been questioning Tero Kivisaari, who was the Head of Business Area Eurasia at the time of the acquisition (a role he continues to hold as at the date of this document), and he is, as a representative of TeliaSonera Group, under investigation in respect of such allegations.

### **Russian Corporate Governance Requirements**

As at the date hereof, OJSC MegaFon is in compliance with the corporate governance requirements of applicable Russian law.

## TRANSACTIONS WITH RELATED PARTIES

*The following is a description of our most significant transactions with related parties for the years ended 31 December 2011, 2010 and 2009, the nine months ended 30 September 2012 and 2011, and for the period from 30 September 2012 to the date hereof. For further details of these transactions see Note 23 to the Audited Consolidated Financial Statements as of and for the year ended 31 December 2011, 2010 and 2009.*

In the ordinary course of our business, we have engaged, and continue to engage, in transactions with parties that are under common control with us or that are otherwise related parties. Transactions with entities under common control with us constitute transactions with parties that have the same beneficial owners as OJSC MegaFon, or who are also members of OJSC MegaFon's board of directors. See "Principal and Selling Shareholders—Changes in Shareholding Structure and Ultimate Beneficial Owners". Other than transactions with entities under common control described herein, we did not engage in any transactions with members of OJSC MegaFon's board of directors during the period under review.

In 2011, 2010 and 2009 and the nine months ended 30 September 2012, the aggregate revenues from related party transactions were less than 0.2% of our consolidated revenues for those periods. We seek to conduct all transactions with entities that are under common control or otherwise constitute related parties on market terms and in accordance with relevant Russian and other legislation. However, there can be no assurance that any or all of these transactions have been or will be conducted on market terms. See "Risk Factors—Risks Relating to Taxation in the Russian Federation—New Russian transfer pricing rules may subject our transfer prices to challenge by the Russian tax authorities" and "Risk Factors—Risks Relating to our Business and Industry—We engage in interested party transactions that our shareholders could contest or that may be concluded on terms not determined by market forces".

Significant transactions with related parties for the years ended 31 December 2011, 2010 and 2009 and the nine months ended 30 September 2011 and 2012 are set out below. The transactions with Altimo, AlfaStrakhovanie and Alfa Bank, members of Alfa Group who held a 25.1% interest in OJSC MegaFon through its member subsidiary Allaction Limited are presented until 24 April 2012, when Allaction Limited ceased to hold any shareholding in OJSC MegaFon and ceased to be a related party.

### Roaming and Interconnection Agreements

As part of our business, we enter into interconnection and roaming agreements with other fixed-line and wireless operators for the provision and purchase of services. Some of these operators are related parties, principally, the TeliaSonera Group.

We received revenues from the TeliaSonera Group in the amount of 235 million rubles, 290 million rubles and 295 million rubles for the years ended 31 December 2011, 2010 and 2009, respectively, and 232 million rubles and 144 million rubles for the nine months ended 30 September 2012 and 2011, respectively. In addition, we incurred cost of revenues from the TeliaSonera Group of 954 million rubles, 1,191 million rubles and 863 million rubles for the years ended 31 December 2011, 2010 and 2009, respectively, and 711 million rubles and 464 million rubles for the nine months ended 30 September 2012 and 2011, respectively. These revenues and cost of services principally related to roaming agreements between us and members of the TeliaSonera Group located outside Russia and a wireline connection agreement with TeliaSonera International Carrier Russia.

### Services

The following table sets forth details of our operating expenses from related party transactions for the years ended 31 December 2011, 2010 and 2009 and the nine months ended 30 September 2012 and 2011.

	For the Year Ended 31 December			For the Nine Months ended 30 September	
	2011	2010	2009	2012	2011
	(millions of rubles)				
TeliaSonera Group .....	1	15	—	11	19
Alfa Group .....	155	71	25	264	11
AF Telecom Group .....	1,158	994	827	655	695
<b>Total operating expenses from related parties .....</b>	<b><u>1,314</u></b>	<b><u>1,080</u></b>	<b><u>852</u></b>	<b><u>930</u></b>	<b><u>725</u></b>

We entered into an agreement with CJSC Telecominvest, a member of the AF Telecom Group, for provision of legal and personnel services effective from April 2009. This agreement was renewed in 2010, 2011 and 2012. Our operating expenses from transactions with the AF Telecom Group also include amounts payable under the terms of a licensing agreement with CJSC Telecominvest for use of the trademark “MEGAFON”, in Latin characters. In addition, we purchased billing system (included in capital expenditures) and related support services (included in operating expenses) from PeterService, another member of the AF Telecom Group, in the amount of 2,013 million rubles, 1,759 million rubles and 1,465 million rubles during the years ended 31 December 2011, 2010 and 2009, respectively and 1,174 million rubles and 1,122 million rubles for the nine months ended 30 September 2012 and 2011, respectively.

Our operating expenses from transactions with the Alfa Group mainly related to an agreement with Altimo, a member of the Alfa Group, for the provision of legal and personnel services, which agreement terminated on 24 April 2012, and with AlfaStrakhovanie, another member of the Alfa Group, for the provision of employees' medical and health insurance in 2012.

### **Acquisitions**

In 2011, we acquired 100% of shares in Web Plus, a wireline operator, from CJSC Telecominvest for an aggregate consideration of 54 million rubles. See “Management’s Discussion and Analysis of Financial Condition and Results of Operations—Key Factors Affecting Results of Operations—Acquisitions and Strategic Partnerships”.

### **Miscellaneous**

We maintain bank deposit accounts with Alfa Bank, an affiliate of the Alfa Group. The amounts on deposit were 7,239 million rubles, 6,553 million rubles and 3,202 million rubles as of 31 December 2011, 2010 and 2009, respectively and 7,456 million rubles and 489 million rubles as of 30 September 2011 and 24 April 2012 (the point at which Alfa Group ceased to be a related party), respectively.

In June 2012, we paid U.S.\$43.6 million (equivalent to 1,431 million rubles at the exchange rates as of the payment dates) in full and final settlement of all contingent consideration liability for the NetByNet acquisition. A portion of this liability has been paid to a company the beneficiary of which is our current CEO, Mr Tavrin. Mr Tavrin was not a related party of ours at the time that we acquired NetByNet in June 2011. See “Management and Corporate Governance—Governance Bodies—Management Board”.

In February 2012, we entered into an MVNO agreement with Yota, for the use of its LTE/4G network in the Russian Federation. In March and April 2012, we prepaid Yota an aggregate amount of \$50 million (1,546 million rubles at the exchange rate as of 30 September 2012) for the provision of future interconnection services under the MVNO agreement. By virtue of the Shareholder JVA (as defined in “Business—Certain Contracts and Projects Relating to the Operation of our Business—Yota MVNO Agreement”), starting from July 2012, both we and Yota became indirect subsidiaries of Garsdale Services Investment Limited. As a result, Yota became a related party of ours. Before this point, Yota was not one of our related parties. The MVNO agreement we entered into with Yota in February 2012 does not qualify as a related party transaction as it was executed at a time when Yota and we were not related parties. Until Yota ceases to be a related party, any future agreement with Yota, or modifications of the pre-existing MVNO agreement, would be treated as a related party transaction.

From May 2011 until March 2012, CMT, one of the significant companies in the VAS Media group, was one of our related parties. Cost of revenues for the year ended 31 December 2011 were 491 million rubles and for the three months ended 31 March 2012 were 90 million rubles related to services we received from CMT.

Also at the time of our acquisition of the VAS Media group of companies in September 2012, a member of our Board of Directors and the spouse of a member of our Group management beneficially owned in aggregate approximately 13% of the shares of the holding company of the VAS Media Group. In addition, at the time of that acquisition, other sellers of significant interests in the holding company of the VAS Media Group were persons who have from time to time been associates of AF Telecom. The transaction was unanimously approved by our board and was concluded based on market terms. Please see “Management’s Discussion and Analysis of Financial Condition and Results of Operations—Key Factors Affecting Results of Operations—Acquisitions and Strategic Partnerships”.

For the year ended 31 December 2011 and for the eight months ended 31 August 2012 (until consolidation of VAS Media Group's results from 1 September 2012 following its acquisition) our costs of revenues were 2,518 million rubles and 2,582 million rubles, respectively related to services we received from the VAS Media Group of companies.

In addition, we expect to enter into an agreement to acquire an indirect 25% stake in Euroset. See "Management's Discussion and Analysis of Financial Condition and Results of Operations—Key Factors Affecting Results of Operations—Acquisitions and Strategic Partnerships—Euroset". If this transaction is successfully completed, Euroset, which is not currently a related party, will become one of our related parties. Until this occurs, the dealership agreement that we entered into with Euroset on 1 January 2011 does not qualify as a related party transaction. However, should Euroset become our related party (and until it ceases to be), any future agreement with Euroset, or modification of the existing dealership agreement, would be treated as a related party transaction.

## PRINCIPAL AND SELLING SHAREHOLDERS

Our shareholders are not required to give us notice of transfers of our ordinary shares and we are only able to verify the exact status of our shareholdings by making a specific request of our independent registrar in connection with a matter requiring a shareholder vote. See “Description of Share Capital and Certain Requirements of Russian Law—Description of Share Capital—Registration and Transfer of Shares”.

### Shareholders

The following table sets out the shareholders of OJSC MegaFon as of 31 October 2012, according to OJSC MegaFon’s share register:

Shareholder	Before the Offering		After the Offering (assuming no exercise of the Over-allotment Option) <sup>(7)</sup>		After the Offering (assuming the Over- allotment Option is exercised in full) <sup>(7)</sup>	
	Number of ordinary shares	Shareholding <sup>(6)</sup>	Number of ordinary shares	Shareholding	Number of ordinary shares	Shareholding
<b>AF Telecom</b>						
Telecominvest Holdings						
Limited <sup>(1)(2)(3)</sup> . . . . .	300,699,700	48.4999%	●	●%	●	●%
CJSC Telecominvest <sup>(1)(3)</sup> . . . . .	9,300,300	1.50%	●	●%	●	●%
LLC AF Telecom						
Holding <sup>(1)(3)</sup> . . . . .	100	0.0000161%	●	●%	●	●%
<b>TeliaSonera Group</b>						
Sonera Holding B.V. <sup>(4)</sup> . . . . .						
LLC Kontakt-S <sup>(4)</sup> . . . . .	211,420,100	34.10%	●	●%	●	●%
	9,300,300	1.50%	●	●%	●	●%
<b>Our subsidiary</b>						
MegaFon Investments (Cyprus)						
Limited <sup>(3)(5)</sup> . . . . .	89,279,500	14.3999%	●	●%	●	●%

- (1) Wholly owned subsidiary of AF Telecom. AF Telecom is a wholly owned subsidiary of Garsdale. The ultimate beneficial ownership of Garsdale is split between Mr Alisher Usmanov (82%); Telconet (13.5%), control of which is split between Mr Sergei Adoniev (50%) and Mr Albert Avdolyan (50%); and Rostekhnologii (4.5%), an entity controlled by the Russian Government.
- (2) Telecominvest Holdings Limited has pledged 40,512,000 of our shares (which represents 6.53% of our outstanding share capital) to TeliaSonera AB (the “**Telecominvest Pledge**”). The Telecominvest Pledge secures the obligations of AF Telecom under the share sale and purchase agreement pursuant to which AF Telecom purchased the 26.1% stake in CJSC Telecominvest from TeliaSonera Group. See “—Changes in Shareholding Structure and Ultimate Beneficial Owners—April and May 2012 Shareholding Changes” below. In addition, Telecominvest Holdings Limited has pledged 209,560,400 of our shares (which represents 33.8% of our outstanding share capital) to Sberbank under certain loans which mature in December 2018 (the “**Sberbank Pledge**”). If enforced, the Telecominvest Pledge or the Sberbank Pledge could result in AF Telecom’s indirect shareholdings in us falling below the current 50% plus one hundred share threshold. For possible consequences of the enforcement of the Sberbank Pledge, see “Risk Factors—Risks Relating to the Securities and the Trading Market—Enforcement of the Sberbank Pledge and subsequent sale of the subject ordinary shares or GDRs could adversely affect our ordinary share and/or GDR price”.
- (3) Telecominvest Holdings Limited, CJSC Telecominvest, LLC AF Telecom Holding and MegaFon Investments (Cyprus) Limited are holding their shares via a nominee holder: Sberbank of Russia.
- (4) Wholly owned subsidiary of TeliaSonera AB, the parent company of the TeliaSonera Group. As at 30 September 2012 according to information from its website, the major shareholders of TeliaSonera AB are: the Swedish State (37.3% of the outstanding shares), the Finnish State (11.7% of the outstanding shares), and Capital Group Funds (3.1% of the outstanding shares). All other shareholders hold less than 3% of the outstanding shares.
- (5) Wholly owned subsidiary of OJSC MegaFon. The 89,279,500 shares have a face value of 8,927,950 rubles and a book value of 63,812 million rubles.
- (6) The percentages that appear in this table have been subject to rounding adjustments. As a result, the sum of the figures may not add up to 100%.



- (7) Under a long-term incentive plan, Mr Tavrín, our chief executive officer, has agreed to purchase from our subsidiary MICL, a 1.25% interest in OJSC MegaFon at the Offer Price within 30 days of Admission. Mr Tavrín will also be given options to buy up to a further 3.75% interest in OJSC MegaFon, subject to certain conditions. These options shall lapse in May 2017. For more information, see “Management and Corporate Governance—Compensation—Ivan Tavrín’s Long-Term Incentive Plan”.

None of our shareholders has any voting rights that are different from any other holders of our ordinary shares. Other than the Telecominvest Pledge and the Sberbank Pledge, we are not aware of any arrangements in place that may result in a change of control of OJSC MegaFon. See “Risk Factors—Risks relating to the recent shareholder re-organisation—The concentration of ownership of our ordinary shares with AF Telecom and TeliaSonera Group, and certain agreements between them which govern the composition of the board and our dividend policy will limit the ability of investors to influence corporate matters and these shareholders interests could conflict with those of the investors”. As far as we are aware, none of our major shareholders intend to subscribe for Securities in the Offering.

## **Changes in Shareholding Structure and Ultimate Beneficial Owners**

### *April and May 2012 Shareholding Changes*

On 24 April 2012, the then shareholders of OJSC MegaFon concluded a series of transactions (the “**Shareholder Transactions**”) pursuant to which:

- Allaction Limited, a company in the Alfa Group which as at that date held a 25.1% stake in OJSC MegaFon, sold (i) 10.7% of the share capital of OJSC MegaFon to Telecominvest Holdings Limited, an existing shareholder of OJSC MegaFon that is a wholly owned subsidiary of AF Telecom, for 47,416 million rubles; (ii) one ordinary share in OJSC MegaFon to LLC AF Telecom Holding, a wholly owned subsidiary of AF Telecom, for 71,474.49 rubles; and (iii) its remaining stake of 14.4% of the share capital of OJSC MegaFon to MICL for 63,883 million rubles; and
- the TeliaSonera Group sold the 26.1% stake it then held in CJSC Telecominvest (which at the time held a 31.3% direct interest in our outstanding share capital directly), one of the shareholders of OJSC MegaFon, to AF Telecom, as a result of which AF Telecom became the sole owner of CJSC Telecominvest;

In addition, on 11 May 2012 OJSC MegaFon resolved to decrease the charter capital by way of acquiring two of its own issued ordinary shares and MICL agreed to sell two such shares (which it had previously acquired from Allaction Limited) (the “**Share Redemption**”), with those ordinary shares to be cancelled upon completion of the Share Redemption. The Share Redemption was completed on 19 July 2012.

Accordingly, as at the date hereof, we are owned by two principal shareholders:

- AF Telecom, which currently owns 50.0% plus one hundred ordinary shares of our share capital following the Share Redemption. AF Telecom is owned by Garsdale, which is ultimately controlled by Mr Alisher Usmanov, who has interests in the metals, mining, internet and media fields; and
- the TeliaSonera Group, which owns 35.6% of our ordinary shares.

The remaining 14.4% of our share capital is held by MICL.

In connection with the Shareholder Transactions, on 24 April 2012, we also paid a dividend to our shareholders of 151,863 million rubles. See “Management’s Discussion and Analysis of Financial Condition and Results of Operations—Recent Developments” and “Management’s Discussion and Analysis of Financial Condition and Results of Operations—Liquidity and Capital Resources—Distributions to Shareholders”. For a discussion of certain issues relating to the beneficial ownership of our company, see “Risk Factors—Risks Relating to the Recent Shareholder Re-organisation—The concentration of ownership of our ordinary shares with AF Telecom and TeliaSonera Group, and the Voting Agreement between them which governs the composition of the board and our dividend policy will limit the ability of investors to influence corporate matters and these shareholders’ interests could conflict with those of the investors”.

In addition, in connection with the Shareholder Transactions, on 24 April 2012 Sonera Holding B.V, Telecominvest Holdings Limited and MICL entered into an agreement pursuant to which Telecominvest Holdings Limited and MICL shall, subject to certain exceptions, have the right of first offer (“**ROFO**”) if the

TeliaSonera Group proposes to transfer any of its ordinary shares in OJSC MegaFon to any third party, where that third party would acquire, along with its affiliates and parties with whom it is acting in concert, at least 10% of the shares in OJSC MegaFon. The ROFO shall cease to be exercisable on the earliest of: (i) the fifth anniversary of the IPO; (ii) the date on which Telecominvest Holdings Limited and its affiliates no longer own or control more than 25% of the issued share capital of OJSC MegaFon; (iii) the date on which Telecominvest Holdings Limited and its affiliates no longer hold more shares in OJSC MegaFon than any other shareholder of OJSC MegaFon; and (iv) 31 December 2019.

### ***AF Telecom Shareholder Arrangements***

On 27 April 2012, the shareholders of AF Telecom (“**AF Party**”) and the shareholders of Yota Holding (“**Yota Party**”) entered into the Shareholder JVA, according to which their shareholdings in AF Telecom and Yota, respectively, were contributed to a newly incorporated joint venture company, Garsdale. As a result of this transaction, Garsdale holds 100% of the shares in AF Telecom, and 99% of the shares in Yota. As at the date hereof, AF Party and Yota Party hold 82% and 18% of the shares of Garsdale, respectively.

According to the Shareholder JVA, the board of directors consists of up to seven members, with AF Party entitled to appoint up to six nominees to Garsdale’s board of directors. In addition, the Chairman and the CEO are appointees of AF Party. The Garsdale board makes decisions on a simple majority basis.

AF Party controls Garsdale with respect to matters concerning MegaFon, with the exception of the limited matters listed below, for which unanimous agreement between AF Party and Yota Party is required:

- changes in nature or scope of the business of OJSC MegaFon or its subsidiaries (where “business” is broadly defined and includes telecommunications, Internet, media, content, services, technology and any retail or other business generally related thereto);
- winding up or liquidation of OJSC MegaFon or any restructuring of the Garsdale group that would reduce the Garsdale group’s holding in OJSC MegaFon.

See further “Risk Factors—Risks relating to the recent shareholder re-organisation—Disagreements among our direct and indirect shareholders might hinder the timely management of OJSC MegaFon”.

### ***Shareholder Restructuring***

Further to what has been reported in the media with respect to the ongoing re-organisation and consolidation of Mr Usmanov’s interests in internet, media, mining, steel and telecommunication assets into a new holding company together with the interests of his long term partners’ (Mr Vladimir Skoch’s and Mr Ardavan Farhad Moshiri’s) interests in Metalloinvest, a leading Russian iron ore producer, Mr Alisher Usmanov entered into a definitive shareholders’ agreement with these aforementioned long-term partners on [●] 2012. See “Shareholder Restructuring”.

### **Selling Shareholders**

The following table sets forth the names and business addresses of the shareholders who will be selling Securities in the Offering:

<u>Shareholder</u>	<u>Business Address</u>	<u>Total offered (assuming exercise of Over-allotment Option)</u>
Sonera Holding B.V. . . . . .	Rodezand 34 K, 3011AN, Rotterdam, The Netherlands	[●]
MegaFon Investments (Cyprus) Limited . . . . .	4 Afentrikas, Afentrika Court, Office 2, 6018, Larnaca, Cyprus	[●]
<b>Total</b> . . . . .		<u>[●]</u>

## SHAREHOLDER RESTRUCTURING

After the completion of the Offering, AF Telecom will continue to own more than 50% of the share capital of OJSC MegaFon. AF Telecom is wholly owned by Garsdale, which is ultimately controlled by Mr Alisher Usmanov. See “Principal and Selling Shareholders”.

Further to what has been reported in the media with respect to the ongoing re-organisation and consolidation of Mr Usmanov’s interests in internet, media, mining, steel and telecommunication assets into a new holding company, together with the interests of his long term partners (Mr Vladimir Skoch and Mr Ardavan Farhad Moshiri) in Metalloinvest, a leading Russian iron ore producer, Mr Alisher Usmanov has entered into a definitive shareholders’ agreement with these aforementioned long-term partners on [●] 2012.

### Purpose

The shareholders’ agreement regulates the future agreed interests of each party in the new holding company (“**USM Holdings Limited**”) as it will relate to, in turn: (i) the agreed interests of USM Holdings Limited in USM Telecom Holdings Limited; (ii) USM Telecom Holdings Limited’s agreed interest in Garsdale; and (iii) Garsdale’s interest in OJSC MegaFon. The shareholders’ agreement therefore regulates the future respective indirect interests of Mr Usmanov, Mr Skoch and Mr Moshiri in OJSC MegaFon. The terms of the shareholders’ agreement are intended to provide certainty with respect to these indirect interests, and, in particular, provide that Mr Usmanov will continue to control OJSC MegaFon, while Mr Skoch and Mr Moshiri will hold purely economic interests and exercise no control over management of OJSC MegaFon.

### Key Terms

Insofar as it relates, directly or indirectly, to OJSC MegaFon, the shareholders’ agreement provides as follows:

- Mr Usmanov will hold 100% of the voting rights with respect to USM Holdings Limited.
- The economic interest of Mr Usmanov in USM Holdings Limited will be 60%, of which a 10% economic interest in USM Holdings Limited may be allocated for the benefit of directors, officers, consultants, advisers and employees of USM Advisers Limited, a company indirectly controlled by Mr Usmanov, created to provide management services to USM Holdings Limited. Any allocation to such beneficiaries in the future will be at the discretion of Mr Usmanov and such beneficiaries will have no voting rights in respect of USM Holdings Limited.
- The economic interests of Mr Skoch and Mr Moshiri in USM Holdings Limited will be 30% and 10%, respectively. Mr Skoch and Mr Moshiri will have no voting rights or management influence with respect to USM Holdings Limited or OJSC MegaFon.
- USM Holdings Limited will own all except a single share in USM Telecom Holdings Limited. Mr Usmanov will, directly or indirectly, control that single remaining share, which will have special rights attached to it, enabling Mr Usmanov, directly or indirectly, to elect the majority of the Board of Directors of USM Telecom Holdings Limited.
- Mr Skoch and Mr Moshiri will not be permitted to transfer their interests in USM Holdings Limited without the consent of Mr Usmanov.
- Mr Skoch and Mr Moshiri will have no veto rights over the management of USM Holdings Limited or, for the avoidance of doubt, in USM Telecom Holdings Limited, as it relates, directly or indirectly, to OJSC MegaFon.
- The shareholders’ agreement provides that it will terminate upon certain actions being taken for the winding up or receivership of USM Holdings Limited.

Each of the parties to the shareholders agreement has separately represented and warranted to OJSC MegaFon that, upon the consummation of the restructuring, it will be holding its interests in USM Holdings Limited for its own account and not for the account of any other person.

While certain elements of this re-organisation may be subject to regulatory and banking review and consent, the parties to the shareholders’ agreement have undertaken that they will use their best efforts to structure the re-organisation such that the agreements included therein, in particular as regards effective control of OJSC MegaFon, are given effect to. We therefore do not expect the re-organisation to have any impact on the governance or control of OJSC MegaFon.

## DESCRIPTION OF SHARE CAPITAL AND CERTAIN REQUIREMENTS OF RUSSIAN LAW

We describe below our share capital, the material provisions of our Charter in effect at the date hereof and certain requirements of Russian law. This description, however, is not complete and is qualified in its entirety by reference to our Charter and any applicable Russian law. GDR holders will be able to exercise their rights with respect to the ordinary shares underlying the GDRs only in accordance with the provisions of the Deposit Agreement and the relevant requirements of Russian law. See “Terms and Conditions of the Global Depositary Receipts”.

### Corporate Purpose

Pursuant to Article 4.1 of our Charter, our primary purpose is to earn profit by providing telecommunication services and other business activities.

### Description of Share Capital

#### *General Matters*

Our company started as CJSC Northwest GSM, which was incorporated on 17 June 1993. In 2002 we were re-organised into an open joint stock company and renamed OJSC MegaFon.

Pursuant to the Joint Stock Companies Law, we have the right to issue registered ordinary shares, preferred shares and other securities. Under Russian law, share capital refers to the aggregate nominal value of the issued and outstanding shares. Our share capital currently consists of 620,000,000 issued, fully paid and outstanding ordinary shares, each with a nominal value of 0.1 rubles. In addition, we are authorised by the Charter to issue an additional 100,000,000,000 ordinary shares. No preferred shares are currently authorised or outstanding. Preferred shares may only be issued if amendments have been made to the Charter pursuant to a resolution of the our General Shareholders’ Meeting.

The Joint Stock Companies Law requires us to dispose of any of our treasury shares that we acquire within one year of their acquisition or, failing that, reduce our share capital by the respective amount. Russian legislation does not allow voting rights or payment of dividends in relation to treasury shares. Currently we do not have any treasury shares (as referred to herein). Any shares that are owned by our subsidiaries are not considered treasury shares under Russian law (i.e., they are considered outstanding shares), and such subsidiaries are able to exercise voting rights and receive dividends relating to such shares and dispose of such shares without the need for any further corporate actions by our shareholders or the Board of Directors. Thus, the shares that our subsidiary MICL currently holds in us (14.4% of our share capital as at the date hereof) are not considered treasury shares under Russian law.

#### *History of our share capital*

The following table sets forth the changes in our share capital that have occurred from the date of our incorporation to the date hereof.

<u>Date of event</u>	<u>Type of shares</u>	<u>Par value</u>	<u>Number of shares</u>	<u>Event</u>	<u>Current status</u>
15 March 1995	Ordinary shares	100 rubles	10,000	Distribution among the founders in relation to our incorporation	All shares of this share issue have been cancelled
17 July 1995	Ordinary shares	10,000 rubles	1,300,001	Closed subscription	All shares of this share issue were consolidated with other issues when the new state registration number was assigned on 16 September 2003
17 July 1995	Preferred shares	10,000 rubles	1,800,000	Closed subscription	All shares of this share issue were converted into Ordinary shares on 23 June 1997

<u>Date of event</u>	<u>Type of shares</u>	<u>Par value</u>	<u>Number of shares</u>	<u>Event</u>	<u>Current status</u>
23 June 1997	Ordinary shares	10,000 rubles	1,800,000	Conversion	All shares of this share issue were consolidated with other issues when the new state registration number was assigned on 16 September 2003
18 February 2002	Ordinary shares	10 rubles	3,100,001	Closed subscription	All shares of this share issue were consolidated with other issues when the new state registration number was assigned on 16 September 2003
16 September 2003	Ordinary shares	10 rubles	464	Closed subscription	The share issue was declared void
16 September 2003	Ordinary shares	10 rubles	6,200,002	Assignment of new state registration number	All shares of this share issue were converted into ordinary shares with nominal value of 0.1 rubles on 17 August 2012
19 July 2012	Ordinary shares	10 rubles	2	Share redemption by purchase of 2 shares held by MegaFon Investments (Cyprus) Limited	These two shares were redeemed and are no longer outstanding.
17 August 2012	Ordinary shares	0.1 rubles	620,000,000	Share split of our ordinary shares with a split ratio of 1:100. As a result of the Share split, each our pre-split ordinary share was converted into 100 post-split ordinary shares.	The shares are outstanding.

### ***Rights Attaching to Ordinary Shares***

Holders of our ordinary shares have the right to vote at all General Shareholders' Meetings. As required by the Joint Stock Companies Law and the Charter, all of our ordinary shares have the same nominal value and grant to their holders identical rights. Each fully paid ordinary share, except for treasury shares, gives its holder the right to:

- freely transfer the ordinary shares without the consent of other shareholders;
- receive dividends;
- participate in General Shareholders' Meetings and vote on all matters within the competence of General Shareholders' Meetings;
- transfer rights to vote in a General Shareholders' Meeting to a representative pursuant to a power of attorney;
- if holding, alone or with other holders, 1% or more of the ordinary shares, to access the list of persons entitled to participate in the General Shareholders' Meeting and to sue in court, on our behalf, members of the Board of Directors, the General Director and members of the Management Board for damages incurred by us as a result of their wrongful actions or failures to act;
- if holding, alone or with other holders, 2% or more of the ordinary shares, within 60 days after the end of our fiscal year, make proposals for the annual General Shareholders' Meeting and nominate candidates to the Board of Directors and the Revision Commission;



- if holding, alone or with other holders, 10% or more of the ordinary shares, demand that the Board of Directors call an extraordinary General Shareholders' Meeting or an unscheduled audit by the Revision Commission;
- demand repurchase by us of all or some of the ordinary shares in the Company held by the shareholder if that shareholder voted against or did not participate in the voting on, the decision approving any of the following actions:
  - a corporate re-organisation,
  - the conclusion of a major transaction involving assets valued in excess of 50% of the balance sheet value of our assets; or
  - amendment to the Charter or the adoption of a new version of the Charter in a manner that restricts shareholders' rights;
- upon our liquidation, receive an amount of our residual assets (after fulfilment of our obligations to creditors) proportionate to their shareholding;
- have access to certain of our documents, receive copies for a reasonable fee, and if holding alone or with other shareholders, 25% or more of the ordinary shares, have free access to minutes of our Management Board and accounting documents; and
- exercise other shareholder rights, provided by our Charter, Russian legislation or duly approved decisions of General Shareholders' Meetings.

Any decision determining the maximum number, nominal value, category (i.e., type) of authorised shares and the rights attached to such shares must be approved by 75% of the shareholders holding ordinary shares participating in the General Shareholders' Meeting.

### ***Pre-emptive Rights***

We have the right to issue shares or securities convertible into shares by way of offering them to the public (an open subscription) or by way of offering them to our shareholders and/or certain third parties determined in the decision on share issuance (a closed subscription). The Joint Stock Companies Law provides existing shareholders with a pre-emptive right to purchase shares or securities convertible into shares issued through an open subscription in an amount proportionate to their existing shareholdings. In addition, the Joint Stock Companies Law provides our shareholders with a pre-emptive right to purchase new shares or securities convertible into shares issued through a closed subscription if the shareholders voted against or did not participate in the voting on the decision approving such subscription. Pre-emptive rights are not available in relation to a closed subscription to existing shareholders, provided that such shareholders may each acquire a whole number of shares (or securities convertible into shares) in proportion to their existing shareholdings. In both cases we must provide our shareholders with written notice of the proposed placement at least 45 days prior to the beginning of the placement period, during which time shareholders may exercise their pre-emptive rights. If the price of the new issue is determined after expiration of the pre-emptive right period, we must provide shareholders with written notice of the proposed placement at least 20 days prior to the beginning of the placement period, during which time shareholders may exercise their pre-emptive rights.

### ***Dividends***

The Joint Stock Companies Law and the Charter set out the procedure for determining the dividends that we distribute to our shareholders.

Under the Charter, we may declare dividends based on our first quarter, six-month, nine-month or annual results. Three quarters of the members of the Board of Directors present at a meeting must recommend the amount of the proposed distribution to a General Shareholders' Meeting, which must then approve such amount by a majority vote. This amount cannot be more than that recommended by the Board of Directors. A decision on quarterly, six-month and nine-month dividends must be taken within three months of the end of the respective quarter at a General Shareholders' Meeting; a decision on annual dividends must be taken at the annual General Shareholders' Meeting. We only pay dividends to shareholders entitled to participate in the shareholders' meeting that approved such dividends. See "Management and Corporate Governance—General Shareholders' Meetings—Notice and Participation". Dividends are not paid on treasury shares.

The Charter provides that the dividends shall be paid in cash except when other form is prescribed by a decision of the General Shareholders' Meeting.

On 8 June 2012 the Company's Board of Directors adopted a dividend policy. See "Dividend Policy" for further details.

The Joint Stock Companies Law allows dividends to be declared only out of net profits calculated under RAS and as long as the following conditions have been met:

- the share capital of the company has been paid in full;
- the company has repurchased all shares from shareholders who have exercised their right to demand repurchase;
- the company is not insolvent on the date of adoption of the decision to pay dividends (and would not become insolvent as a result of the proposed dividend payment);
- the value of the company's net assets, calculated under RAS, on the date of adoption of the decision to pay dividends is not less (and would not become less as a result of the proposed dividend payment) than the sum of the company's share capital, the company's reserve fund and the difference between the liquidation value and the nominal value of the issued and outstanding preferred shares of the company; and
- other requirements of Russian legislation have been fulfilled.

In addition, a Russian company is prohibited from paying dividends (even if they have been declared) if:

- the company is insolvent on the date of payment or would become insolvent as a result of the proposed dividend payment;
- the value of the company's net assets, calculated under Russian accounting standards, on the date of payment, is less (or would become less as a result of the proposed dividend payment) than the sum of the company's share capital, the company's reserve fund and the difference between the liquidation value and the nominal value of the issued and outstanding preferred shares of the company; and
- otherwise prohibited by the Russian legislation.

According to the Amendments on DR Programmes, from the 1 January 2013 a Russian company may not pay dividends with respect to its shares represented by depositary receipts if the information on the "owners of depositary receipts" has not been disclosed to the company. Furthermore, the company's obligation to pay such dividends terminates one month from the expiry of the general period for payment of dividends established by the respective corporate decision, the company's charter or the Joint Stock Companies Law. Given that as of the date hereof the FSFM has not yet adopted relevant implementing regulations, the procedure for disclosing information about the owners of depositary receipts is yet to be clarified. It is currently unclear whether an "owner of depositary receipts" means a registered holder, a securities intermediary or the beneficial holder. Further, it is also not clear what information is required to be disclosed. See "Risk Factors—Risks Relating to the Securities and the Trading Market—The Amendments on DR Programmes, once in force, may complicate the exercise of rights to, and the ability to derive benefits from, the underlying ordinary shares and could expose investors to a risk of suspension of our GDRs programme".

#### ***Distributions to Shareholders on Liquidation***

Under Russian legislation, liquidation of a company results in its termination without the transfer of rights and obligations to other persons as legal successors. The Joint Stock Companies Law and the Charter allow a company to be liquidated:

- by a three-quarters majority vote of a General Shareholders' Meeting; or
- by a court order.

Following a decision to liquidate the company, the right to manage its affairs would pass to a liquidation commission which, in the case of voluntary liquidation, is appointed by a General Shareholders' Meeting and, in an involuntary liquidation, is appointed by the court. Creditors may file claims within a period to be determined by the liquidation commission, but such period must not be less than two months from the date of publication of notice of liquidation by the liquidation commission.

The Civil Code of the Russian Federation, as amended (the “**Civil Code**”) gives creditors the following order of priority during liquidation:

- first priority—to individuals owed compensation for injuries or deaths or moral damages;
- second priority—to employees and copyright claims;
- third priority—to federal and local Governmental authorities claiming taxes and similar payments to the budgets and non-budgetary funds; and
- fourth priority—to other creditors in accordance with Russian legislation.

Claims of creditors in obligations secured by a pledge of the company’s property shall be satisfied from the sale proceeds of the pledged property prior to claims of any other creditors, save for the creditors of the first and second orders of priority, provided that claims of those creditors of the first and second orders of priority arose before the respective pledges have been entered into. Any residual claims of secured creditors that remain unsatisfied after the sale of the pledged property rank *pari passu* with claims of the fourth priority creditors.

The remaining assets of a company are distributed among shareholders in the following order of priority:

- payments to repurchase shares from shareholders having the right to demand repurchase;
- payments of declared but unpaid dividends on preferred shares and the liquidation value of the preferred shares, if any; and
- distribution of the remaining assets of a company between the holders of ordinary and preferred shares on a *pro rata* basis.

### ***Liability of Shareholders***

The Civil Code and the Joint Stock Companies Law generally provide that shareholders in a Russian joint stock company are not liable for the obligations of a joint stock company and only bear the risk of loss of their investments. This may not be the case, however, when one person or entity (the “effective parent”) is capable of determining decisions made by another entity (the “effective subsidiary”) by way of giving binding instructions to the effective subsidiary. If the effective subsidiary is a joint stock company, the effective parent bears joint and several liability for a transaction concluded by an effective subsidiary if:

- (i) the effective parent caused the effective subsidiary to conclude the transaction; and
- (ii) the ability of the effective parent to give binding instructions is provided for in the charter of the effective subsidiary or in a contract between such entities.

If the effective subsidiary is a Russian limited liability company, the effective parent bears joint and several liability if the effective parent caused the effective subsidiary to conclude the transaction (regardless of how the effective parent’s ability to determine decisions of the effective subsidiary arises).

Thus, a shareholder of an effective parent is not itself liable for the debts of the effective parent’s effective subsidiary, unless that shareholder is itself an effective parent of the effective parent.

Accordingly, the shareholders will not be personally liable for our debts or those of our effective subsidiaries unless such shareholders control our business and/or its effective subsidiaries, and the conditions set forth above are met.

In addition, an effective parent may be held secondarily liable for the debts of an effective subsidiary if the latter becomes insolvent or bankrupt as a result of the action or inaction of the former. This is the case no matter how the effective parent’s capability to determine decisions of the effective subsidiary arises, such as through ownership of voting securities or by contract. If the effective subsidiary is a joint stock company, then the effective parent will have secondary liability only if the effective parent caused the effective subsidiary to take any action or fail to take any action knowing that such action or failure to take action would result in insolvency of the effective subsidiary. If the effective subsidiary is a limited liability company, then the effective parent will be held secondarily liable if the effective subsidiary’s insolvency is caused by the wilful misconduct or negligence of such effective parent, subject to the insufficiency of the effective subsidiary’s assets to cover its obligations.

Shareholders of an effective subsidiary that is a joint stock company may also claim compensation for the effective subsidiary's losses from the effective parent if: (i) the effective parent caused the effective subsidiary to take any action or fail to take any action that resulted in a loss and (ii) the effective parent knew that such action or failure to take such action would result in the effective subsidiary's loss. Participants of an effective subsidiary that is a limited liability company may claim compensation for the effective subsidiary's losses from the effective parent if the effective parent through its wilful misconduct or negligence caused the effective subsidiary to take any action, or fail to take any action, that resulted in a loss.

### ***Share Capital Increase***

We may increase our share capital by:

- issuing new shares, or
- increasing the nominal value of our previously issued shares.

According to Joint Stock Companies Law and our Charter, decisions on additional issuance of shares and increase of the nominal value of previously issued shares shall be passed by the General Shareholders' Meeting by a majority of shareholders present at the meeting. Voting at a General Shareholders' Meeting must be preceded by a meeting of the Board of Directors approving recommendation for the shareholders to increase share capital. A decision on issuance of shares or securities convertible into shares by closed subscription, or an issuance by open subscription of ordinary shares or securities convertible into ordinary shares constituting more than 25% of the number of issued ordinary shares, requires a three-quarter majority vote by a General Shareholders' Meeting. In addition, the issuance of shares above the number of authorised shares provided in the Charter requires a Charter amendment, to be approved by a three-quarter majority vote of a General Shareholders' Meeting.

The Joint Stock Companies Law requires that the placement price of the newly issued shares be determined by the Board of Directors based on their market value but not less than their nominal value. Placement price for existing shareholders exercising a pre-emptive right to purchase shares may be less than the price paid by third parties, but in any event no more than by 10% of the price paid by third parties. Fees of an intermediary participating in the placement of shares cannot exceed 10% of the share price. The Board of Directors may, but is not required to, involve an independent appraiser to set the placement price of the shares. There is a specific requirement for determining the placement price of securities, for which prices are regularly published, that the Board of Directors shall take into account such prices. The Board of Directors shall value any in-kind contributions for new shares, based on the appraisal report of an independent appraiser.

Russian securities laws and regulations set out detailed procedures for the issuance and registration of shares of a Russian joint stock company. These procedures require:

- adoption of a decision to increase capital by placing additional shares;
- adoption of a decision on share issuance (and in certain cases of a prospectus);
- prior registration of a share issuance (and in certain cases of a prospectus) with FSFM;
- placement of the shares;
- registration of the report or filing of the notice on the results of the share issuance; and
- public disclosure of information at the required stages of the issuance.

### ***Share Capital Decrease and Share Repurchases***

We have the right to, and under certain circumstances, are statutorily required to, decrease our share capital.

The Joint Stock Companies Law does not allow a company to reduce its share capital below the minimum share capital required by law, which is 100,000 rubles (approximately U.S.\$3,200 at the exchange rate as at 30 September 2012) for an open joint stock company. The Joint Stock Companies Law requires that any decision to reduce the share capital of the company, whether through the repurchase and cancellation of shares or a reduction in the nominal value of the shares, be made by a General Shareholders' Meeting. In addition, within three business days of a decision to reduce the company's share capital, the company should notify the competent authority on adoption of such decision, and then twice publish a notification on the decrease of the share capital in specially designated mass media with regularity of once in a month. Our General Shareholders' Meeting

approved the Share Redemption on 11 May 2012. We duly published the first notification on 30 May 2012 and the second on 4 July 2012. See also “Risk Factors—Risks Relating to the Legal and Regulatory Environment in the Russian Federation—Our creditors may demand early performance of our obligations or compensation of damages as a result of the Share Redemption”.

The Joint Stock Companies Law allows a company to decrease the share capital through a reduction in the nominal value of the shares only if the following conditions have been met:

- the company’s share capital has been paid in full;
- the company has repurchased all shares from shareholders who have exercised their right to demand repurchase of their shares;
- the company is not insolvent on the date of adoption of the decision to decrease the share capital and would not become insolvent, as a result of the proposed decrease of share capital;
- the value of a company’s net assets on the date of adoption of the decision to decrease the share capital is not less (and would not become less, as a result of the proposed decrease of share capital) than the sum of its share capital, the reserve fund and the difference between the liquidation value and nominal value of the company’s issued and outstanding preferred shares;
- the company has paid all declared and unpaid dividends; and
- other requirements of Russian legislation have been fulfilled.

Russian legislation provides that a company’s shareholders may demand repurchase of all or some of their shares so long as the shareholder demanding repurchase voted against or did not participate in the voting on the decision approving any of the following actions:

- re-organisation of the company;
- conclusion of a major transaction involving assets in excess of 50% of the balance sheet value of the assets of the company; or
- amendment to the charter or approval of a new version of the charter in a manner that restricts the shareholder’s rights.

The company may spend up to 10% of its net assets calculated under RAS for a share redemption demanded by the shareholders. If the value of shares in respect of which the shareholders have exercised their right to demand repurchase exceeds 10% of net assets of the company, the company will repurchase shares from each such shareholder on a *pro rata* basis.

### ***Registration and Transfer of Shares***

Our shares comprise our ordinary shares in registered form. Russian legislation requires that a joint stock company hold a register of its shareholders. A register of shareholders may be held by a company itself or by a specialised registrar. The Joint Stock Companies Law and the Securities Market Law require that a register of shareholders of (i) a joint stock company with more than 50 shareholders or (ii) a joint stock company that has a statutory obligation to disclose information in connection with placement and (or) circulation of shares be held by a specialised registrar. Ownership of our shares is evidenced solely by entries made in the shareholders’ register or on the books of a Russian licensed depository.

The Central Depository Law, which came into force on 1 January 2012, set out a legal framework for establishment and operation of the central depository. On 6 November 2012, the FSFM granted NSD the status of central depository. Within one year from the date of having been granted such a status, the central depository shall take all necessary steps to open its nominal holder accounts in, among others, all securities registers of the issuers which are obliged to disclose information in accordance with the Securities Market Law. As we are required to make public disclosures since the registration of the prospectus in connection with the share split on 17 August 2012, the above requirement is applicable to us, which means that the central depository should become the only person having a nominal holder account in our share register. Also, the Central Depository Law prohibits persons maintaining securities registers from opening and depositing securities (save for limited exceptions) to other nominal holder accounts from the date of the opening of a nominal holder account with the central depository.



Any of our shareholders may obtain an extract from the register of our shareholders maintained by the registrar or from their respective depository, as the case may be, certifying the number of shares that such shareholder holds. We are also entitled to obtain an extract from our shareholders' register which sets out all of our shareholders registered directly therein. However, currently we are unable to monitor transfers of our shares that are held on the books of a Russian licensed depository registered in our shareholders' register maintained by the registrar as a nominal holder, because underlying shareholders have no obligation to reveal and such depository has no obligation to notify us about such transfers. As a result, we can currently only identify our actual shareholders in a limited number of cases when such possibility is provided for by Russian law, including when requesting our registrar to compile a list of shareholders of record for the General Shareholders' Meeting. However, our shareholders shall notify us and the FSFM of an acquisition of 5% or more of our ordinary shares or of an acquisition of the right to vote on 5% or more of our ordinary shares by virtue of an agreement or otherwise, and of any subsequent change in the number of such ordinary shares above or below certain thresholds, and we are required to disclose such information in accordance with Russian securities regulations. See "Description of Share Capital and Certain Requirements of Russian Law—Certain Requirements of Russian Legislation—Notification of Acquisition of Significant Interest" and also "Description of Share Capital and Certain Requirements of Russian Law—Disclosure of Information".

Since 25 December 2008, Closed Joint Stock Company "Computershare Registrar" (previously named Closed Joint Stock Company "National Registration Company"), located at 8 Ivan Franco Street, 121108 Moscow, Russian Federation, has held our shareholders' register.

The purchase, sale or other transfer of shares is accomplished through the registration of the transfer in the shareholders' register, or the registration of the transfer with a depository if shares are held through a depository. The registrar or depository may not require any documents in addition to those required by Russian legislation in order to register a transfer of shares in the register. Refusal to register the shares in the name of the transferee or, upon request of the beneficial holder, in the name of a nominee holder, is not allowed, and such refusals may be challenged in court.

See also "Risk Factors—Risks Relating to the Securities and the Trading Market—The current lack of a central and rigorously regulated share registration system in the Russian Federation may result in improper recording of the ownership of our ordinary shares".

### **Reserve Fund**

Russian legislation requires each joint stock company to establish a reserve fund to be used only to cover the company's losses, redeem the company's bonds and repurchase the company's shares in cases when other funds are not available. The Joint Stock Companies Law and the Charter provide for a minimum reserve fund of 5% of our share capital, funded through mandatory annual transfers of at least 5% of net profits of the company until the reserve fund has reached the above target 5% requirement. We also may establish special purpose funds upon a decision of a General Shareholders' Meeting. Decisions on use of such funds shall be approved by our Board of Directors.

### **Disclosure of Information**

In accordance with Russian securities regulations, since registration of the prospectus on the share issue on 16 August 2012, we are required to make the following public disclosures and filings on a periodical basis:

- publishing on the website quarterly issuer's reports containing information about us, our shareholders, the structure of our management bodies, the members of the Board of Directors and Management Board, our branches and representative offices, our shares, bank accounts and statutory auditors, important developments during the reporting quarter, and other information about our financial and business activity;
- filing with the FSFM and publishing in newswire as well as on our website any information concerning material facts and changes in our financial and business activity, including among other things:
  - our re-organisation;
  - certain changes in the amount of our assets;
  - certain facts related to share issuances;
  - decisions of the General Shareholders' Meetings;

- acquisition by a person of 5% or more of our ordinary shares or an acquisition of the right to vote on 5% or more of the ordinary shares by virtue of an agreement or otherwise, and any subsequent change in the number of such ordinary shares above or below any of 5%, 10%, 15%, 20%, 25%, 30%, 50%, 75% or 95% threshold;
- the information on any of the following documents received:
  - a voluntary offer (including any competing offer);
  - a mandatory offer (including any competing offer);
  - a notice of the right of shareholders to sell their shares to the person that has acquired more than 95% of the ordinary shares;
  - a demand that minority shareholders sell their shares to the person that has acquired more than 95% of the ordinary shares;
- disclosing information at various stages of share issuances through publication of certain data as required by securities regulations;
- disclosing our annual report and annual financial statements;
- disclosing on our website on a quarterly basis a list of our affiliated persons; and
- other information as required by applicable Russian securities legislation.

## **Corporate Governance**

Our ordinary shares were listed on quotation list “V” of MICEX on 21 September 2012. In order to maintain the listing, we must be in compliance with the following corporate governance requirements:

- at least one independent director on the Board of Directors as per Russian law requirements;
- establishment of an audit committee of the Board of Directors comprised of non-executive directors and chaired by an independent director;
- adoption of a by-law on insider trading;
- establishment of internal control procedures;
- provision in the Charter that shareholders must be given at least 30 days’ notice of the annual General Shareholders’ Meeting; and
- a provision in our by-laws requiring our General Director and members of the Board of Directors to disclose information concerning their ownership, sale and purchase of our issued securities.

As of the date of this document, we are in compliance with these requirements.

## **Certain Requirements of Russian Legislation**

### ***Interested Party Transactions***

The Joint Stock Companies Law contains special requirements with respect to approval of interested party transactions. “Interested party transactions” include transactions involving a member of the Board of Directors or member of any executive body of the company (including members of the company’s management board and the company’s chief executive officer), any person that owns, together with any affiliates, at least 20% of a company’s issued voting stock or any person who is able to direct the actions of the company, if that person and/or that person’s spouse, parents, children, adoptive parents or children, brothers or sisters or their affiliates, is/are:

- a party to, or beneficiary of, a transaction with the company, whether directly or as a representative or intermediary;
- the owner of at least 20% of the issued shares of a legal entity that is a party to, or beneficiary of, a transaction with the company, whether directly or as a representative or intermediary;
- a member of any management body of a company that is a party to, or beneficiary of, a transaction with the company, whether directly or as a representative or intermediary, or a member of any management body of a management organisation of such a company; or
- in other cases, provided by a charter of the company.

The Joint Stock Companies Law requires that an interested party transaction by a company with more than 1,000 shareholders be approved by a majority vote of the independent directors of the company who are not interested in the transaction. For purposes of this rule, an “independent director” is a person who is not, and within the year preceding the decision to approve the transaction was not, the General Director, a member of any executive body or an affiliate of the company except for being its director, or a member of any management body of the company’s management organisation or a person whose relatives held positions on management bodies of a company or the managing company or were sole manager of such company. For companies with 1,000 or fewer shareholders, an interested party transaction must be approved by a majority vote of the directors who are not interested in the transaction if the number of these directors is sufficient to constitute a quorum.

Approval by a majority of shareholders who are not interested in the transaction is required if:

- the value of such transaction or a number of interrelated transactions is 2% or more of the balance sheet value of the company’s assets determined under RAS;
- the transaction or a number of interrelated transactions involves the placement by subscription or secondary market sale of shares in the amount exceeding 2% of the company’s issued ordinary shares and ordinary shares, in which issued convertible securities may be converted;
- the transaction or a number of interrelated transactions involves the placement by subscription of issued securities convertible into shares that may be converted into ordinary shares constituting more than 2% of the company’s issued ordinary shares and ordinary shares, in which issued convertible securities may be converted;
- the number of directors who are not interested in the transaction is not sufficient to constitute a quorum; or
- all the members of the Board of Directors of the company are interested parties, or none of them is an independent director.

Approval of an interested party transaction by a majority of disinterested shareholders may not be required if such transaction is substantially similar to transactions entered into by the company and the interested party in the ordinary course of business before such party became an interested party with respect to the transaction. This exemption is effective only within a period from the date when such party became an interested party with respect to the transaction and until the next annual General Shareholders’ Meeting.

The approval of an interested party transaction is not required if:

- the company has only one shareholder that simultaneously performs the functions of the company’s sole executive body;
- all shareholders of the company are deemed interested in the transaction;
- the shareholders are executing their pre-emptive rights to purchase newly issued shares or securities converted into shares;
- the company is repurchasing its issued shares;
- the company is merging with or into another company; or
- the company is required by law to enter into the transaction, and settlements under such transactions are made pursuant to prices set by the Russian Government on or pursuant to tariffs and prices established by appropriate state authorities authorised by the Russian Government.

Upon a claim by a company or any of its shareholders, a court may invalidate any interested party transaction entered into in breach of the above requirements. However, pursuant to Joint Stock Companies Law, a court shall dismiss the claim seeking to invalidate an interested party transaction entered into in breach of the abovementioned requirement in the following instances:

- voting by the disinterested shareholder who brought a claim contesting the validity of an interested party transaction that was subject to approval of the General Shareholders’ Meeting, could not affect the outcome of the voting;
- it is not proved that execution of the interested party transaction in question caused or could cause losses to or have other adverse effect on the company or the shareholder challenging the interested party transaction;

- evidence of duly subsequent approval of the challenged interested party transaction pursuant to the Joint Stock Companies Law is provided by the time of consideration of the claim by the court; or
- it is duly proved in front of the court that the counterparty to the interested party transaction in question did not know and could not have known that the transaction is entered into in violation of the respective requirements of the Joint Stock Companies Law.

We are developing enhanced internal procedures to better identify interested party transactions. We are currently developing a regularly updated list in our enterprise resource planning system of both: (i) our own affiliated parties; and (ii) the affiliated parties of potential counterparties. Our internal procedure shall require that no agreements are permitted to be entered into before possible overlaps between these two lists are checked.

### ***Major Transactions***

The Joint Stock Companies Law defines a major transaction as a transaction, or a series of interrelated transactions, involving the acquisition or disposal, or the possibility of disposal directly or indirectly of property having the value of 25% or more of the balance sheet value of the assets of a company as determined under RAS, with the exception of:

- transactions conducted in the ordinary course of business;
- transactions in connection with the placement of ordinary shares through a subscription (sale of ordinary shares), or with the placement of securities convertible into ordinary shares, and
- transactions which are mandatory for a company pursuant to Russian law requirements, and settlements under which transactions are made pursuant to prices set by the Russian Government or pursuant to tariffs and prices established by appropriate state authorities authorised by the Russian Government.

Major transactions involving the acquisition or disposal, or the possibility of disposal, directly or indirectly, of assets ranging from 25% to 50% of the balance sheet value of the assets of a company requires unanimous approval by all members of the Board of Directors. If the transaction fails to receive such approval, it can be approved by a simple majority vote of a shareholders meeting. Major transactions involving assets in excess of 50% of the balance sheet value of the assets of a company require a three-quarter majority vote of shareholders present at the General Shareholders' Meeting.

The approval of a major transaction is not required if a company has only one shareholder that simultaneously performs the functions of the sole executive body of the company.

Any major transaction entered into in breach of the above requirements may be invalidated by a court following an action brought by the company or any of its shareholders. Similarly to the rules applicable to the interested party transactions entered into in breach of requirements of the Joint Stock Companies Law, a court considering a claim seeking to invalidate a major transaction shall dismiss it in the same instances. See “—Interested party transactions”, above.

### ***Shareholders' Agreements***

The Joint Stock Companies Law provides for the possibility to enter into shareholders' agreements in respect of Russian joint stock companies. Thus, the Joint Stock Companies Law stipulates that shareholders may enter into an agreement under which they undertake to exercise their shareholder rights in a certain manner or to refrain from exercising their shareholder rights, including, *inter alia*:

- (i) to vote in a certain manner at a General Shareholders' Meeting;
- (ii) to coordinate voting with other shareholders;
- (iii) to acquire or dispose of shares at a pre-determined price or upon occurrence of certain circumstances;
- (iv) to refrain from disposing of shares until occurrence of certain circumstances; and
- (v) to perform jointly other actions relating to the company's management, activities, re-organisation and liquidation.

Provisions of the Joint Stock Companies Law in respect of shareholders' agreements are very generic, rather vaguely drafted and remain largely untested. It is still to be seen how this new regulation is implemented and enforced in practice.

### ***Foreign Ownership***

The Foreign Strategic Investments Law that came into force on 7 May 2008 regulates foreign investments (whether direct or indirect) in Russian businesses having strategic importance for procuring state defence and security and, *inter alia*, requires foreign investors to receive a prior consent of the special Government commission before acquiring certain percentages of ordinary shares or certain management rights in respect of strategic companies. The Foreign Strategic Investments Law provides for an extensive list of types of activities having strategic importance for procuring state defence and security, which includes, *inter alia*, provision of telecommunication services by a company having dominant position in the respective market in the Russian Federation and included in the register of companies holding dominant position by FAS. See “Regulation of the Russian Telecommunications Industry—Foreign Strategic Investments Law”.

In addition, foreign persons registered as individual entrepreneurs in the Russian Federation and foreign companies (regardless of whether they are registered with the Russian tax authorities) that acquire shares in a Russian joint stock company may need to notify the Russian tax authorities within one month following such acquisition.

### ***Offering Outside the Russian Federation***

Russian law requires a permit from the FSFM to be obtained prior to effecting an offering of a Russian issuer’s shares outside the Russian Federation, including offerings of equity securities through either sponsored or unsponsored depositary receipt programmes offering depositary receipts (e.g. GDRs) representing interests in the Russian issuer’s shares. On 27 September 2012 we received permission from the FSFM for 123,380,000 of our ordinary shares, but in any event not more than 20% of our outstanding ordinary shares at any given moment of time, to be circulated abroad through GDRs.

### ***Notification of Acquisition of Significant Interest***

Pursuant to Russian securities legislation, each holder of ordinary shares of a joint stock company that has issued securities and registered a prospectus in respect of such securities in the Russian Federation must notify the company and the FSFM of an acquisition of 5% or more of the company’s ordinary shares or of an acquisition of the right to vote on 5% or more of the ordinary shares by virtue of an agreement or otherwise, and of any subsequent change in the number of such ordinary shares above or below any of 5%, 10%, 15%, 20%, 25%, 30%, 50%, 75% or 95% thresholds. Each notification should contain the name of the acquirer, the name of the company and the number of the ordinary shares acquired (or votes that can be cast). Such notifications must be generally given within ten days after the ordinary shares have been transferred to such shareholder’s securities account or after the acquisition of the right to cast votes attached to such ordinary shares. In addition, a foreign investor or a group of persons must notify FAS of any acquisition of 5% or more of the shares of strategic enterprise under the Foreign Strategic Investments Law. See “Regulation of the Russian Telecommunications Industry—Foreign Strategic Investments Law”.

### ***Change of Control and Anti-takeover Protection***

The Joint Stock Companies Law provides for anti-takeover protection measures applicable under the Russian law.

A person intending to acquire more than 30% of an open joint stock company’s ordinary shares, including shares already owned by such person and its affiliates, has the right to make a public offer to purchase the remaining shares from other shareholders (voluntary offer). A voluntary offer may be made at any price (although the price should be the same for all tendering shareholders).

Within 35 days after acquisition by any means of more than 30%, 50% or 75% of ordinary shares or 35 days from the date when the acquirer learned or should have learned that it, either independently or together with its affiliates, owns such number of shares, the acquirer is required to make a public offer to purchase the remaining shares from other shareholders (mandatory offer). A mandatory offer should be made at a price that is the higher of: (i) the highest acquisition value that the offeror or its affiliate paid or agreed to pay for the target securities in any transaction in the six months preceding the date of the mandatory offer launch, or (ii) in the case of a publicly traded open joint stock company, the weighted average price of the target securities on the Russian stock exchange during the six months preceding the date of the mandatory offer filing with the FSFM and, if the company is not publicly traded or is traded for less than six months, the price determined as “market value” by a certified independent appraiser.



While the offeror is required to make an all-cash voluntary or mandatory offer, it may also offer securities or a mix of cash and securities as an alternative, in which case tendering shareholders have the right to choose between the cash consideration and the consideration in the form of securities (or mixed consideration).

If, as a result of either the voluntary or the mandatory offer, the acquirer purchases more than 95% of the ordinary shares, including shares owned by its affiliates, it is required to (i) notify all the other shareholders (within 35 days after acquisition of shares above such threshold) of their right to sell their shares and other securities convertible into such shares, and (ii) purchase their shares upon request of each minority shareholder at a price equal to the highest of: (i) the highest acquisition value that the offeror or its affiliate paid or agreed to pay for the target securities in any transaction in the six months preceding the date of the respective notification (including the price paid in the voluntary offer or mandatory offer that resulted in passing the 95% threshold), (ii) in the case of a publicly traded company, the weighted average price of the target securities on the Russian stock exchange during the six months preceding the date of filing of the respective notification with the FSFM and, if the company is not publicly traded or is traded for less than six months, the price determined as “market value” by a certified independent appraiser, and (iii) the highest price that the 95% shareholder or its affiliates paid or agreed to pay for the target securities after the end of the voluntary offer or mandatory offer that resulted in passing the 95% threshold.

Instead of giving notice, the acquirer may deliver a buy-out demand, binding on the minority shareholders, that they sell their shares if the acquirer crossed the 95% threshold by acquiring at least 10% of the ordinary shares in a voluntary or mandatory offer at a price that may not be lower than: (i) the price paid in the voluntary offer or the mandatory offer that resulted in passing the 95% threshold, and (ii) determined as “market value” by a certified independent appraiser, and (iii) the highest price that the 95% shareholder or its affiliates paid or agreed to pay for securities after the end of the voluntary offer or the mandatory offer that resulted in passing the 95% threshold.

An offer of the kind described in either of the preceding four paragraphs must be accompanied by an irrevocable bank guarantee of payment (except for a buy-out demand) and certain other documents. If the company is publicly traded, prior notice of the offers must be filed with the FSFM; otherwise, such offers must be filed with the FSFM no later than the date of the offer. The FSFM may require revisions to be made to the terms of the offer (including the price) in order to bring them into compliance with the rules.

At any time after the company receives a voluntary or a mandatory offer and until 25 days prior to the expiration of the relevant acceptance period, any person will have the right to make a competing offer (that satisfies the requirements for a voluntary or mandatory offer, respectively) to purchase shares in the quantity of and at the price that is greater than or equal to the quantity and the price offered in the initial voluntary or mandatory offer. Any shareholder may revoke its previous acceptance of the respective offer and accept the competing offer. A copy of the competing offer shall be sent to the person who made the initial voluntary or mandatory offer so that such person can amend its offer by increasing the purchase price and/or shortening the settlement period. As soon as the voluntary or mandatory offer has been received by a company and until expiration of a 20-day period after the expiration of the period for acceptance of the voluntary or mandatory offer, only the company’s shareholders’ meeting will have the exclusive power to make decisions on a share capital increase through an additional share issuance, on approval of interested party and certain other transactions and on certain other significant matters. The Joint Stock Companies Law provides for instances when the mandatory offer may not be made, which include, *inter alia*, the following:

- acquisition of the company’s shares was performed within the course of its establishment or re-organisation;
- partial redemption of its shares by the company;
- acquisition of shares by a company’s shareholder as a result of using respective pre-emptive rights;
- shares of the company were earlier acquired under the voluntary offer;
- shares of the company were earlier acquired under another mandatory offer;
- transfer of shares between shareholder of the company and its affiliates;
- acquisition of shares by contribution thereof to the share capital of the company by the Russian Federation, its subject or municipality provided the Russian Federation, its subject or municipality is or becomes owner of more than 50% of the company’s share capital as a result of such transaction; and

- acquisition of shares by contribution thereof as a payment for the newly issued shares placed under the closed subscription of an open joint stock company included in the list of strategic enterprises and strategic joint stock companies approved by the President of the Russian Federation by Order No. 1009 On Approval of the List of Strategic Enterprises and Strategic Joint Stock Companies of 4 August 2004, as amended.

### ***Currency control***

Russian currency control restrictions with regard to such instruments as GDRs and ordinary shares are set forth in the Currency Law and respective regulations of the CBR.

Pursuant to the Currency Law, currency operations with GDRs and ordinary shares between residents and non-residents may be conducted without limitations in both Rubles and in foreign currencies.

Under the Currency Law, currency operations with securities between non-residents may be conducted either in Rubles or in foreign currencies, subject to compliance with Russian securities and antimonopoly laws and regulations.

Finally, non-residents may receive dividends declared by Russian companies both in foreign currencies (confirmed by the CBR in its Information Letter No. 31 dated 31 March 2005) and Rubles. Dividends declared and paid in Rubles may be freely converted through Russian authorised banks and remitted outside of the Russian Federation.

## TERMS AND CONDITIONS OF THE GLOBAL DEPOSITARY RECEIPTS

### Terms and Conditions of the GDRs

*The following terms and conditions (subject to completion and amendment and excepting sentences in italics) will apply to the Global Depositary Receipts, and will be endorsed on each Global Depositary Receipt certificate:*

The Global Depositary Receipts (“**GDRs**”) represented by this certificate are issued in respect of ordinary shares (the “**Shares**”) in OJSC “MegaFon” (the “**Company**”) pursuant to and subject to an agreement dated 24 August 2012, and made between the Company and The Bank of New York Mellon (Luxembourg) S.A. in its capacity as depositary (the “**Depositary**”) for the “Regulation S Facility” and for the “Rule 144A Facility” (such agreement, as amended from time to time, being hereinafter referred to as the “**Deposit Agreement**”). Pursuant to the provisions of the Deposit Agreement, the Depositary has appointed Sberbank of Russia as Custodian (the “**Custodian**”) to receive and hold on its behalf any relevant documentation respecting certain Shares (the “**Deposited Shares**”) and all rights, interests and other securities, property and cash deposited with the Custodian which are attributable to the Deposited Shares (together with the Deposited Shares, the “**Deposited Property**”). The Depositary shall hold Deposited Property for the benefit of the Holders (as defined below) as bare trustee (other than any cash comprised in the Deposited Property which is held as banker pursuant to Condition 26) in proportion to their holdings of GDRs. In these terms and conditions (the “**Conditions**”), references to the “Depositary” are to The Bank of New York Mellon (Luxembourg) S.A. and/or any other depositary which may from time to time be appointed under the Deposit Agreement, references to the “Custodian” are to Sberbank of Russia or any other custodian from time to time appointed under the Deposit Agreement and references to the “Main Office” mean, in relation to the relevant Custodian, its head office in the city of Moscow or such other location of the head office of the Custodian in Russia as may be designated by the Custodian with the approval of the Depositary (if outside the city of Moscow) or the head office of any other custodian from time to time appointed under the Deposit Agreement.

*The GDRs will upon issue be represented by interests in a Regulation S Master GDR, evidencing Regulation S GDRs, and by interests in a Rule 144A Master GDR, evidencing Rule 144A GDRs (as each such term is defined in the Deposit Agreement). The GDRs are exchangeable in the circumstances set out in [“Summary of the Provisions Relating to the Global Depositary Receipts Whilst in Master Form”] for a certificate in definitive registered form in respect of GDRs representing all or part of the interest of the holder in the Master GDR.*

References in these Conditions to the “Holder” of any GDR shall mean the person or persons registered on the books of the Depositary maintained for such purpose (the “**Register**”) as holder. These Conditions include summaries of, and are subject to, the detailed provisions of the Deposit Agreement, which includes the forms of the certificates in respect of the GDRs. Copies of the Deposit Agreement are available for inspection at the specified office of the Depositary and each Agent (as defined in Condition 17) and at the Main Office of the Custodian. Terms used in these Conditions and not defined herein but which are defined in the Deposit Agreement have the meanings ascribed to them in the Deposit Agreement. **Holders of GDRs are not party to the Deposit Agreement and thus, under English Law, have no contractual rights against, or obligations to, the Company or Depositary. However, the Deed Poll executed by the Company in favour of the Holders provides that, if the Company fails to perform the obligations imposed on it by certain specified provisions of the Deposit Agreement, any Holder may enforce the relevant provisions of the Deposit Agreement as if it were a party to the Deposit Agreement and was the “Depositary” in respect of that number of Deposited Shares to which the GDRs of which he is the Holder relate. The Depositary is under no duty to enforce any of the provisions of the Deposit Agreement on behalf of any Holder of a GDR or any other person.**

#### 1. Withdrawal of Deposited Property and Further Issues of GDRs

1.1 Any Holder may request withdrawal of, and the Depositary shall thereupon relinquish, the Deposited Property attributable to any GDR upon production of such evidence of the entitlement of the Holder to the relative GDR as the Depositary may reasonably require, at the specified office of the Depositary or any Agent accompanied by:

- (a) a duly executed order (in a form approved by the Depositary) requesting the Depositary to cause the Deposited Property being withdrawn to be delivered at the Main Office of the Custodian, or (at the request, risk and expense of the Holder, and only if permitted by applicable law from time to time) at the specified office located in New York, London or Russia of the Depositary or any Agent, or to the order in writing of, the person or persons designated in such order;

- (b) the payment of such fees, taxes, duties, charges, costs, expenses and governmental charges as may be required under these Conditions or the Deposit Agreement;
- (c) the surrender (if appropriate) of GDR certificates in definitive registered form properly endorsed in blank or accompanied by proper instruments of transfer satisfactory to the Depositary to which the Deposited Property being withdrawn is attributable; and
- (d) the delivery to the Depositary of a duly executed and completed certificate substantially in the form set out in Schedule 4, Part B to the Deposit Agreement (or as amended by the Depositary in accordance with Clause 3.10 of the Deposit Agreement and Condition 1.7), if Deposited Property is to be withdrawn or delivered in respect of surrendered Rule 144A GDRs.

1.2 Upon production of such documentation and the making of such payment as aforesaid for withdrawal of the Deposited Property in accordance with Condition 1.1, the Depositary will direct the Custodian, by tested telex, facsimile or SWIFT message, within a reasonable time after receiving such direction from such Holder, to deliver at its Main Office to, or to the order in writing of, the person or persons designated in the accompanying order:

- (a) a certificate (if any) for, or other appropriate instrument of title (if any) to or evidence of a book- entry transfer in respect of the relevant Deposited Shares, registered in the name of the Depositary or its nominee and accompanied by such instruments of transfer in blank or to the person or persons specified in the order for withdrawal and such other documents, if any, as are required by law for the transfer thereof; and
- (b) all other property forming part of the Deposited Property attributable to such GDR, accompanied, if required by law, by one or more duly executed endorsements or instruments of transfer in respect thereof; **provided however that** the Depositary may make delivery at its specified office in New York of any Deposited Property which is in the form of cash;

**PROVIDED THAT** the Depositary (at the request, risk and expense of any Holder so surrendering a GDR):

- (i) will direct the Custodian to deliver the certificates for, or other instruments of title to, or book-entry transfer in respect of, the relevant Deposited Shares and any document relative thereto and any other documents referred to in sub-paragraphs 1.2(a) and (b) of this Condition (together with any other property forming part of the Deposited Property which may be held by the Custodian or its agent and is attributable to such Deposited Shares); and/or
- (ii) will deliver any other property forming part of the Deposited Property which may be held by the Depositary and is attributable to such GDR (accompanied, if required by law, by one or more duly executed endorsements or instruments of transfer in respect thereof);

in each case to the specified office located in New York or London of the Depositary (if permitted by applicable law from time to time) or at the specified office in Russia of any Agent as designated by the surrendering Holder in the order accompanying such GDR.

- 1.3 Delivery by the Depositary, any Agent and the Custodian of all certificates, instruments, dividends or other property forming part of the Deposited Property as specified in this Condition will be made subject to any laws or regulations applicable thereto.
- 1.4 The Depositary may, in accordance with the terms of the Deposit Agreement and upon delivery of a duly executed order (in a form reasonably approved by the Depositary) and a duly executed certificate substantially in the form of (a) Schedule 3 of the Deposit Agreement (*which is described in the following paragraph*) (or as amended by the Depositary in accordance with Clause 3.10 of the Deposit Agreement and Condition 1.7) by or on behalf of any investor who is to become the beneficial owner of the Regulation S GDRs or (b) Schedule 4, Part A of the Deposit Agreement (*which is described in the second following paragraph*) (or as amended by the Depositary in accordance with Clause 3.10 of the Deposit Agreement and Condition 1.7) by or on behalf of any investor who is to become the beneficial owner of Rule 144A GDRs from time to time execute and deliver further GDRs having the same terms and conditions as the GDRs which are then outstanding in all respects (or the same in all respects except for the first dividend payment on the Shares represented by such further GDRs) and, subject to the terms of the Deposit Agreement, the Depositary shall accept for deposit any further Shares in connection therewith, so that such further GDRs shall form a single series with the already outstanding GDRs. References in these Conditions to the GDRs include (unless the context requires otherwise) any further GDRs issued pursuant to this Condition and forming a single series with the already outstanding GDRs.

*The certificate to be provided in the form of Schedule 3 of the Deposit Agreement certifies, among other things, that the person providing such certificate is located outside the United States and will comply with the restrictions on transfer set forth under “Transfer Restrictions”.*

*The certificate to be provided in the form of Schedule 4, Part A, of the Deposit Agreement certifies, among other things that the person providing such certificate is a qualified institutional buyer (as defined in Rule 144A under the Securities Act of 1933, as amended (the “Securities Act”)(“QIB”)) or is acting for the account of another person and such person is a QIB and, in either case, will comply with the restrictions on transfer set forth under “Transfer Restrictions”.*

- 1.5 Any further GDRs issued pursuant to Condition 1.4 which (i) represent Shares which have rights (whether dividend rights or otherwise) which are different from the rights attaching to the Shares represented by the outstanding GDRs, or (ii) are otherwise not fungible (or are to be treated as not fungible) with the outstanding GDRs, will be represented by a GDR certificate in definitive form or a separate temporary Regulation S Master GDR and/or a separate temporary Rule 144A Master GDR. Upon becoming fungible with outstanding GDRs, such further GDRs shall be evidenced by a Regulation S Master GDR and/or a Rule 144A Master GDR (by increasing the total number of GDRs evidenced by the relevant Regulation S Master GDR or Rule 144A Master GDR by the number of such further GDRs, as applicable).
- 1.6 Unless requested in writing by the Company to cease doing so, and notwithstanding the provisions of Condition 1.4, the Depositary may execute and deliver GDRs or issue interests in a Regulation S Master GDR or a Rule 144A Master GDR, as the case may be, prior to the receipt of Shares (a “**Pre-Release**”). The Depositary may, pursuant to Condition 1.1, deliver Shares upon the receipt and cancellation of GDRs, which have been Pre-Released, whether or not such cancellation is prior to the termination of such Pre-Release or the Depositary knows that such GDR has been Pre-Released. The Depositary may receive GDRs in lieu of Shares in satisfaction of a Pre-Release. Each Pre-Release will be (a) preceded or accompanied by a written representation and agreement from the person to whom GDRs or Deposited Property are to be delivered (the “**Pre-Releasee**”) that such person, or its customer, (i) owns or represents the owner of the corresponding Deposited Property or GDRs to be remitted (as the case may be), (ii) assigns all beneficial right, title and interest in such Deposited Property or GDRs (as the case may be) to the Depositary in its capacity as such and for the benefit of the Holders, and (iii) will not take any action with respect to such GDRs or Deposited Property (as the case may be) that is inconsistent with the transfer of beneficial ownership (including without the consent of the Depositary, disposing of such GDRs or Deposited Property, as the case may be), other than in satisfaction of such Pre-Release, (b) at all times fully collateralised with cash or such other collateral as the Depositary determines in good faith will provide substantially similar liquidity and security, (c) terminable by the Depositary on not more than five (5) business days' notice, and (d) subject to such further indemnities and credit regulations as the Depositary deems appropriate. The number of GDRs which are outstanding at any time as a result of Pre-Release will not normally represent more than thirty per cent. of the total number of GDRs then outstanding; **provided, however, that** the Depositary reserves the right to change or disregard such limit from time to time as it deems appropriate and may, with the prior written consent of the Company, change such limit for the purpose of general application. The Depositary will also set dollar limits with respect to Pre-Release transactions hereunder with any particular Pre-Releasee on a case by case basis as the Depositary deems appropriate. The collateral referred to in sub-paragraph (b) above shall be held by the Depositary as security for the performance of the Pre-Releasee's obligations in connection herewith, including the Pre-Releasee's obligation to deliver Shares and/or other securities or GDRs upon termination of a Pre-Release transaction anticipated hereunder (and shall not, for the avoidance of doubt, constitute Deposited Property hereunder).

The Depositary may retain for its own account any compensation received by it in connection with the foregoing including, without limitation, earnings on the collateral.

The person to whom any Pre-Release of Rule 144A GDRs or Rule 144A Shares is to be made pursuant to this Condition 1.6 shall be required to deliver to the Depositary a duly executed and completed certificate substantially in the form set out in Schedule 4 Part A of the Deposit Agreement (or as amended by the Depositary in accordance with Clause 3.10 of the Deposit Agreement and Condition 1.7). The person to whom any Pre-Release of Regulation S GDRs or Regulation S Shares is to be made pursuant to this paragraph shall be required to deliver to the Depositary a duly executed and completed certificate substantially in the form set out in Schedule 3 of the Deposit Agreement (or as amended by the Depositary in accordance with Clause 3.10 of the Deposit Agreement and Condition 1.7).

- 1.7 The Depositary may make such amendments to the certificates contained in the Deposit Agreement in Schedule 3 and in Schedule 4 Part A and Part B as it may reasonably determine are required in order for the



Depository to perform its duties under the Deposit Agreement, or to comply with any applicable law or with the rules and regulations of any securities exchange, market or automated quotation system upon which the GDRs may be listed or traded, or to comply with the rules or requirements of any book entry system by which the GDRs may be transferred, or to confirm compliance with any special limitations or restrictions to which any particular GDRs are subject.

- 1.8 In order to comply with any applicable laws and regulations or constitutional documents of the Company, the Depository may (including upon the Company's request) from time to time request each Holder to, and each Holder shall upon receipt of such request, provide to the Depository information relating to: (a) the capacity in which such Holder and/or any owner of GDRs holds its GDRs; (b) the identity of any owners of GDRs or other person or persons then or previously interested in such GDRs; (c) the nature of any such interests in the GDRs; and (d) any other matter where disclosure of such matter is required to enable compliance by the Company and the Depository with applicable laws and regulations or the constitutional documents of the Company. Each owner of the GDRs and Holder agrees to provide all information known to it in response to a request made pursuant to a request of that kind. Each owner of GDRs consents to the disclosure by the Holder of the GDRs or other person through which it holds GDRs, directly or indirectly, of all information responsive to a request of that kind that is known to that Holder of the GDRs or other person.
- 1.9 In order to comply with any applicable laws and regulations, the Depository may (including upon the Company's request) from time to time request Euroclear, Clearstream and DTC to provide the Depository with details of the accountholders within such settlement systems that hold interests in GDRs and the number of GDRs recorded in the account of each such accountholder, and each Holder or owner of GDRs, or intermediary acting on behalf of such Holder or owner, hereby authorises each of Euroclear, Clearstream and DTC to disclose such information to the Depository as issuer of the GDRs, to the Company and/or as required under any applicable laws and regulations.
- 1.10 Pursuant to applicable Russian law, as amended from time to time, the Company may request that the Depository request and provide information received, including quarterly registered Holder information and information relating to Holders and owners of GDRs obtainable from the relevant settlement systems.
- 1.11 Notwithstanding anything in the Deposit Agreement or in these Conditions to the contrary, after the initial issuance of GDRs, the Depository shall not accept for deposit any new Shares issued by the Company unless, or issue GDRs in respect of any new Shares otherwise than on a provisional basis represented by a temporary Master GDR until, as the case may be, the Depository has received written notice from the Company that a Placement Report (Notification) in relation to such Shares has been registered or filed, as the case may be, with the FSFM, at which time the relevant temporary GDRs shall be automatically exchanged for GDRs represented by an existing Master GDR. Prior to receiving written notice from the Company as required by this Condition 1.11, notwithstanding any other terms of this Agreement or the Conditions, where new Shares are deposited into a temporary Facility subject to this Condition 1.11, the Depository shall not permit such Shares to be withdrawn from the temporary Facility.
- 1.12 Notwithstanding any other provisions of the Deposit Agreement or these Conditions, the Depository may, with (to the extent reasonably practicable) prior notice to the Holders, cancel a number of the GDRs then outstanding, sell (either by public or private sale and otherwise in its discretion, subject to all applicable laws and regulations) the Deposited Property formerly represented by such GDRs and distribute the net proceeds of such sale as a cash distribution pursuant to Condition 4 to the Holders entitled thereto, and thereby reduce the Depository's holdings of any class of Deposited Property below an amount that the Depository determines to be necessary or advisable if (i) the Depository or its agent(s) receives any notice from any Russian governmental or regulatory authority that the existence or operation of a Facility or the holding by the Depository (or the Custodian or any of their respective nominees) of the Deposited Property violates any Russian law or regulation, or that the Depository (or the Custodian or any of their respective nominees) is required to make any filing or obtain any consent, approval or licence to operate that Facility or to own or exercise any rights with respect to the Deposited Shares or other Deposited Property (other than such filings, consents, approvals or licences which the Depository in its reasonable discretion considers to be of a routine administrative nature required in the ordinary course of business) or (ii) the Depository or the Custodian receives advice from recognised Russian counsel that the Depository (or the Custodian or any of their respective nominees) is reasonably likely to be subject to criminal, civil or administrative liabilities as a result of the existence or operation of a Facility or the holding or exercise by the Depository (or the Custodian or any of their respective nominees) of any rights with respect to the Deposited Shares or other Deposited Property. If the Depository cancels GDRs and sells Deposited Property under the preceding sentence, the Depository shall allocate the cancelled GDRs converted under the preceding sentence and the net proceeds of the sale of the Deposited Property previously represented thereby among the Holders *pro*

*rata* to their respective holdings of GDRs immediately prior to the cancellation, except that the allocations may be adjusted by the Depositary in its sole discretion so that no fraction of a cancelled GDR is allocated to any Holder. Any payment pursuant to this Condition 1.12 in connection with a GDR in definitive registered form shall be made to the relevant Holder only after surrender to the Depositary of the GDR certificate by such Holder for cancellation of the relevant number of GDRs. The Depositary shall also cancel GDRs and sell Deposited Property in accordance with this Condition 1.12 if the Depositary receives written instructions from the Company to do so and such cancellation and sale is necessary to enable the Company to comply with any applicable Russian law or regulation.

## **2. Suspension of Issue of GDRs and of Withdrawal of Deposited Property**

The Depositary shall be entitled, at its reasonable discretion, at such times as it shall determine, to suspend the issue or transfer of GDRs (and the deposit of Shares) generally or in respect of particular Shares. In particular, to the extent that it is in its opinion practicable for it to do so, the Depositary will refuse to accept Shares for deposit, to execute and deliver GDRs or to register transfers of GDRs if it has been notified by the Company in writing that the Deposited Shares or GDRs or any depositary receipts representing Shares are listed on a U.S. Securities Exchange or quoted on a U.S. automated inter dealer quotation system unless accompanied by evidence satisfactory to the Depositary that any such Shares are eligible for resale pursuant to Rule 144A under the United States Securities Act of 1933, as amended (the “Securities Act”). Further, the Depositary may suspend the withdrawal of Deposited Property during any period when the Register, or the register of shareholders of the Company is closed or, generally or in one or more localities, suspend the withdrawal of Deposited Property or deposit of Shares if deemed necessary or desirable or advisable by the Depositary in good faith at any time or from time to time, in order to comply with any applicable law or governmental or stock exchange regulations or any provision of the Deposit Agreement or for any other reason. The Depositary shall (unless otherwise notified by the Company) restrict the withdrawal of Deposited Shares where the Company notifies the Depositary in writing that such withdrawal would result in ownership of Shares exceeding any limit under any applicable law, government resolution or the Company's constitutive documents or would otherwise violate any applicable laws.

The Depositary will refuse to accept Shares for deposit whenever it is notified in writing by the Company that the Company has restricted the transfer of such Shares to comply with ownership restrictions under applicable Russian law or that such deposit would result in any violation of any applicable Russian laws or governmental or stock exchange regulations. The Company may, following receipt from the relevant Russian authority or regulator of formal approval given in anticipation of a further issue of Shares and GDRs to increase the number of Shares that may be deposited in the Regulation S Facility or the Rule 144A Facility, as applicable, instruct the Depositary to refuse to accept for deposit any Shares that would not have been permitted to be so deposited had such formal approval not been obtained, for a period ending no later than the relevant issue date of such further Shares and GDRs and the Depositary will refuse to accept such Shares.

## **3. Transfer and Ownership**

The GDRs are in registered form. Title to the GDRs passes by registration in the Register and accordingly, transfer of title to a GDR is effective only upon such registration. The Depositary will refuse to accept for transfer any GDRs if it reasonably believes that such transfer would result in violation of any applicable laws. The Holder of any GDR will (except as otherwise required by law) be treated by the Depositary and the Company as its beneficial owner for all purposes (whether or not any payment or other distribution in respect of such GDR is overdue and regardless of any notice of ownership, trust or any interest in it or any writing on, or theft or loss of any certificate issued in respect of it) and no person will be liable for so treating the Holder.

Interests in Rule 144A GDRs represented by the Rule 144A Master GDR may be transferred to a person whose interest in such Rule 144A GDRs is subsequently represented by the Regulation S Master GDR only upon receipt by the Depositary of written certifications (in the forms provided in the Deposit Agreement) from the transferor and the transferee to the effect that such transfer is being made in accordance with Rule 903 or Rule 904 of Regulation S under the Securities Act.

## **4. Cash Distributions**

Whenever the Depositary shall receive from the Company any cash dividend or other cash distribution on or in respect of the Deposited Shares (including any amounts received in the liquidation of the Company) or otherwise in connection with the Deposited Property, the Depositary shall, as soon as practicable, convert

the same into United States dollars in accordance with Condition 8. The Depositary shall, if practicable in the opinion of the Depositary, give notice to the Holders of its receipt of such payment in accordance with Condition 22, specifying the amount per Deposited Share payable in respect of such dividend or distribution and the earliest date, determined by the Depositary, for transmission of such payment to Holders and shall as soon as practicable distribute any such amounts to the Holders in proportion to the number of Deposited Shares represented by the GDRs so held by them respectively, subject to and in accordance with the provisions of Conditions 9 and 11; **PROVIDED THAT:**

- (a) in the event that the Depositary is aware that any Deposited Shares are not entitled to such full proportionate amount, the amount so distributed to the relative Holders shall be adjusted accordingly; and
- (b) the Depositary will distribute only such amounts of cash dividends and other distributions as may be distributed without attributing to any GDR a fraction of the lowest integral unit of currency in which the distribution is made by the Depositary, and any balance remaining shall be retained by the Depositary beneficially as an additional fee under Condition 16.1(d).

#### 5. **Distributions of Shares**

Whenever the Depositary shall receive from the Company any distribution in respect of Deposited Shares which consists of a dividend or free distribution of Shares, the Depositary shall, as soon as practicable, cause to be distributed to the Holders entitled thereto, in proportion to the number of Deposited Shares represented by the GDRs held by them respectively, additional GDRs representing an aggregate number of Shares received pursuant to such distribution. Such additional GDRs shall be distributed by an increase in the number of GDRs represented by the Master GDRs or by an issue of certificates in definitive registered form in respect of GDRs, according to the manner in which the Holders hold their GDRs; **PROVIDED THAT**, if and in so far as the Depositary deems any such distribution to all or any Holders not to be reasonably practicable (including, without limitation, due to the fractions which would otherwise result or to any requirement that the Company, the Custodian or the Depositary withhold an amount on account of taxes or other governmental charges) or to be unlawful, the Depositary shall (either by public or private sale and otherwise at its discretion, subject to all applicable laws and regulations) sell such Shares so received and distribute the net proceeds of such sale as a cash distribution pursuant to Condition 4 to the Holders entitled thereto.

#### 6. **Distributions other than in Cash or Shares**

Whenever the Depositary shall receive from the Company any dividend or distribution in securities (other than Shares) or in other property (other than cash) on or in respect of the Deposited Property, the Depositary shall distribute or cause to be distributed such securities or other property to the Holders entitled thereto, in proportion to the number of Deposited Shares represented by the GDRs held by them respectively, in any manner that the Depositary may deem equitable and practicable for effecting such distribution; **PROVIDED THAT**, if and in so far as the Depositary deems any such distribution to all or any Holders not to be reasonably practicable (including, without limitation, due to the fractions which would otherwise result or to any requirement that the Company, the Custodian or the Depositary withhold an amount on account of taxes or other governmental charges) or to be unlawful, the Depositary shall deal with the securities or property so received, or any part thereof, in such way as the Depositary may determine to be equitable and practicable, including, without limitation, by way of sale (either by public or private sale and otherwise at its discretion, subject to all applicable laws and regulations) and shall (in the case of a sale) distribute the resulting net proceeds as a cash distribution pursuant to Condition 4 to the Holders entitled thereto.

#### 7. **Rights Issues**

If and whenever the Company announces its intention to make any offer or invitation to the holders of Shares to subscribe for or to acquire Shares, securities or other assets by way of rights, the Depositary shall as soon as practicable give notice to the Holders, in accordance with Condition 22, of such offer or invitation, specifying, if applicable, the earliest date established for acceptance thereof, the last date established for acceptance thereof and the manner by which and time during which Holders may request the Depositary to exercise such rights as provided below or, if such be the case, specifying details of how the Depositary proposes to distribute the rights or the proceeds of any sale thereof. The Depositary will deal with such rights in the manner described below:

- (a) if and to the extent that the Depositary shall, at its discretion, deem it to be lawful and reasonably practicable, the Depositary shall make arrangements whereby the Holders may, upon payment of the

subscription price in Rubles or other relevant currency together with such fees, taxes, duties, charges, costs and expenses as may be required under the Deposit Agreement and completion of such undertakings, declarations, certifications and other documents as the Depositary may reasonably require, request the Depositary to exercise such rights on their behalf with respect to the Deposited Shares and to distribute the Shares, securities or other assets so subscribed or acquired to the Holders entitled thereto by an increase in the numbers of GDRs represented by the Master GDRs or an issue of certificates in definitive registered form in respect of GDRs, according to the manner in which the Holders hold their GDRs; or

- (b) if and to the extent that the Depositary shall at its discretion, deem it to be lawful and reasonably practicable, the Depositary will distribute such rights to the Holders entitled thereto in such manner as the Depositary may at its discretion determine; or
- (c) if and to the extent that the Depositary deems any such arrangement and distribution as is referred to in paragraphs (a) and (b) above to all or any Holders not to be lawful and reasonably practicable (including, without limitation, due to the fractions which would otherwise result or to any requirement that the Company, the Custodian or the Depositary withhold an amount on account of taxes or other governmental charges) or to be unlawful, the Depositary (i) will, **PROVIDED THAT** Holders have not taken up rights through the Depositary as provided in (a) above, sell such rights (either by public or private sale and otherwise at its discretion subject to all applicable laws and regulations) or (ii) may, if such rights are not transferable, in its discretion, arrange for such rights to be exercised and the resulting Shares or securities sold and, in each case, distribute the net proceeds of such sale as a cash distribution pursuant to Condition 4 to the Holders entitled thereto.
- (d)
  - (i) Notwithstanding the foregoing, in the event that the Depositary offers rights pursuant to Condition 7(a) (the “**Primary GDR Rights Offering**”), if authorised by the Company to do so, the Depositary may, in its discretion, make arrangements whereby in addition to instructions given by a Holder to the Depositary to exercise rights on its behalf pursuant to Condition 7(a), such Holder is permitted to instruct the Depositary to subscribe on its behalf for additional rights which are not attributable to the Deposited Shares represented by such Holder's GDRs (“**Additional GDR Rights**”) if at the date and time specified by the Depositary for the conclusion of the Primary GDR Rights Offering (the “**Instruction Date**”) instructions to exercise rights have not been received by the Depositary from the Holders in respect of all their initial entitlements. Any Holder's instructions to subscribe for such Additional GDR Rights (“**Additional GDR Rights Requests**”) shall specify the maximum number of Additional GDR Rights that such Holder is prepared to accept (the “**Maximum Additional Subscription**”) and must be received by the Depositary by the Instruction Date. If by the Instruction Date any rights offered in the Primary GDR Rights Offering have not been subscribed by the Holders initially entitled thereto (“**Unsubscribed Rights**”), subject to Condition 7(d)(iii) and receipt of the relevant subscription price in Rubles or other relevant currency, together with such fees, taxes, duties, charges, costs and expenses as it may deem necessary, the Depositary shall make arrangements for the allocation and distribution of Additional GDR Rights in accordance with Condition 7(d)(ii).
  - (ii) Holders submitting Additional GDR Rights Requests shall be bound to accept the Maximum Additional Subscription specified in such Additional GDR Rights Request but the Depositary shall not be bound to arrange for a Holder to receive the Maximum Additional Subscription so specified but may make arrangements whereby the Unsubscribed Rights are allocated *pro rata* on the basis of the extent of the Maximum Additional Subscription specified in each Holder's Additional GDR Rights Request.
  - (iii) In order to proceed in the manner contemplated in this Condition 7(d), the Depositary shall be entitled to receive such opinions from Russian counsel and US counsel as in its discretion it deems necessary which opinions shall be in a form and provided by counsel satisfactory to the Depositary and at the expense of the Company and may be requested in addition to any other opinions and/or certifications which the Depositary shall be entitled to receive under the Deposit Agreement and these Conditions. For the avoidance of doubt, save as provided in these Conditions and the Deposit Agreement, the Depositary shall have no liability to the Company or any Holder in respect of its actions or omissions to act under this Condition 7(d) and, in particular, the Depositary will not be regarded as being negligent, acting in bad faith, or in wilful default if it elects not to make the arrangements referred to in Condition 7(d)(i).



The Company has agreed in the Deposit Agreement that it will not, unless prohibited by applicable law or regulation, unreasonably withhold its consent to, and if it has so consented will on request use all reasonable endeavours (subject to the next paragraph) to facilitate, any such distribution, sale or subscription by the Depositary or the Holders, as the case may be, pursuant to Conditions 4, 5, 6, 7 or 10 (including the obtaining of legal opinions from counsel reasonably satisfactory to the Depositary concerning such matters as the Depositary may reasonably specify).

If the Company notifies the Depositary that registration is required in any jurisdiction under any applicable law of the rights, securities or other property to be distributed under Conditions 4, 5, 6, 7 or 10 or the securities to which such rights relate in order for the Company to offer such rights or distribute such securities or other property to the Holders or owners of GDRs and to sell the securities corresponding to such rights, the Depositary will not offer such rights or distribute such securities or other property to the Holders or sell such securities unless and until the Company procures the receipt by the Depositary of an opinion from counsel reasonably satisfactory to the Depositary that a registration statement is in effect or that the offering and sale of such rights or securities to such Holders or owners of GDRs are exempt from registration under the provisions of such law. Neither the Company nor the Depositary shall be liable to register such rights, securities or other property or the securities to which such rights relate and they shall not be liable for any losses, damages or expenses resulting from any failure to do so.

If at the time of the offering of any rights, at its discretion, the Depositary shall be satisfied that it is not lawful or practicable (for reasons outside its control) to dispose of the rights in any manner provided in paragraphs (a), (b), (c) and (d) above, the Depositary shall permit the rights to lapse. The Depositary will not be responsible for any failure to determine that it may be lawful or feasible to make such rights available to Holders or owners of GDRs in general or to any Holder or owner of a GDR or Holders or owners of GDRs in particular.

## **8. Conversion of Foreign Currency**

Whenever the Depositary shall receive any currency other than United States dollars by way of dividend or other distribution or as the net proceeds from the sale of securities, other property or rights, and if at the time of the receipt thereof the currency so received can in the judgement of the Depositary be converted on a reasonable basis into United States dollars and distributed to the Holders entitled thereto, the Depositary shall as soon as practicable convert or cause to be converted, by sale or in any other manner that it may reasonably determine, the currency so received into United States dollars. If such conversion or distribution can be effected only with the approval or licence of any government or agency thereof, the Depositary may make reasonable efforts to apply, or procure that an application be made, for such approval or licence, if any, as it may deem desirable. If at any time the Depositary shall determine that in its judgement any currency other than United States dollars is not convertible on a reasonable basis into United States dollars and distributable to the Holders entitled thereto, or if any approval or licence of any government or agency thereof which is required for such conversion is denied or, in the opinion of the Depositary, is not obtainable, or if any such approval or licence is not obtained within a reasonable period as determined by the Depositary, the Depositary may distribute such other currency received by it (or an appropriate document evidencing the right to receive such other currency) to the Holders entitled thereto to the extent permitted under applicable law, or the Depositary may in its discretion hold such other currency without liability for interest for the benefit of the Holders entitled thereto. If any conversion of any such currency can be effected in whole or in part for distribution to some (but not all) Holders entitled thereto, the Depositary may at its discretion make such conversion and distribution in United States dollars to the extent possible to the Holders entitled thereto and may distribute the balance of such other currency received by the Depositary to, or hold such balance for the account of, the Holders entitled thereto, and notify the Holders accordingly.

## **9. Distribution of any Payments**

- 9.1 Any distribution of cash under Conditions 4, 5, 6, 7 or 10 will be made by the Depositary to Holders on the record date established by the Depositary for that purpose (such date to be as close to the record date set by the Company as is reasonably practicable) and, if practicable in the opinion of the Depositary, notice shall be given promptly to Holders in accordance with Condition 23, in each case subject to any laws or regulations applicable thereto and (subject to the provisions of Condition 8) distributions will be made in United States dollars by cheque drawn upon a bank in New York City or, in the case of the Master GDRs, according to usual practice between the Depositary and Clearstream, Euroclear or DTC, as the case may be. The Depositary or the Agent, as the case may be, may deduct and retain from all moneys due in respect of



such GDR in accordance with the Deposit Agreement all fees, taxes, duties, charges, costs and expenses which may become or have become payable under the Deposit Agreement or under applicable law or regulation in respect of such GDR or the relative Deposited Property.

- 9.2 Delivery of any securities or other property or rights other than cash shall be made as soon as practicable to the Holders on the record date established by the Depositary for that purpose (such date to be as close to the record date set by the Company as is reasonably practicable), subject to any laws or regulations applicable thereto. If any distribution made by the Company with respect to the Deposited Property and received by the Depositary shall remain unclaimed at the end of three years from the first date upon which such distribution is made available to Holders in accordance with the Deposit Agreement, all rights of the Holders to such distribution or the proceeds of the sale thereof shall be extinguished and the Depositary shall (except for any distribution upon the liquidation of the Company when the Depositary shall retain the same) return the same to the Company for its own use and benefit subject, in all cases, to the provisions of applicable law or regulation and the Company's constitutional documents.

## **10. Capital Re-organisation**

Upon any change in the nominal or par value, sub-division, consolidation or other reclassification of Deposited Shares or any other part of the Deposited Property or upon any reduction of capital, or upon any re-organisation, merger or consolidation of the Company or to which it is a party (except where the Company is the continuing corporation), the Depositary shall as soon as practicable give notice of such event to the Holders and at its discretion may treat such event as a distribution and comply with the relevant provisions of Conditions 4, 5, 6 and 9 with respect thereto, or may execute and deliver additional GDRs in respect of Shares or may require the exchange of existing GDRs for new GDRs which reflect the effect of such change.

## **11. Withholding Taxes and Applicable Laws**

- 11.1 Payments to Holders of dividends or other distributions on or in respect of the Deposited Shares will be subject to deduction of Russian and other withholding taxes, if any, at the applicable rates.
- 11.2 If any governmental or administrative authorisation, consent, registration or permit or any report to any governmental or administrative authority is required under any applicable law in Russia in order for the Depositary to receive from the Company Shares or other securities to be deposited under these Conditions, or in order for Shares, other securities or other property to be distributed under Condition 4, 5, 6 or 10 or to be subscribed under Condition 7 or to offer any rights or sell any securities represented by such rights relevant to any Deposited Shares, the Company has agreed to apply for such authorisation, consent, registration or permit or file such report on behalf of the Holders within the time required under such laws. In this connection, the Company has undertaken in the Deposit Agreement to the extent reasonably practicable to take such action as may be required in obtaining or filing the same. The Depositary shall not be obliged to distribute GDRs representing such Shares, Shares, other securities or other property deposited under these Conditions or make any offer of any such rights or sell any securities corresponding to any such rights with respect to which (as notified to the Depositary by the Company) such authorisation, consent, registration or permit or such report has not been obtained or filed, as the case may be, and shall have no duties to obtain (but shall, where assistance is reasonably requested by the Company and such assistance does not require the Depositary to take any action in conflict with market practice or in a capacity other than its capacity as Depositary, at the expense of the Company, make reasonable endeavours to assist the Company to obtain) any such authorisation, consent, registration or permit, or to file any such report.

## **12. Voting Rights**

- 12.1 Holders will have voting rights with respect to the Deposited Shares. The Company has agreed to notify the Depositary of any resolution to be proposed at a General Meeting of the Company, or any resolution proposed as a written resolution, and the Depositary will vote or cause to be voted the Deposited Shares in the manner set out in this Condition 12.

The Company has agreed with the Depositary that it will promptly provide to the Depositary sufficient copies, as the Depositary may reasonably request, of notices of meetings of the shareholders of the Company and the agenda therefor as well as any proposed written resolution of the Company and written requests containing voting instructions by which each Holder may give instructions to the Depositary to vote for or against, or abstain from voting on, each and any resolution specified in the agenda for the meeting or

proposed as a written resolution, which the Depositary shall send to any person who is a Holder on the record date established by the Depositary for that purpose (which shall be the same as the corresponding record date set by the Company or as near as practicable thereto) as soon as practicable after receipt of the same by the Depositary in accordance with Condition 22. The Company has also agreed to provide to the Depositary appropriate proxy forms to enable the Depositary to appoint a representative to attend the relevant meeting and vote on behalf of the Depositary.

- 12.2 In order for each voting instruction to be valid, the voting instructions form must be completed and duly signed by the respective Holder (or in the case of instructions received from the settlement systems should be received by authenticated SWIFT message) in accordance with the written request containing voting instructions and returned to the Depositary by such record date as the Depositary may specify.
- 12.3 The Depositary will exercise or cause to be exercised the voting rights in respect of the Deposited Shares so that, as relevant, a portion of the Deposited Shares will be voted for and a portion of the Deposited Shares will be voted against any resolution specified in the agenda for the relevant meeting in accordance with the voting instructions it has received.
- 12.4 If the Depositary is advised in the opinion referred to in Condition 12.7 below that it is not permitted by Russian law to exercise the voting rights in respect of the Deposited Shares differently (so that a portion of the Deposited Shares may be voted for a resolution and a portion of the Deposited Shares may be voted against a resolution) the Depositary shall, if the opinion referred to in Condition 12.7 below confirms it to be permissible under Russian law, calculate from the voting instructions that it has received from all Holders (x) the aggregate number of votes in favour of a particular resolution and (y) the aggregate number of votes opposed to such resolution and cast or cause to be cast in favour of or opposed to such resolution the number of votes representing the net positive difference between such aggregate number of votes in favour of such resolution and such aggregate number of votes opposed to such resolution.
- 12.5 The Depositary will only endeavour to vote or cause to be voted the votes attaching to Shares in respect of which voting instructions have been received. If no voting instructions are received by the Depositary (either because no voting instructions are returned to the Depositary or because the voting instructions are incomplete, illegible or unclear) from a Holder with respect to any or all of the Deposited Shares represented by such Holder's GDRs on or before the record date specified by the Depositary, the Depositary shall not, and shall have no obligation to, vote or cause to be voted such Deposited Shares.
- 12.6 If and to the extent the Depositary is advised in the opinion referred to in Condition 12.7 below that it is not permissible under Russian law or the Depositary determines that it is not reasonably practicable to vote or cause to be voted such Deposited Shares in accordance with Conditions 12.3 or 12.4 the Depositary shall not to such extent vote or cause to be voted such Deposited Shares.
- 12.7 Where the Depositary is to vote in respect of each and any resolution in the manner described in Conditions 12.3 or 12.4 above the Depositary shall notify the chief executive officer of the Company and appoint a person designated by him as a representative of the Depositary to attend such meeting and vote the Deposited Shares in the manner required by this Condition. The Depositary is entitled to request the Company to provide to the Depositary, and where such request has been made shall not be required to take any action required by this Condition 12 unless it shall have received, an opinion from the Company's legal counsel (such counsel being reasonably acceptable to the Depositary) at the expense of the Company to the effect that such voting arrangement (or restriction of rights to receive distributions or exercise voting rights) is valid and binding on Holders under Russian law and the constitutional documents of the Company and that the Depositary is permitted to exercise votes (or withhold distribution rights or voting rights from Holders and/or owners in accordance with Condition 12.9) in accordance with the provisions of this Condition 12 but that in doing so the Depositary will not be deemed to be exercising voting discretion.
- 12.8 By continuing to hold GDRs, all Holders shall be deemed to have agreed to the provisions of this Condition as it may be amended from time to time in order to comply with applicable Russian law.
- 12.9 Notwithstanding any other provision of the Deposit Agreement or these Conditions, to the extent that the Company notifies the Depositary that applicable Russian law or regulations provide that Deposited Shares for which required disclosures have not been received may be deprived of rights such as rights to receive distributions or to exercise voting rights, the Depositary shall, to the extent practicable, comply with reasonable written instructions received by it from the Company to withhold those rights from Holders and/or owners of some or all of the GDRs, and owners of GDRs and Holders hereby consent to that withholding of rights.

12.10 The Depositary shall not, and the Depositary shall ensure that the Custodian and its nominees do not, vote or attempt to exercise the right to vote that attaches to the Deposited Shares, other than in accordance with instructions given in accordance with this Condition.

**13. Recovery of Taxes, Duties and Other Charges, and Fees and Expenses due to the Depositary**

The Depositary shall not be liable for any taxes, duties, charges, costs or expenses which may become payable in respect of the Deposited Shares or other Deposited Property or the GDRs, whether under any present or future fiscal or other laws or regulations, and such part thereof as is proportionate or referable to a GDR (the “Charges”) shall be payable by the Holder thereof to the Depositary at any time on request or may be deducted from any amount due or becoming due on such GDR in respect of any dividend or other distribution. The Depositary may sell (whether by way of public or private sale and otherwise at its discretion, subject to all applicable laws and regulations) for the account of the Holder an appropriate number of Deposited Shares or amount of other Deposited Property and will discharge out of the proceeds of such sale any Charges, and any fees or expenses due to the Depositary from the Holder pursuant to Condition 16, and subsequently pay any surplus to the Holder. Any request by the Depositary for the payment of Charges shall be made by giving notice pursuant to Condition 22.

**14. Liability**

14.1 In acting hereunder the Depositary shall have only those duties, obligations and responsibilities expressly specified in the Deposit Agreement and these Conditions and, other than holding the Deposited Property for the benefit of Holders as bare trustee, does not assume any relationship of trust for or with the Holders or owners of GDRs or any other person.

14.2 Neither the Depositary, the Custodian, the Company, any Agent, nor any of their agents, officers, directors or employees shall incur any liability to any other of them or to any Holder or owner of a GDR or any other person with an interest in any GDRs if, by reason of any provision of any present or future law or regulation of Russia or any other country or of any relevant governmental authority, or by reason of the interpretation or application of any such present or future law or regulation or any change therein, or by reason of any other circumstances beyond their control, or in the case of the Depositary, the Custodian, any Agent, or any of their agents, officers, directors or employees, by reason of any provision, present or future, of the constitutional documents of the Company, any of them shall be prevented, delayed or forbidden from doing or performing any act or thing which the terms of the Deposit Agreement or these Conditions provide shall or may be done or performed; nor shall any of them incur any liability to any Holder or owner of GDRs or any other person with an interest in any GDRs by reason of any exercise of, or failure to exercise, any voting rights attached to the Deposited Shares or any of them or any other discretion or power provided for in the Deposit Agreement (where such exercise or failure to exercise results from any of the circumstances described above). Any such party may rely on, and shall be protected in acting upon, any written notice, request, direction or other document reasonably believed by it to be genuine and to have been duly signed or presented (including a translation which is made by a translator believed by it to be competent or which appears to be authentic).

14.3 Neither the Depositary nor any Agent shall be liable to the Company or any Holder or owner of GDRs or any other person: (i) by reason of having accepted as valid or not having rejected any certificate for Shares or GDRs or any signature on any transfer or instruction purporting to be such and subsequently found to be forged or not authentic, or (ii) for its failure to perform any obligations under the Deposit Agreement or these Conditions, except in either case for its own wilful default, negligence or bad faith or that of its agents, officers, directors or employees.

14.4 The Depositary and its agents may engage or be interested in any financial or other business transactions with the Company or any of its subsidiaries or affiliates, or in relation to the Deposited Property (including without prejudice to the generality of the foregoing, the conversion of any part of the Deposited Property from one currency to another), may at any time hold or be interested in GDRs for its own account, and shall be entitled to charge and be paid all usual fees, commissions and other charges for business transacted and acts done by it as a bank, and not in the capacity of Depositary, in relation to matters arising under the Deposit Agreement (including, without prejudice to the generality of the foregoing, charges on the conversion of any part of the Deposited Property from one currency to another and on any sales of property) without accounting to Holders or any other person for any profit arising therefrom.

- 14.5 The Depositary shall endeavour to effect any such sale as is referred to or contemplated in Conditions 5, 6, 7, 10, 13 or 20 or any such conversion as is referred to in Condition 8 in accordance with the Depositary's normal practices and procedures but shall have no liability (in the absence of its own wilful default, negligence or bad faith or that of its agents, officers, directors or employees) with respect to the terms of such sale or conversion or if such sale or conversion shall not be reasonably practicable.
- 14.6 The Depositary shall not be required or obliged to monitor, supervise or enforce the observance and performance by the Company of its obligations under or in connection with the Deposit Agreement or these Conditions.
- 14.7 The Depositary shall have no responsibility whatsoever to the Company, any Holders or any owner of GDRs or any other person as regards any deficiency which might arise because the Depositary is subject to any tax in respect of the Deposited Property or any part thereof or any income therefrom or any proceeds thereof.
- 14.8 In connection with any proposed modification, waiver, authorisation or determination permitted by the terms of the Deposit Agreement, the Depositary shall not, except as otherwise expressly provided in Condition 21, be obliged to have regard to the consequence thereof for the Holders or the owners of GDRs or any other person.
- 14.9 Notwithstanding anything else contained in the Deposit Agreement or these Conditions, the Depositary may refrain from doing anything which could or might, in its opinion, be contrary to any law of any jurisdiction or any directive or regulation of any agency or state or which would or might otherwise render it liable to any person and the Depositary may do anything which is, in its opinion, necessary to comply with any such law, directive or regulation.
- 14.10 The Depositary may, in relation to the Deposit Agreement and these Conditions, act or take no action on the advice or opinion of, or any certificate or information obtained from, any lawyer, valuer, accountant, banker, broker, securities company or other expert whether obtained by the Company, the Depositary or otherwise, and shall not be responsible or liable for any loss or liability occasioned by so acting or refraining from acting or relying on information from persons presenting Shares for deposit or GDRs for surrender or requesting transfers thereof.
- 14.11 Any such advice, opinion, certificate or information (as discussed in Condition 14.10 above) may be sent or obtained by letter, telex, facsimile transmission, telegram or cable and the Depositary shall not be liable for acting on any advice, opinion, certificate or information purported to be conveyed by any such letter, telex or facsimile transmission although (without the Depositary's knowledge) the same shall contain some error or shall not be authentic.
- 14.12 The Depositary may call for and shall be at liberty to accept as sufficient evidence of any fact or matter or the expediency of any transaction or thing, a certificate, letter or other communication, whether oral or written, signed or otherwise communicated on behalf of the Company by a director of the Company or by a person duly authorised by a director of the Company or such other certificate from persons specified in Condition 14.10 above which the Depositary considers appropriate and the Depositary shall not be bound in any such case to call for further evidence or be responsible for any loss or liability that may be occasioned by the Depositary acting on such certificate.
- 14.13 The Depositary shall have no obligation under the Deposit Agreement except to perform its obligations as are specifically set out therein without wilful default, negligence or bad faith.
- 14.14 The Depositary may delegate by power of attorney or otherwise to any person or persons or fluctuating body of persons, whether being a joint Depositary of the Deposit Agreement or not and not being a person to whom the Company may reasonably object, all or any of the powers, authorities and discretions vested in the Depositary by the Deposit Agreement and such delegation may be made upon such terms and subject to such conditions, including power to sub-delegate and subject to such regulations as the Depositary may in the interests of the Holders think fit, **provided that** no objection from the Company to any such delegation as aforesaid may be made to a person whose financial statements are consolidated with those of the Depositary's ultimate holding company (each a **"Depositary Group Entity"**). Any delegation by the Depositary shall be on the basis that the Depositary is acting on behalf of the Holders and the Company in making such delegation. The Company shall not in any circumstances and the Depositary shall not (**provided that** it shall have exercised reasonable care in the selection of such delegate) be bound to supervise the proceedings or be in any way responsible for any loss, liability, cost, claim, action, demand or expense incurred by reason of any misconduct or default on the part of any such delegate or sub-delegate. However, the Depositary shall, if practicable, and if so requested by the



Company, pursue (at the Company's expense and subject to receipt by the Depositary of such indemnity and security for costs as the Depositary may reasonably require) any legal action it may have against such delegate or sub-delegate arising out of any such loss caused by reason of any such misconduct or default. The Depositary shall, within a reasonable time of any such delegation or any renewal, extension or termination thereof, give notice thereof to the Company. Any delegation under this Condition which includes the power to sub-delegate shall provide that the delegate shall, within a specified time of any sub-delegation or amendment, extension or termination thereof, give notice thereof to the Company and the Depositary. Notwithstanding the foregoing, the Depositary has agreed to provide to the Company prior written notice of any delegation or sub-delegation under this Condition 14.14, if such delegation or sub-delegation is deemed material and not in the ordinary course of business in the reasonable opinion of the Depositary (save that no prior written notice shall be required in the case of delegation to any affiliate or subsidiary of the Depositary), and any person who is the subject of a delegation or sub-delegation in respect of which prior written notice is required pursuant to this sentence shall be deemed an agent of the Depositary for the purposes of Condition 14.16.

- 14.15 The Depositary may, in the performance of its obligations hereunder, instead of acting personally, employ and pay an agent, whether a solicitor or other person, to transact or concur in transacting any business and do or concur in doing all acts required to be done by such party, including the receipt and payment of money.
- 14.16 Notwithstanding anything to the contrary contained in the Deposit Agreement or these Conditions, the Depositary shall not be liable in respect of any loss or damage which arises out of or in connection with its performance or non-performance, or the exercise or attempted exercise of (or the failure to exercise any of) its powers or discretions, under the Deposit Agreement, except to the extent that such loss or damage arises from the wilful default, negligence or bad faith of the Depositary or that of its agents, officers, directors or employees. Without prejudice to the generality of the foregoing, in no circumstances shall the Depositary have any liability for any act or omission of any securities depository, clearing agency or settlement system in connection with or arising out of book-entry settlement of Deposited Shares or otherwise.
- 14.17 No provision of the Deposit Agreement or these Conditions shall require the Depositary to expend or risk its own funds or otherwise incur any financial liability in the performance of any of its duties or in the exercise of any of its rights or powers.
- 14.18 For the avoidance of doubt, the Depositary shall be under no obligation to check, monitor or enforce compliance with any ownership restrictions in respect of GDRs or Shares under any applicable Russian law as the same may be amended from time to time. Notwithstanding the generality of Condition 3, the Depositary shall refuse to register any transfer of GDRs or any deposit of Shares against issuance of GDRs if notified by the Company, or the Depositary becomes aware of the fact, that such transfer or issuance would result in a violation of the limitations set forth above.
- 14.19 The Depositary may, in its sole discretion and at its expense, transfer all or any of its rights and obligations under the Deposit Agreement or the Conditions by way of an assignment or novation to any Depositary Group Entity, subject to the Company's prior written consent, which consent the Company has agreed shall not be unreasonably withheld and if given the Company has agreed shall be given by the Company within 30 days after receipt by the Company of a written request for such assignment or novation. The Company must be provided by the Depositary with a written assignment/novation request specifying the relevant Depositary Group Entity and the rights and/or obligations which such Depositary Group Entity will assume pursuant to Clause 9.19 of the Deposit Agreement and this Condition 14.19. Upon any such assignment or novation becoming effective, the relevant Depositary Group Entity specified in such assignment/novation request shall assume the rights and/or obligations specified in such assignment/novation request as if it was originally a party to the Deposit Agreement. In the case of a novation, then upon such novation becoming effective, the relevant Depositary Group Entity shall be deemed to be named as Depositary in each GDR. Following receipt by the Depositary of the Company's written consent to an assignment or novation pursuant to Clause 9.19 of the Deposit Agreement and this Condition 14.19, notice thereof shall be duly given by the Depositary to the Holders in accordance with Condition 22.
- 14.20 Each Holder, where relevant, acting also on behalf of the owner of or other person interested in one or more GDRs, by subscribing or acquiring a GDR and any time thereafter so long as it is a Holder, owner of or other person interested in one or more GDRs, mandates, authorises and empowers the Depositary to disclose, or make available for further processing, any information entrusted to it and concerning the relevant Holder, owner of or other person interested in one or more GDRs under or in the context of these



Conditions of the Deposit Agreement which comes within the scope of the statutory confidentiality duty of the Depositary pursuant to Article 41 of the Luxembourg law dated 5 April 1993 on the financial sector, as amended, or the disclosure or making available of which is restricted under applicable data protection legislation (“**Confidential Holder Information**”), including, without limitation, information on (i) the relevant Holder, owner of or other person interested in one or more GDRs hereby (including, without limitation, registered office or residence, business sector, financial data, representatives, beneficial ownership and ownership structure as well as other information obtained for customer identification and on-boarding purposes) and (ii) the transactions with the Holder, owner of or other person interested in one or more GDRs (including, without limitation, Deposited Property, GDRs and these Conditions, transaction positions, fees, taxes, corporate actions, events of default or similar data or information) to the Company, The Bank of New York Mellon, New York, any other appropriate Depositary Group Entity, the Custodian, any securities clearing and settlement system, in particular DTC, Clearstream and Euroclear or SWIFT (Society for Worldwide Interbank Financial Telecommunication), a bank or other payment services provider or other agent used by any of the foregoing for the receipt or payment of money, Agents used for making distributions to the Holders or proxy distribution agents (“**Disclosure Addressees**”, and each of them a “**Disclosure Addressee**”), be such Disclosure Addressees incorporated or established inside or outside the European Union, for the purpose of and to the extent this is necessary for assisting or enabling the Depositary to perform its obligations under this Agreement (“**Disclosure Purposes**”).

In case a new delegation, sub-delegation or granting of a power to sub-delegate or a new employment of an agent or an amendment or extension of an existing delegation, sub-delegation, power to sub-delegate or agent employment relationship (including the appointment of a successor or additional Custodian or Custodians of the Deposited Property in accordance with Clause 3.1 of the Deposit Agreement and Condition 18) or the appointment of a successor depositary in accordance with Clause 11 of the Deposit Agreement and Condition 19 is envisaged which involves, or introduces or widens the possibility of, disclosure or making available of Confidential Holder Information to the relevant delegate, sub-delegate, potential sub-delegate, agent or successor depositary that is not a Disclosure Addressee, the Depositary shall give at least 15 business days prior notice thereof in accordance with Condition 22 to the Holders. As of lapsing of such notice period, the relevant delegate, sub-delegate, potential sub-delegate, agent or successor depositary shall be deemed to be a Disclosure Addressee and the Depositary shall be deemed to be mandated, authorised and empowered by the Holders, owners and other persons interested in the GDRs to disclose Confidential Holder Information to such new Disclosure Addressee for the Disclosure Purposes. Holders, owners and other persons interested in the GDRs disagreeing with the disclosure or making available of Confidential Holder Information to a new Disclosure Addressee shall be given the possibility at any time before lapsing of such notice period to dispose of their holding, ownership or interest in a GDR and thereby to cease being a Holder, owner or other person interested in a GDR preventing disclosure and making available of Confidential Holder Information to a new Disclosure Addressee. A disagreeing Holder or a Holder acting on behalf of a disagreeing owner or other person interested in a GDR shall in particular be entitled at any time before lapsing of such notice period to obtain delivery of the Deposited Property relative to each GDR held by it, subject to the provisions of Condition 1.1 and upon compliance with Condition 1, payment by the Holder of the charge specified in Condition 16.1(a) and Clause 10.1(a)(i) of the Deposit Agreement for such delivery and surrender, and payment by the Holder of any sums payable by the Depositary and/or any other expenses incurred by the Depositary (together with all amounts which the Depositary is obliged to pay to the Custodian) in connection with such delivery and surrender, and otherwise in accordance with the Deposit Agreement.

For the avoidance of doubt, each Holder, where relevant, acting also on behalf of the owner of or other person interested in one or more GDRs, by subscribing or acquiring a GDR and any time thereafter so long as it is a Holder, owner of or other person interested in one or more GDRs, as appropriate, hereby waives to the extent necessary any confidentiality obligations that the Depositary may have vis-à-vis the relevant Holder, owner of or other person interested in one or more GDRs for the purpose of allowing the above-mentioned disclosures of Confidential Holder Information by the Depositary and authorises the Depositary to transmit any Confidential Holder Information as may be necessary to the Disclosure Addressees for the Disclosure Purposes.

Each Holder by subscribing or acquiring a GDR and any time thereafter so long as it is a Holder represents and warrants that it is and will be duly authorised and has obtained and, where relevant, will obtain respective prior consent and waiver declarations from any owner or other person interested in one or more GDRs and will for such purpose promptly as of receipt of notices given by the Depositary to the Holders inform these owners or other persons interested in one or more GDRs of the content of any such

notices as foreseen in this Condition 14.20 so as to permit the disclosure of Confidential Holder Information by the Depositary and its employees, agents, delegates, sub-delegates or other representatives to the Disclosure Addressees for the Disclosure Purposes or to permit such owners or other persons interested in one or more GDRs to dispose of such GDRs before the lapsing of the relevant notice period if they disagree with a disclosure of Confidential Holder Information relating to them to a new Disclosure Addressee.

The transmission of Confidential Holder Information via or transmission or making available of Confidential Holder Information to a communication medium belonging to any of the Disclosure Addressees (as and to the extent permitted hereunder) may entail all Confidential Holder Information being processed by, including stored in the central data banks of a Disclosure Addressee for the Disclosure Purposes. Such data banks may be located in Europe, in the United States of America (in particular, without limitation, in New York) or anywhere in the world. The Holder, where relevant, acting also on behalf of the owner of or other person interested in one or more GDRs, by subscribing or acquiring one or more GDRs and any time thereafter so long as it is a Holder, is informed and acknowledges of being aware that due to the fact that the Confidential Holder Information is transferred electronically or otherwise and made available outside of Luxembourg the same level of confidentiality and the same level of protection in relation to data protection and confidentiality laws and regulations as currently in force in Luxembourg may not be guaranteed while the Confidential Holder Information is transferred and stored abroad. Consequently, Confidential Holder Information thus stored may be disclosed or made available to authorities of the country of storage pursuant to that country's legislation.

To the extent Confidential Holder Information consists of personal data of a Holder or owner or other person interested in one or more GDRs who is an individual and such data are processed under the responsibility of the Depositary, such individual is hereby being informed that its data will only be processed by the Depositary for the purpose of performing its obligations under the Deposit Agreement and the Conditions and that such individual has a right of access to and rectification of its personal data in the premises of the Depositary upon its reasonable request.

- 14.21 In accordance with Condition 14.20 above, the Depositary shall be at liberty to hold or to deposit the Deposit Agreement and any deed or document relating thereto in any part of the world with a Disclosure Addressee to the extent necessary for the Disclosure Purposes, and the Depositary shall not (in the case of deposit with itself, in the absence of its own negligence, wilful default, or bad faith or that of its agents, directors, officers or employees) be responsible for any losses, liability or expenses incurred in connection with any such deposit.
- 14.22 No disclaimer of liability under the Securities Act or mandatory provisions of Luxembourg securities laws, including under the Luxembourg law of 1 August 2001 concerning the circulation of fungible securities and other financial instruments, as amended, is intended by any provision of the Deposit Agreement or these Conditions.

## 15. **Issue and Delivery of Replacement GDRs and Exchange of GDRs**

Subject to the payment of the relevant fees, taxes, duties, charges, costs and expenses and such terms as to evidence and indemnity as the Depositary may require, replacement GDRs will be issued by the Depositary and will be delivered in exchange for or replacement of outstanding lost, stolen, mutilated, defaced or destroyed GDRs upon surrender thereof (except in the case of the destruction, loss or theft) at the specified office of the Depositary or (at the request, risk and expense of the Holder) at the specified office of any Agent.

## 16. **Depositary's Fees, Costs and Expenses**

- 16.1 The Depositary shall be entitled to charge the following remuneration and to receive the following remuneration and reimbursement (such remuneration and reimbursement being payable on demand) from the Holders in respect of its services under the Deposit Agreement:
- (a) for the issue of GDRs (other than upon the issue of GDRs pursuant to the Offering) or the cancellation of GDRs upon the withdrawal of Deposited Property: U.S.\$5.00 or less per 100 GDRs (or portion thereof) issued or cancelled;
  - (b) for issuing GDR certificates in definitive registered form in replacement for mutilated, defaced, lost, stolen or destroyed GDR certificates: a sum per GDR certificate which is determined by the Depositary to be a reasonable charge to reflect the work, costs and expenses involved;

- (c) for issuing GDR certificates in definitive registered form (other than pursuant to (b) above): the greater of U.S.\$1.50 per GDR certificate (plus printing costs) or such other sum per GDR certificate which is determined by the Depositary to be a reasonable charge to reflect the work plus costs (including but not limited to printing costs) and expenses involved;
- (d) for receiving and paying any cash dividend or other cash distribution on or in respect of the Deposited Shares: a fee of U.S.\$ 0.02 or less per GDR for each such dividend or distribution;
- (e) in respect of any issue of rights or distribution of Shares (whether or not evidenced by GDRs) or other securities or other property (other than cash) upon exercise of any rights, any free distribution, stock dividend or other distribution: U.S.\$5.00 or less per 100 outstanding GDRs (or portion thereof) for each such issue of rights, dividend or distribution;
- (f) for transferring interests from and between the Regulation S Master GDR and the Rule 144A Master GDR: a fee of U.S.\$0.05 or less per GDR;
- (g) a fee of U.S.\$0.03 or less per GDR (or portion thereof) per calendar year for depositary services which shall be payable as provided in paragraph (i) below;
- (h) a fee of U.S.\$0.01 or less per GDR per annum for local share registry inspection and related services by the Depositary or the Custodian or their respective agents, which shall be payable as provided in paragraph (i) below; and
- (i) any other charge payable by the Depositary, any of the Depositary's agents, including the Custodian, or the agents of the Depositary's agents, in connection with the servicing of Deposited Shares or other Deposited Property (which charge shall be assessed against Holders as of the date or dates set by the Depositary and shall be payable at the sole discretion of the Depositary by billing such Holders for such charge or deducting such charge from one or more cash dividends or other cash distributions),

together with all expenses (including currency conversion expenses), transfer and registration fees, taxes, duties and charges payable by the Depositary, any Agent or the Custodian, or any of their agents, in connection with any of the above.

- 16.2 The Depositary is entitled to receive from the Company the fees, taxes, duties, charges costs and expenses as specified in a separate agreement between the Company and the Depositary.
- 16.3 From time to time, the Depositary may make payments to the Company to reimburse and / or share revenue from the fees collected from GDR holders, or waive fees and expenses for services provided, generally relating to costs and expenses arising out of establishment and maintenance of the GDR facilities established pursuant to the Deposit Agreement. In performing its duties under the Deposit Agreement, the Depositary may use brokers, dealers or other service providers that are affiliates of the Depositary and that may earn or share fees and commissions.

## 17. Agents

- 17.1 The Depositary shall be entitled to appoint one or more agents (the "**Agents**") for the purpose, *inter alia*, of making distributions to the Holders.
- 17.2 Notice of appointment or removal of any Agent or of any change in the specified office of the Depositary or any Agent will be duly given by the Depositary to the Holders.

## 18. The Custodian

The Depositary has agreed with the Custodian that the Custodian will receive and hold (or appoint agents approved by the Depositary to receive and hold) all Deposited Property for the account and to the order of the Depositary in accordance with the applicable terms of the Deposit Agreement which include a requirement to segregate the Deposited Property from the other property of, or held by, the Custodian **PROVIDED THAT** the Custodian shall not be obliged to segregate cash comprised in the Deposited Property from cash otherwise held by the Custodian. The Custodian shall be responsible solely to the Depositary **PROVIDED THAT**, if and so long as the Depositary and the Custodian are the same legal entity, references to them separately in these Conditions and the Deposit Agreement are for convenience only and that legal entity shall be responsible for discharging both functions directly to the Holders and the Company. The Custodian may resign or be removed by the Depositary (including on the instructions of the Company) by giving prior notice, except that if a replacement Custodian is appointed which is a

branch or affiliate of the Depositary, the Custodian's resignation or discharge may take effect immediately on the appointment of such replacement Custodian. Upon the removal of or receiving notice of the resignation of the Custodian, the Depositary shall promptly appoint a successor Custodian, which shall, upon acceptance of such appointment, and the expiry of any applicable notice period, become the Custodian. The Depositary in its discretion may appoint a substitute or additional custodian or custodians, which shall, upon acceptance of such appointment, become the Custodian under the Deposit Agreement. The Depositary shall notify Holders of such change in accordance with Condition 22. Notwithstanding the foregoing, the Depositary may temporarily deposit the Deposited Property in a manner or a place other than as therein specified; **PROVIDED THAT**, in the case of such temporary deposit in another place, the Company shall have consented to such deposit, and such consent of the Company shall have been delivered to the Custodian. In case of transportation of the Deposited Property under this Condition, the Depositary shall obtain appropriate insurance at the expense of the Company if and to the extent that the obtaining of such insurance is reasonably practicable and the premiums payable are of a reasonable amount.

## 19. **Resignation and Termination of Appointment of the Depositary**

- 19.1 The Company may terminate the appointment of the Depositary under the Deposit Agreement by giving at least 90 days' prior notice in writing to the Depositary and the Custodian, and the Depositary may resign as Depositary by giving at least 90 days' prior notice in writing to the Company and the Custodian. Within 30 days after the giving of either such notice, notice thereof shall be duly given by the Depositary to the Holders in accordance with Condition 22.

The termination of the appointment or the resignation of the Depositary shall take effect on the date specified in such notice; **PROVIDED THAT** no such termination of appointment or resignation shall take effect until the appointment by the Company of a successor depositary under the Deposit Agreement and the acceptance of such appointment to act in accordance with the terms thereof and of these Conditions, by the successor depositary. The Company has undertaken in the Deposit Agreement to use all reasonable endeavours to procure the appointment of a successor depositary with effect from the date of termination specified in such notice as soon as reasonably possible following notice of such termination or resignation. Upon any such appointment and acceptance, notice thereof shall be duly given by the Depositary to the Holders in accordance with Condition 22.

- 19.2 Upon the termination of the appointment or resignation of the Depositary and against payment of all fees and expenses due to the Depositary from the Company under the Deposit Agreement, the Depositary shall deliver to its successor as depositary sufficient information and records to enable such successor efficiently to perform its obligations under the Deposit Agreement and shall deliver and pay to such successor depositary all property and cash held by it under the Deposit Agreement (or any replacement agreement). The Deposit Agreement provides that, upon the date when such termination of appointment or resignation takes effect, the Custodian shall be deemed to be the Custodian thereunder for such successor depositary, and shall hold the Deposited Property for such successor depositary, and the Depositary shall thereafter have no obligation under the Deposit Agreement or the Conditions (other than liabilities accrued prior to the date of termination of appointment or resignation or any liabilities stipulated in relevant laws or regulations).

## 20. **Termination of Deposit Agreement**

- 20.1 Either the Company or the Depositary but, in the case of the Depositary, only if the Company has failed to appoint a replacement Depositary within 90 days of the date on which the Depositary has given notice pursuant to Condition 19 that it wishes to resign, may terminate the Deposit Agreement by giving 90 days' prior notice to the other and to the Custodian. After a termination notice has been given in accordance with this Condition 20.1: (a) within 30 days after the giving of such notice, notice of such termination shall be duly given by the Depositary to Holders of all GDRs then outstanding in accordance with Condition 22; and (b) the Depositary shall make reasonable endeavours to take all appropriate steps for the termination of the GDR facilities established pursuant to the Deposit Agreement as soon as reasonably practicable.
- 20.2 During the period beginning on the date of the giving of such notice by the Depositary to the Holders and ending on the date on which such termination takes effect, each Holder shall be entitled to obtain delivery of the Deposited Property relative to each GDR held by it, subject to the provisions of Condition 1.1 and upon compliance with Condition 1, payment by the Holder of the charge specified in Condition 16.1(a) and Clause 10.1(a) of the Deposit Agreement for such delivery and surrender, and payment by the Holder



of any sums payable by the Depositary and/or any other expenses incurred by the Depositary (together with all amounts which the Depositary is obliged to pay to the Custodian) in connection with such delivery and surrender, and otherwise in accordance with the Deposit Agreement.

- 20.3 If any GDRs remain outstanding after the date of termination, the Depositary shall as soon as reasonably practicable sell the Deposited Property then held by it under the Deposit Agreement by public or private sale, and on such terms, as the Depositary considers appropriate, and the Depositary shall, to the extent reasonably practicable, consult the Company in relation to the manner and terms of any such sale prior to such sale. The Depositary shall have no obligation to, and shall not, register transfers, shall not pass on dividends or distributions or take any other action in relation to GDRs remaining outstanding after the date of termination, except that it will deliver the net proceeds of any sale of Deposited Property, together with any other cash then held by it under the Deposit Agreement, *pro rata* to Holders of GDRs which have not previously been so surrendered by reference to that proportion of the Deposited Property which is represented by the GDRs of which they are the Holders. After making such sale, the Depositary shall be discharged from all obligations under the Deposit Agreement and these Conditions, except its obligation to account to Holders for such net proceeds of sale and other cash comprising the Deposited Property without interest.

## 21. **Amendment of Deposit Agreement and Conditions**

- 21.1 Subject to Condition 21.3, all and any of the provisions of the Deposit Agreement and these Conditions (other than this Condition 21) may at any time and from time to time be amended by written agreement between the Company and the Depositary in any respect which they may deem necessary or desirable. Notice of any amendment of these Conditions (except to correct a manifest error) shall be duly given to the Holders by the Depositary, and any amendment (except as aforesaid) which shall increase or impose fees payable by Holders or which shall otherwise, in the opinion of the Depositary, be materially prejudicial to the interests of the Holders (as a class) shall not become effective so as to impose any obligation on the Holders until the expiration of 30 calendar days after such notice shall have been given. During such period of 30 calendar days, each Holder shall be entitled to obtain, subject to and upon compliance with Condition 1, delivery of the Deposited Property relative to each GDR held by it upon surrender thereof, payment of the charge specified in Condition 16.1(a) for such delivery and surrender and otherwise in accordance with the Deposit Agreement and these Conditions. Each Holder at the time when such amendment so becomes effective shall be deemed, by continuing to hold a GDR, to approve such amendment and to be bound by the terms thereof in so far as they affect the rights of the Holders. In no event shall any amendment impair the right of any Holder to receive, subject to and upon compliance with Condition 1, the Deposited Property attributable to the relevant GDR.
- 21.2 For the purposes of this Condition 21, an amendment shall not be regarded as being materially prejudicial to the interests of Holders if its principal effect is to permit the creation of GDRs in respect of additional Shares to be held by the Depositary which are or will become fully consolidated as a single series with the other Deposited Shares **PROVIDED THAT** temporary GDRs will represent such Shares until they are so consolidated.
- 21.3 The Company and the Depositary may at any time by agreement in any form amend the number of Shares represented by each GDR, provided that each outstanding GDR represents the same number of Shares as each other outstanding GDR, and at least 30 calendar days notice of such amendment is given to the Holders, but in no circumstances shall any amendment pursuant to this Condition 21.3 be regarded as an amendment requiring 30 calendar days notice in accordance with Condition 21.1.
- 21.4 For the avoidance of doubt, if at all relevant to the issuance of the GDRs, it is expressly agreed that articles 86 to 94-8 of the Luxembourg law of dated 15 August 1915 on commercial companies, as amended, shall not apply to the GDRs or to the representation of the Holders thereof.

## 22. **Notices**

- 22.1 Any and all notices to be given to any Holder shall be duly given if personally delivered, or sent by mail (if domestic, first class, if overseas, first class airmail) or air courier, or by facsimile transmission confirmed by letter sent by mail or air courier, addressed to such Holder at the address of such Holder as it appears on the transfer books for GDRs of the Depositary, or, if such Holder shall have filed with the Depositary a written request that notices intended for such Holder be mailed to some other address, at the address specified in such request.



22.2 Delivery of a notice sent by mail or air courier shall be effective three days (in the case of domestic mail or air courier) or seven days (in the case of overseas mail) after despatch, and any notice sent by facsimile transmission, as provided in this Condition, shall be effective when the intended recipient has confirmed by telephone to the transmitter thereof that the recipient has received such facsimile in complete and legible form. The Depositary or the Company may, however, act upon any facsimile transmission received by it from the other or from any Holder, notwithstanding that such facsimile transmission shall not subsequently be confirmed as aforesaid.

### 23. **Reports and Information on the Company**

23.1 The Company has undertaken in the Deposit Agreement (so long as any GDR is outstanding) to furnish the Depositary with six copies in the English language (and to make available to the Depositary, the Custodian and each Agent as many further copies as they may reasonably require to satisfy requests from Holders) of any reports and accounts publicly filed by the Company and sent to holders of Shares generally.

23.2 The Company has undertaken in the Deposit Agreement (so long as any GDR is outstanding) to furnish the Depositary with such number of copies of any notices referred to in Condition 24 and other material (which contains information having a material bearing on the interests of Holders) furnished to holders of the Shares or other Deposited Property or such number of English translations of the originals if the originals were prepared in a language other than English, as the Depositary may reasonably request.

23.3 The Depositary shall upon receipt thereof give due notice to the Holders that such copies are available upon request at its specified office and the specified office of any Agent.

23.4 For so long as any of the GDRs remains outstanding and are “**restricted securities**” within the meaning of Rule 144(a)(3) under the Securities Act, if at any time the Company is neither subject to and in compliance with the reporting requirements of Section 13 or 15(d) of the United States Securities Exchange Act of 1934, as amended, nor exempt from such reporting requirements by complying with the information furnishing requirements of Rule 12g3-2(b) thereunder, the Company has agreed in the Deposit Agreement to supply to the Depositary such information, in the English language and in such quantities as the Depositary may from time to time reasonably request, as is required to be delivered to any Holder or beneficial owner of GDRs or to any holder of Shares or a prospective purchaser designated by such Holder, beneficial owner or holder pursuant to a Deed Poll executed by the Company in favour of such persons and the information delivery requirements of Rule 144A(d)(4) under the Securities Act, to permit compliance with Rule 144A thereunder in connection with resales of GDRs or Shares or interests therein in reliance on Rule 144A under the Securities Act and otherwise to comply with the requirements of Rule 144A(d)(4) under the Securities Act. Subject to receipt, the Depositary will deliver such information, during any period in which the Company informs the Depositary it is subject to the information delivery requirements of Rule 144(A)(d)(4), to any such holder, beneficial owner or prospective purchaser but in no event shall the Depositary have any liability for the contents of any such information.

### 24. **Copies of Company Notices**

The Company has undertaken in the Deposit Agreement to transmit to the Custodian and the Depositary on or before the day when the Company first gives notice, by mail, publication or otherwise, to holders of any Shares or other Deposited Property, whether in relation to the taking of any action in respect thereof or in respect of any dividend or other distribution thereon or of any meeting or adjourned meeting of such holders or otherwise, such number of copies of such notice and any other material (which contains information having a material bearing on the interests of the Holders) furnished to such holders by the Company (or such number of English translations of the originals if the originals were prepared in a language other than English) in connection therewith as the Depositary may reasonably request. If such notice is not furnished to the Depositary in English, either by the Company or the Custodian, the Depositary shall, at the Company's expense, arrange for an English translation thereof (which may be in such summarised form as the Depositary may deem adequate to provide sufficient information) to be prepared. Except as provided below, the Depositary shall, as soon as practicable after receiving notice of such transmission or (where appropriate) upon completion of translation thereof, give due notice to the Holders which notice may be given together with a notice pursuant to Condition 9.1, and shall make the same available to Holders in such manner as it may determine.

25. **Moneys held by the Depositary**

The Depositary shall be entitled to deal with moneys paid to it by the Company for the purposes of the Deposit Agreement in the same manner as other moneys paid to it as a banker by its customers and shall not be liable to account to the Company or any Holder or any other person for any interest thereon, except as otherwise agreed and shall not be obliged to segregate such moneys from other moneys belonging to the Depositary.

26. **Severability**

If any one or more of the provisions contained in the Deposit Agreement or in these Conditions shall be or become invalid, illegal or unenforceable in any respect, the validity, legality and enforceability of the remaining provisions contained therein or herein shall in no way be affected, prejudiced or otherwise disturbed thereby.

27. **Governing Law**

27.1 The Deposit Agreement, the GDRs, and all non-contractual obligations arising from or connected with the Deposit Agreement and the GDRs, are governed by, and shall be construed in accordance with, English law except that the certifications set forth in Schedule 3 and Schedule 4 to the Deposit Agreement and any provisions relating thereto shall be governed by and construed in accordance with the laws of the State of New York. The rights and obligations attaching to the Deposited Shares will be governed by Russian law. The Company has agreed in the Deposit Agreement and the Deed Poll that Disputes thereunder shall be resolved by arbitration under the Rules of the London Court of International Arbitration.

27.2 Any disputes which may arise out of or in connection with the GDRs (including any dispute relating to the existence, validity or termination of the GDRs, or any non-contractual obligation arising out of or in connection with the GDRs, or the consequences of the nullity of the GDRs) (each a “**Dispute**”) shall be referred to and finally resolved by arbitration and not litigation. In such case, the Dispute shall be referred to arbitration under the Rules of the London Court of International Arbitration (“**LCIA**”) (the “**Rules**”) which Rules are deemed to be incorporated by reference into this Condition 27. Judgement upon the award rendered by the arbitrators may be entered in any court having jurisdiction thereof or having jurisdiction over the relevant party or assets.

27.3 The Depositary and each Holder of GDRs agrees that:

- (a) The number of arbitrators shall be three, appointed by the London Court of International Arbitration in accordance with its Rules;
- (b) The place of the arbitration shall be London;
- (c) The language to be used in the arbitration proceedings shall be English; and
- (d) The decision and award of the arbitration shall be final.

27.4 If any Dispute raises issues which are substantially the same as or connected with issues raised in a Dispute which has already been referred to arbitration (an “**Existing Dispute**”), or arises out of substantially the same facts as are the subject of an Existing Dispute, or a dispute, controversy or claim, arising out of or in connection with the Deposit Agreement or the Deed Poll, whether in tort, contract, statute or otherwise, including any question regarding its existence, validity, interpretation, breach or termination (in any such case a “**Related Dispute**”), the arbitrators appointed or to be appointed in respect of any such Existing Dispute shall also be appointed as the arbitrators in respect of any Related Dispute, save where the arbitrators consider such appointment to be inappropriate.

27.5 The arbitrators, upon the request of one of the parties to a Dispute or Related Dispute or a party to this Agreement which itself wishes to be joined in any reference to arbitration proceedings in relation to a Dispute or Related Dispute, may join any party to any reference to arbitration proceedings in relation to that Dispute or Related Dispute and may make a single, final award determining all Disputes and Related Disputes between them. Each of the Depositary and each Holder of GDRs hereby consents to be joined to any reference to arbitration proceedings in relation to any dispute at the request of a party to that Dispute or Related Dispute, and to accept joinder of any party requesting to be joined under this Clause 27.5.

- 27.6 Where, pursuant to the above provisions, the same arbitrators have been appointed in relation to an Existing Dispute and one or more Related Disputes, the arbitrators may, with the agreement of all the parties concerned or upon the application of one of the parties, being a party to each of the Disputes, order that the whole or part of the matters at issue shall be heard together upon such terms or conditions as the arbitrators think fit. The arbitrators shall have power to make such directions and any provisional, interim or partial awards as they consider just and desirable.
- 27.7 Nothing in these dispute resolution provisions shall be construed as preventing either party from seeking conservatory or similar interim relief in any court of competent jurisdiction.
- 27.8 The parties hereby agree to waive any right of appeal to any court of law or other judicial authority insofar as such waiver may be validly made.
- 27.9 Without prejudice to the powers of the arbitrators provided in the Rules, statute or otherwise, the arbitrators shall have power at any time, following the written request (with reasons) of any party at any time, and after due consideration of any written and/or oral response(s) to such request made within such time periods as the arbitrators shall determine, to make an award in favour of the claimant(s) (or the respondent(s) if a counterclaim) in respect of any claims (or counterclaims) if it appears to the arbitrators that there is no reasonably arguable defence to those claims (or counterclaims), either at all or except as to the amount of any damages or other sum to be awarded.
- 27.10 The parties agree that in no circumstances will they request the arbitrators to, and the arbitrators shall have no authority to, exercise any power to award damages which are not calculated by reference to the party's actual costs or to award any loss of profit whatsoever or any consequential, special or punitive damages.
- 27.11 In the event that the Depositary is made a party to, or is otherwise required to participate in, any litigation, arbitration, or Proceeding (whether judicial or administrative) which arises from or is related to or is based upon any act or failure to act by the Company, or which contains allegations to such effect, upon notice from the Depositary, the Company has agreed to fully cooperate with the Depositary in connection with such litigation, arbitration or Proceeding.
- 27.12 To the extent that the Company may in any jurisdiction claim for itself or its assets or revenues immunity from suit, execution, attachment (whether in aid of execution, before judgment or otherwise) or other legal process and to the extent that such immunity (whether or not claimed) may be attributed in any such jurisdiction to the Company or its assets or revenues, the Company has agreed not to claim and irrevocably waives such immunity to the full extent permitted by the laws of such jurisdiction.

## 28. Language

Although the Deposit Agreement or these Conditions may be translated into the Russian language, the Russian version of the Deposit Agreement and these Conditions is for informational purposes only. In the event of any discrepancies between the English version and the Russian version of the Deposit Agreement or these Conditions, or any dispute regarding the interpretation of any provision in the English version or Russian version of the Deposit Agreement or these Conditions, the English version of the Deposit Agreement and these Conditions shall prevail and questions of interpretation shall be addressed solely in the English language.

### **Form of certification requested in relation to deposit of ordinary shares**

The Depositary has confirmed that, subject to and in accordance with the Depositary's authority under the Deposit Agreement to make amendments from time to time to the form of certificates to be provided upon deposits of Shares into the Regulation S Facility or the Rule 144A Facility by persons other than the Company (and without prejudice to the fact that such authority permits further changes at any time), the Depositary intends that, where Shares are to be deposited into the Regulation S Facility or the Rule 144A Facility by a person other than the Company, the Depositary will require certifications in substantially the forms set out below to be given by or on behalf of each person who will be the beneficial owner of the relevant GDRs to be issued in respect of such Shares.

***Certificate and Agreement of persons acquiring the Regulation S GDRs upon Deposit of Shares in the Regulation S Facility pursuant to Condition 1 and Clause 3.3 of the Deposit Agreement***

[Date]

The Bank of New York Mellon (Luxembourg) S.A., as Depositary  
101 Barclay Street  
New York, New York 10286

Dear Sirs

**OJSC “MEGAFON”**

Reference is hereby made to the Deposit Agreement, dated 24 August 2012 (the “**Deposit Agreement**”), between OJSC “MegaFon” (the “**Company**”) and The Bank of New York Mellon (Luxembourg) S.A., as Depositary with respect to Regulation S Global Depositary Receipts (“**Regulation S GDRs**”) issued thereunder. Capitalised terms used but not defined herein shall have the meanings given to them in the Deposit Agreement.

1. This certification and agreement is furnished in connection with the deposit of Regulation S Shares in the Regulation S Facility under the Deposit Agreement and issuance of Regulation S GDRs pursuant to Condition 1 and Clause 3.3 of the Deposit Agreement.
2. We represent and warrant that:
  - (a) the Shares presented for deposit (and the certificates therefor, if applicable) are validly issued, fully paid, nonassessable and free of any pre-emptive rights of the holders of outstanding Shares and that the person making such deposit is duly authorized so to do;
  - (b) the Shares presented for deposit are free and clear of any lien, encumbrance, security interest, charge, mortgage or adverse claim; and
  - (c) the Shares presented for deposit are not subject to any unfulfilled requirements of applicable law or regulation.

The above representations and warranties shall survive the deposit and withdrawal of Shares and the issuance and cancellation of Regulation S GDRs in respect thereof and the transfer of such Regulation S GDRs. If any such representations or warranties are false in any way, the Company and the Depositary shall be authorised, at the cost and expense of the person depositing Shares, to take any and all actions necessary to correct the consequences thereof.

3. We acknowledge (or if we are acting for the account of another person, such person has confirmed to us that it acknowledges) that the Regulation S GDRs and the Regulation S Shares represented thereby have not been and will not be registered under the United States Securities Act of 1933, as amended (the “**Act**”).
4. We certify that either:
  - (a) we are, or at the time the Shares are deposited and at the time the Regulation S GDRs are issued will be, the beneficial owner of the Shares represented by such Regulation S GDRs, and (i) we are located outside the United States (within the meaning of Regulation S under the Act) and we have acquired, or have agreed to acquire and will have acquired, the Shares to be deposited outside the United States (within the meaning of Regulation S under the Act), (ii) we are not an affiliate of the Company or a person acting on behalf of such an affiliate, and (iii) we are not in the business of buying and selling securities or, if we are in such business, we did not acquire the securities to be deposited from the Company or any affiliate thereof in the initial distribution of the GDRs and the Shares,

**OR**

- (b) we are a broker-dealer acting on behalf of our customer, and such customer has confirmed to us that it is, or at the time the Shares are deposited and at the time the Regulation S GDRs are issued will be, the beneficial owner of the Regulation S Shares represented by such Regulation S GDRs and (i) it is located outside the United States (within the meaning of Regulation S under the Act) and it has acquired, or has agreed to acquire and will have acquired, the Shares to be deposited outside the United States (within the meaning of Regulation S under the Act), (ii) it is not an affiliate of the Company or a person acting on behalf of such an affiliate, and (iii) it is not in the business of buying and selling

securities or, if it is in such business, it did not acquire the securities to be deposited from the Company or any affiliate thereof in the initial distribution of the GDRs and the Shares.

5. We certify that the Shares being deposited are not “restricted securities” as defined in Rule 144 under the Act.

Very truly yours,

[name of CERTIFYING ENTITY]

[By: \_\_\_\_\_]

[Title:]

***Certificate and Agreement of Acquirors of Rule 144A GDRs upon Deposit of Shares in the Rule 144A Facility pursuant to Condition 1 and Clause 3.3 of the Deposit Agreement***

[Date]

The Bank of New York Mellon (Luxembourg) S.A., as Depositary  
101 Barclay Street  
New York, New York 10286

Dear Sirs

**OJSC “MEGAFON”**

Reference is hereby made to the Deposit Agreement dated 24 August 2012 (the “**Deposit Agreement**”), between OJSC “MegaFon” (the “**Company**”) and The Bank of New York Mellon (Luxembourg) S.A., as Depositary with respect to Rule 144A Global Depositary Receipts (“**Rule 144A GDRs**”) issued thereunder. Capitalised terms used but not defined herein shall have the meanings given to them in the Deposit Agreement.

1. This certification and agreement is furnished in connection with the deposit of Rule 144A Shares in the Rule 144A Facility under the Deposit Agreement and issuance of Rule 144A GDRs pursuant to Condition 1 and Clause 3.3 of the Deposit Agreement.
2. We represent and warrant that:
  - (a) the Shares presented for deposit (and the certificates therefor, if applicable) are validly issued, fully paid, nonassessable and free of any pre-emptive rights of the holders of outstanding Shares and that the person making such deposit is duly authorized so to do;
  - (b) the Shares presented for deposit are free and clear of any lien, encumbrance, security interest, charge, mortgage or adverse claim; and
  - (c) the Shares presented for deposit are not subject to any unfulfilled requirements of applicable law or regulation.

The above representations and warranties shall survive the deposit and withdrawal of Shares and the issuance and cancellation of Rule 144A GDRs in respect thereof and the transfer of such Rule 144A GDRs. If any such representations or warranties are false in any way, the Company and the Depositary shall be authorised, at the cost and expense of the person depositing Shares, to take any and all actions necessary to correct the consequences thereof.

3. We acknowledge (or if we are acting for the account of another person, such person has confirmed to us that it acknowledges) that the Rule 144A GDRs and the Rule 144A Shares represented thereby have not been and will not be registered under the United States Securities Act 1933, as amended (the “**Act**”).
4. We certify (or if we are acting for the account of another person, such person has confirmed that it certifies) that either:
  - (a) we are (or it is) a qualified institutional buyer (within the meaning of Rule 144A under the Act) and at the time of issue of the Rule 144A GDRs referred to above, we (or it) (or one or more qualified institutional buyers for whose account we are acting) will be the beneficial owner of such Rule 144A GDRs.



**OR**

- (b) we are (or it is) a broker-dealer acting for the account of a customer, such customer has confirmed to us (or it) that it is a qualified institutional buyer (within the meaning of Rule 144A under the Act) and either (i) at the time of issuance of the Rule 144A GDRs referred to above, it will be the beneficial owner of such Rule 144A GDRs, or (ii) it is acting for the account of a qualified institutional buyer that, at the time of issuance of the Rule 144A GDRs referred to above, will be the beneficial owner of such Rule 144A GDRs.
5. We agree (or if we are acting for the account of another person, such person has confirmed to us that it agrees) that we (or it) will not offer, sell, pledge or otherwise transfer the Rule 144A GDRs or the Rule 144A Shares represented thereby except (a) to a person whom we and anyone acting on our behalf reasonably believe (or it and anyone acting on its behalf reasonably believe) is a qualified institutional buyer (“**QIB**”) within the meaning of Rule 144A under the Act in a transaction meeting the requirements of Rule 144A, (b) in an offshore transaction in accordance with Rule 903 or Rule 904 under Regulation S under the Act or (c) pursuant to an exemption from registration provided by Rule 144 under the Act (if available), in each case in accordance with any applicable securities laws of any state or other jurisdiction of the United States.

Very truly yours,

[NAME OF CERTIFYING ENTITY]

[By: \_\_\_\_\_  
Title: ]

## SUMMARY OF THE PROVISIONS RELATING TO THE GLOBAL DEPOSITARY RECEIPTS WHILST IN MASTER FORM

The GDRs will initially be evidenced by (i) a single Regulation S Master GDR in registered form and (ii) a single Rule 144A Master GDR in registered form. The Regulation S Master GDR will be registered in the name of The Bank of New York Depository (Nominees) Limited, as nominee for The Bank of New York Mellon, London Branch, as common depository for Euroclear and Clearstream, Luxembourg and the Rule 144A Master GDR will be deposited with The Bank of New York Mellon in New York as custodian for DTC and registered in the name of Cede & Co., as nominee for DTC. The Master GDRs contain provisions that apply to the GDRs while they are in master form, some of which modify the effect of the Conditions of the GDRs set out in this Prospectus. The following is a summary of certain of those provisions. Unless otherwise defined herein, the terms defined in the Conditions shall have the same meaning herein.

Any increase or decrease in the number of GDRs evidenced thereby from that initially notified to the Holder, as defined in the Conditions, will be notified to the Holder by the Depository in accordance with the Conditions.

For risks related to potential future limitations on the exercise of voting and/or dividends rights by a GDRs holder, see “Risk Factors—Risks Relating to the Securities and the Trading Market—The Amendments on DR Programmes, once in force, may complicate the exercise of rights to, and the ability to derive benefits from, the underlying ordinary shares and could expose investors to a risk of suspension of our GDRs programme” and also “Risk Factors—Risks Relating to the Securities and the Trading Market”.

### Exchange

The Master GDRs will be exchanged for certificates in definitive registered form representing GDRs only in the circumstances described in (i), (ii), (iii), or (iv) below, in whole but not in part. The Depository will irrevocably undertake in the Master GDRs to deliver certificates in definitive registered form in exchange for the relevant Master GDR, to GDR holders within 60 calendar days in the event that:

- (i) DTC, in the case of the Rule 144A Master GDR, or Euroclear or Clearstream, in the case of the Regulation S Master GDR, notifies OJSC MegaFon that it is unwilling or unable to continue as a settlement system and a successor settlement system is not appointed within 90 calendar days; or
- (ii) either DTC in the case of Rule 144A Master GDR, or Euroclear or Clearstream in the case of the Regulation S Master GDR, is closed for business for a continuous period of 14 calendar days (other than by reason of holiday, statutory or otherwise) or announces an intention permanently to cease business or does in fact do so, and, in each case, no alternative settlement system satisfactory to the Depository is available within 45 calendar days; or
- (iii) in respect of the Rule 144A Master GDR, DTC or any successor ceases to be a “clearing agency” registered under the United States Securities Exchange Act of 1934, as amended; or
- (iv) the Depository has determined that, on the occasion of the next payment in respect of the Master GDRs, the Depository or its agent would be required to make any deduction or withholding from any payment in respect of the Master GDRs which would not be required were the GDRs represented by certificates in definitive registered form, provided that the Depository shall have no obligation to so determine or to attempt to so determine.

Any such exchange shall be at the expense (including printing costs) of the Holders.

A GDR evidenced by an individual definitive certificate will not be eligible for clearing and settlement through: Euroclear; Clearstream, Luxembourg; or DTC.

Upon any exchange of a Master GDR for certificates in definitive registered form, or any exchange of interests between the Rule 144A Master GDR and the Regulation S Master GDR pursuant to Clause 4 of the Deposit Agreement, or any distribution of GDRs pursuant to Conditions 5, 7 or 10 or any reduction in the number of GDRs represented thereby following any withdrawal of Deposited Property pursuant to Condition 1, the relevant details shall be entered by the Depository on the register maintained by the Depository whereupon the number of GDRs represented by the Master GDR shall be reduced or increased (as the case may be) for all purposes by the number so exchanged and entered on the register. If the number of GDRs represented by a Master GDR is reduced to zero such Master GDR shall continue in existence until the obligations of OJSC MegaFon under the Deposit Agreement and the obligations of the Depository pursuant to the Deposit Agreement and the Conditions have terminated.

## **Payments, Distributions and Voting Rights**

Payments of cash dividends and other amounts (including cash distributions) will, in the case of GDRs represented by the Regulation S Master GDR be made by the Depositary through Euroclear and Clearstream and, in the case of GDRs represented by the Rule 144A Master GDR, will be made by the Depositary through DTC, on behalf of persons entitled thereto upon receipt of funds therefor from OJSC MegaFon. A free distribution or rights issue of Shares to the Depositary on behalf of the Holders will result in the record maintained by the Depositary being marked up to reflect the enlarged number of GDRs represented by the relevant Master GDR.

Holders of GDRs will have voting rights as set out in the Conditions.

## **Surrender of GDRs**

Any requirement in the Conditions relating to the surrender of a GDR to the Depositary shall be satisfied by the production by Euroclear and Clearstream (in the case of GDRs represented by the Regulation S Master GDR), or DTC (in the case of GDRs represented by the Rule 144A Master GDR), on behalf of a person entitled to an interest therein of such evidence of entitlement of such person as the Depositary may reasonably require, which is expected to be a certificate or other documents issued by Euroclear or Clearstream, or DTC, as appropriate. The delivery or production of any such evidence shall be sufficient evidence, in favour of the Depositary, any Agent and the Custodian of the title of such person to receive (or to issue instructions for the receipt of) all money or other property payable or distributable in respect of the Deposited Property represented by such GDRs.

## **Notices**

For as long as the Regulation S Master GDR is registered in the name of a nominee for a common depository holding on behalf of Euroclear and Clearstream, and the Rule 144A Master GDR is registered in the name of DTC or its nominee, notices to Holders may be given by the Depositary by delivery of the relevant notice to Euroclear and Clearstream, or (as appropriate) DTC, for communication to persons entitled thereto in substitution for delivery of notices in accordance with the Conditions.

## **Information**

For so long as any of the Rule 144A GDRs or the Offer Shares remain outstanding and are “restricted securities” within the meaning of Rule 144(a) (3) under the Securities Act, if at any time OJSC MegaFon is neither subject to and in compliance with the reporting requirements of Section 13 or 15(d) of the Exchange Act, nor exempt from such reporting requirements by complying with the information furnishing requirements of Rule 12g3-2(b) thereunder, OJSC MegaFon has agreed to supply to the Depositary such information in the English language and in such quantities as the Depositary may from time to time reasonably request, as is required to be delivered to any Holder or beneficial owner of Rule 144A GDRs or to any holder of Shares or prospective purchaser designated by such Holder, beneficial owner or holder pursuant to a Deed Poll executed by OJSC MegaFon in favour of such persons and the information delivery requirements of Rule 144A(d)(4) under the Securities Act, as amended, to permit compliance with Rule 144A in connection with resales of Rule 144A GDRs or Shares or interests therein in reliance on Rule 144A under the Securities Act and otherwise will comply with the requirements of Rule 144A(d)(4) under the Securities Act.

## **Governing Law**

The Master GDRs, and all non-contractual obligations arising from or connected with the Master GDRs, shall be governed by and construed in accordance with English law.

## PLAN OF DISTRIBUTION

### Description of the Distribution

The Offering comprises (i) an offering of Offer Shares in the Russian Federation and (ii) an offering of Offer Shares and GDRs outside of the Russian Federation. The Securities are being offered outside the United States in reliance on Regulation S and within the United States to certain QIBs, as defined in, and in reliance on, Rule 144A of the Securities Act.

Under the terms of, and subject to, the conditions contained in an underwriting agreement (the “**Underwriting Agreement**”) dated [●] 2012 entered into by OJSC MegaFon, the Selling Shareholders, the Joint Global Coordinators and the joint bookrunners named below (the “**Joint Bookrunners**”), the Joint Bookrunners named below have severally agreed to themselves purchase, at the Offer Price, the number of ordinary shares in the Form of Offer Shares and GDRs in the amount as indicated below. The Selling Shareholders have agreed to make available, at the Offer Price, to the Joint Bookrunners, the applicable number of ordinary shares for such purpose:

<u>Joint Bookrunners</u>	<u>Number of ordinary shares in the form of Offer Shares</u>	<u>Number of ordinary shares in the form of GDRs</u>	<u>Maximum number of ordinary shares in the form of Offer Shares in respect of the Over-Allotment Option</u>	<u>Maximum number of ordinary shares in the form of GDRs in respect of the Over-Allotment Option</u>
Morgan Stanley & Co. International plc . . . . .	[●]	[●]	[●]	[●]
CJSC “Sberbank CIB”, acting with SIB (Cyprus) Limited . . . . .	[●]	[●]	[●]	[●]
Citigroup Global Markets Limited . . . . .	[●]	[●]	[●]	[●]
Credit Suisse Securities (Europe) Limited . . . . .	[●]	[●]	[●]	[●]
VTB Capital plc . . . . .	[●]	[●]	[●]	[●]
	<u>[●]</u>	<u>[●]</u>	<u>[●]</u>	<u>[●]</u>

The total expenses payable by OJSC MegaFon for the Offering, other than the Joint Bookrunners’ fees and commissions, are estimated to be approximately U.S.\$[●].

The Joint Bookrunners propose to resell the Securities at the Offer Price within the United States to QIBs (as defined in Rule 144A) in reliance on Rule 144A and outside the United States in reliance on Regulation S. See “Selling and Transfer Restrictions”. The price at which the Securities are offered may be changed at any time without notice.

The Securities have not been and will not be registered under the Securities Act or any state securities laws and may not be offered or sold within the United States except in transactions exempt from, or not subject to, the registration requirements of the Securities Act. See “Selling and Transfer Restrictions”.

In addition, until 40 days after the commencement of this Offering, an offer or sale of Securities within the United States by a dealer that is not participating in this Offering may violate the registration requirements of the Securities Act if that offer or sale is made otherwise than in accordance with Rule 144A.

### Underwriting Agreement and Over-Allotment Option

The Underwriting Agreement and related arrangements contain the following provisions, among others:

- The Selling Shareholders have, *pro rata* to the number of Offer Shares and GDRs being sold by each of them, granted an Over-Allotment Option to the Joint Global Coordinators on behalf of the Joint Bookrunners to acquire up to [●] additional ordinary shares in the form of ordinary shares and GDRs at the Offer Price for the purpose of covering over-allotments and other short positions, if any, in connection with the Offering. The Over-Allotment Option is exercisable upon written notice to the Selling Shareholders at any time up to and including the thirtieth day following the announcement of the Offer Price. If the Joint Global Coordinators on behalf of the Joint Bookrunners exercise the Over-Allotment Option, the Selling Shareholders will be obligated to sell and each Joint Bookrunner will be severally obligated, subject to the conditions contained in the Underwriting Agreement, to purchase, a

number of additional ordinary shares in the form of ordinary shares and GDRs proportionate to that Joint Bookrunner's initial amount indicated in the table above. The Over-Allotment Option is granted to the Joint Bookrunners as part of the Underwriting Agreement for no additional consideration to the Selling Shareholders from the Joint Bookrunners.

- The Joint Bookrunners will deduct from the proceeds of the Offering or have reimbursed to them, as the case may be:
  - certain costs and expenses incurred by the Joint Bookrunners in connection with the Offering, including, but not limited to, fees, expenses and disbursements of their legal counsel and out of pocket and other expenses; and
  - underwriting commissions payable by the Selling Shareholders amounting to [●]% of the gross proceeds of the Offering and, at the sole and absolute discretion of the Company and the Selling Shareholders, an additional fee of up to [●]% of the gross proceeds of the Offering, including in respect of any GDRs purchased by the Joint Bookrunners pursuant to the Over-Allotment Option.

The Joint Bookrunners are offering the Securities when, as and if, delivered to and accepted by them, subject to approval of legal matters by their counsel, including the validity of the Securities and other conditions contained in the Underwriting Agreement, such as the receipt by the Joint Bookrunners of, among other things, officer's certificates and legal opinions.

### **Lock-up Provisions**

Each of the Selling Shareholders, OJSC MegaFon, TeliaSonera AB, Garsdale, Telecominvest Holdings Limited and CJSC Telecominvest (each a "**Covenantor**") has agreed with the Joint Bookrunners that neither it, nor any of its subsidiaries, nor any person acting on its or their behalf will, from the date hereof until 180 days after the Closing Date, without the prior written consent of the Joint Global Coordinators (such consent not to be unreasonably withheld or delayed):

- (i) issue, offer, sell, lend, mortgage, assign, pledge, charge, contract to sell or issue any option or contract to purchase, purchase any option or contract to sell or issue, grant any option, right or warrant to purchase, lend, or otherwise transfer or dispose of (or publicly announce any such action), directly or indirectly, any GDRs, ordinary shares of OJSC MegaFon or any securities convertible or exchangeable into or exercisable for, or substantially similar to, any GDRs, ordinary shares of OJSC MegaFon or any security or financial product whose value is determined directly or indirectly by reference to the price of the underlying securities, including equity swaps, forward sales and options or global depository receipts representing the right to receive any such securities; or
- (ii) enter into any swap, derivative or other agreement that transfers, in whole or in part, any of the economic consequences of ownership of GDRs or ordinary shares of OJSC MegaFon; or
- (iii) agree to, or publicly announce any intention to enter into any transaction described above,

whether such transaction described above is to be settled by delivery of GDRs, ordinary shares of OJSC MegaFon or such other securities in cash or otherwise.

The lock-up arrangements described above do not apply to the Offering. The foregoing undertakings do not apply to the offer and sale of Securities by a Covenantor (or its subsidiaries) to any subsidiaries (and in the case of Sonera and TeliaSonera AB, any affiliates) of such Covenantor provided that such entities first agree to be bound by a legally valid, binding and enforceable agreement including undertakings substantially similar to the above undertakings.

The foregoing undertakings of the Selling Shareholders and TeliaSonera AB do not apply to the offer and sale of all of the Securities held by either of them in one or more transactions to a single purchaser, provided that such entity first agrees to be bound by a legally valid, binding and enforceable agreement including undertakings substantially similar to the above undertakings.

The foregoing undertakings of Garsdale, Telecominvest Holdings Limited and CJSC Telecominvest also do not apply to, *inter alia*, (i) other than the pledge mentioned in sub-paragraph (iii) below, any transaction the purpose of which is to provide a guarantee, security or similar arrangement in connection with the raising of debt finance or any acquisition, disposal, merger, consolidation or similar transaction by or involving Garsdale or any company in the Garsdale and its subsidiaries (the "**Garsdale Group**"), provided that Garsdale, Telecominvest



Holdings Limited and/or CJSC Telecominvest, as the case may be, uses its reasonable efforts to ensure that the recipient of any such guarantee, security or similar arrangement executes a legally valid, binding and enforceable agreement including undertakings substantially similar to the above undertakings; (ii) any direct or indirect private sale, assignment, transfer or disposal of ordinary shares of OJSC MegaFon (and, for the avoidance of doubt, shares of any company in the Garsdale Group) as consideration for the acquisition of a business or assets by the Garsdale Group (or, for the avoidance of doubt, any merger, consolidation or similar transaction by or involving Garsdale or any company in the Garsdale Group in connection with such acquisition), provided that (A) any such sale, assignment, transfer or disposal of ordinary shares of OJSC MegaFon does not involve the issuance of any public instruments and (B) Garsdale, Telecominvest Holdings Limited and/or CJSC Telecominvest, as the case may be, uses its reasonable efforts to ensure that the transferee of such ordinary shares of OJSC MegaFon executes a legally valid, binding and enforceable agreement including undertakings substantially similar to the above undertakings; (iii) the pledge of (A) 40,512,000 ordinary shares of OJSC MegaFon to TeliaSonera AB and (B) 209,560,400 ordinary shares of OJSC MegaFon to OJSC Sberbank in connection with a loan (or any re-pledge to or other arrangement with lender(s) or trustee(s) in connection with the refinancing of such loan). For risks relating to the Sberbank Pledge, see “Risk Factors—Risks Relating to the Securities and the Trading Market—Enforcement of the Sberbank Pledge and subsequent sale of the subject ordinary shares or GDRs could adversely affect our ordinary share price and/or GDR price.”

### **Stabilisation**

In connection with the Offering, the Stabilising Managers or any agent or other person acting for the Stabilising Managers, may over-allot or effect transactions intended to enable it to satisfy any over-allocations or which stabilise, maintain, support or otherwise affect the market price of the GDRs or the Offer Shares at a level higher than that which might otherwise prevail for a period of 30 days following the announcement of the Offer Price. However, there is no obligation on the Stabilising Managers or any agent of the Stabilising Managers, to do this. Such transactions may be effected on the London Stock Exchange and any other securities market, over-the-counter market, stock exchange or otherwise. Such stabilising, if commenced, may be discontinued at any time, and must be brought to an end 30 days following the announcement of the Offer Price. Save as required by law, the Joint Bookrunners do not intend to disclose the extent of any over-allotments and/or stabilisation transactions under the Offering.

In accordance with applicable regulations, the Joint Bookrunners may also sell the Offer Shares or GDRs in excess of their Over-Allotment Option up to a maximum of [●]% of the Offering, creating a naked short position. The Joint Bookrunners must close out any naked short position by purchasing Offer Shares or GDRs in the open market.

In connection with the Offering, each of the Joint Bookrunners and any affiliate acting as an investor for its own account may take up the Offer Shares or GDRs offered in the Offering and in that capacity may retain, purchase or sell the Offer Shares or GDRs for its own account and may offer or sell such securities otherwise than in connection with the Offering. The Joint Bookrunners do not intend to disclose the extent of any such investment or transactions otherwise than in accordance with any legal or regulatory obligation to do so.

### **Other relationships**

The Joint Bookrunners are full service financial institutions engaged in various activities, which may include securities trading, commercial and investment banking, financial advisory, investment management, principal investment, hedging, financing and brokerage activities. The Joint Bookrunners and their respective affiliates have in the past performed commercial banking, investment banking and advisory services for us from time to time for which they have received customary fees and reimbursement of expenses and may, from time to time, engage in transactions with and perform services for us in the ordinary course of their business for which they may receive customary fees and reimbursement of expenses. In the ordinary course of their various business activities, the Joint Bookrunners and their respective affiliates may make or hold a broad array of investments and actively trade debt and equity securities (or related derivative securities) and financial instruments (which may include bank loans and/or credit default swaps) for their own account and for the accounts of their customers and may at any time hold long and short positions in such securities and instruments. Such investment and securities activities may involve our securities and instruments.

## MATERIAL CONTRACTS

The following is a summary of each contract (not being a contract entered into in the ordinary course of business) which has been entered into by any member of our Group: (i) within the two years immediately preceding the date of this document and which is, or may be, material; or (ii) which contains any provision under which any member of the Group has any obligation or entitlement which is material to the Group as at the hereof.

### **Material Financing Facilities**

For details of the material financing facilities that we have entered into and that are outstanding as of the date hereof, see “Management’s Discussion and Analysis of Financial Condition and Results of Operations—Liquidity and Capital Resources—Indebtedness”.

### **Agreements relating to the Offering**

#### ***Underwriting Agreement***

On [●] 2012, OJSC MegaFon, the Selling Shareholders, the Joint Global Coordinators and the Joint Bookrunners entered into the Underwriting Agreement providing for, *inter alia*, the underwriting of the Offering. See “Plan of Distribution—Underwriting Agreement”.

#### ***Deposit Agreement***

On 24 August 2012, OJSC MegaFon and the Depositary entered into the Deposit Agreement for the establishment and maintenance of (i) the Regulation S Facility and the Regulation S GDRs issued pursuant thereto and (ii) the Rule 144A Facility and the Rule 144A GDRs issued pursuant thereto, pursuant to which it also executed a Deed Poll in favour of the holders of the GDRs in the form attached to the Deposit Agreement. See “Terms and Conditions of the Global Depositary Receipts”.

### **Other Agreements**

#### ***Right of First Offer***

On 24 April 2012, MICL, Sonera and Telecominvest Holdings Limited entered into an agreement pursuant to which, *inter alia*, Telecominvest Holdings Limited and MICL have the right of first offer, subject to certain exceptions, if the TeliaSonera Group proposes to transfer any of its ordinary shares to a third party. See “Principal and Selling Shareholders—Recent Changes in Shareholding Structure and Ultimate Beneficial Owners—April and May 2012 Shareholding Changes”.

#### ***Yota Agreement***

In February 2012, we entered into an agreement with Yota for the joint development of LTE/4G networks in the Russian Federation which will (i) allow us provide LTE/4G services to our clients using Yota network, and (i) permit Yota to use our network infrastructure to provide certain services to its clients. See “Business—Certain Contracts and Projects Relating to the Operation of our Business—Yota MVNO Agreement”.

## TAXATION

*The following summary of certain U.S. federal income and estate, United Kingdom and Russian tax consequences of ownership of the Securities based upon laws, regulations, decrees, rulings, income tax conventions (treaties), administrative practice and judicial decisions in effect at the date hereof. Legislative, judicial or administrative changes or interpretations may, however, be forthcoming. Any such changes or interpretations could affect the tax consequences to holders of the Securities, possibly on a retroactive basis, and could alter or modify the statements and conclusions set forth herein. This summary does not purport to be a legal opinion or to address all tax aspects that may be relevant to a holder of the Securities. Each prospective holder is urged to consult its own tax advisor as to the particular tax consequences to such holder of the ownership and disposition of the Securities, including the applicability and effect of any other tax laws or tax treaties, of pending or proposed changes in applicable tax laws as at the date hereof, and of any actual changes in applicable tax laws after such date.*

### **Russian Tax Considerations**

*The following is a general description of certain Russian tax considerations relating to the Securities. It does not purport to be a complete analysis of all tax considerations relating to the Securities.*

**Prospective holders of the Securities should consult their tax advisers as to which countries' tax laws could be relevant to acquiring, holding and disposing of Securities and receiving payments of dividends and the consequences of such actions under the tax laws of those countries. This summary is based upon the law as in effect as at the date hereof. The information and analysis contained in this section are limited to issues relating to taxation, and prospective holders should not apply any information or analysis set out below to other issues, including (but not limited to) the legality of transactions involving the Securities.**

### ***General***

The following is a summary of certain Russian tax considerations relevant to the purchase, ownership and disposal of the Securities, as well as the taxation of dividend income and is based on the laws of the Russian Federation in effect at the date hereof, 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 the regions, municipalities or other non-federal authorities of the Russian Federation. Nor does the overview seek to address the availability of double tax treaty relief in respect of the Securities, and it should be noted that there may be practical difficulties, including satisfying certain documentation requirements, involved in claiming relief under an applicable double tax treaty. Prospective holders should consult their own professional advisors regarding the tax consequences of investing in the Securities. No representations with respect to the Russian tax consequences to any particular holder are made hereby.

The provisions of the Russian Tax Code applicable to holders of and transactions involving the Securities are ambiguous and lack interpretive guidance. Both the substantive provisions of the Russian Tax Code applicable to financial instruments and the interpretation and application of those provisions by the Russian tax authorities may be subject to more rapid and unpredictable change and inconsistency than in jurisdictions with more developed capital markets or more developed taxation systems. In particular, the interpretation and application of such provisions will in practice rest substantially with local tax inspectorates.

In practice, interpretation by different tax inspectorates may be inconsistent or contradictory and may involve the imposition of conditions, requirements or restrictions not provided for by the existing legislation. Similarly, in the absence of binding precedents, court rulings on tax or related matters by different Russian courts relating to the same or similar circumstances may also be inconsistent or contradictory.

According to the Russian Tax Code, a tax resident is an individual who spent not less than 183 days in the Russian Federation within 12 consecutive months (days of medical treatment and education outside the Russian Federation are also counted as days spent in the Russian Federation if the individual departed from the Russian Federation for these purposes for less than six months).

The interpretation of this definition by the Ministry of Finance states that for tax withholding purposes an individual's tax residence status should be determined on the date of the income payment (based on the number of days in the Russian Federation in the 12-month period preceding the date of payment). The individual's final

tax liability in the Russian Federation for the reporting calendar year should be determined based on his/her tax residence status for such calendar year, *i.e.*, based on the number of days spent in the Russian Federation in the 12-month period as of the end of such calendar year.

For the purposes of this summary, a “**non-resident holder**” means (i) an individual holder of the Securities who has not established a Russian tax residence status for the reporting calendar year, as discussed above; or (ii) a legal entity or organisation in each case not organised under Russian law that holds and disposes of Securities otherwise than through an office in the Russian Federation, and a “**Special Holder**” means a legal entity or organisation not organised under Russian law that holds the Securities through an office in the Russian Federation (a “**Special Holder**”)

For the purposes of this summary, a “**Russian resident holder**” means (i) an individual holder who has established a Russian tax residence status for the reporting calendar year as discussed above or (ii) a legal entity or organisation which is a holder but is not a non-resident holder as defined in the previous paragraph.

### *Taxation of Acquisition of the Securities*

No Russian tax implications generally should arise for holders, whether they are Russian resident holders or non-resident holders, upon purchase of the Securities. However, in certain circumstances, taxable income in the form of a material benefit may arise for individual holders if the Securities are purchased at a price below market value. Also, in certain circumstances, Russian resident holders that are legal entities or organisations acquiring either the GDRs over-the-counter (*i.e.*, not on a stock exchange) or the Offer Shares must fulfil the responsibilities of a Russian tax agent (*i.e.*, a legal entity resident in the Russian Federation for tax purposes paying taxable Russian source income to non-resident legal persons, organisations and non-resident individuals that is responsible for withholding Russian profits tax) with respect to profits withholding tax from the sales proceeds for the GDRs or the Offer Shares to be transferred to a non-resident holder disposing of such GDRs or the Offer Shares. Holders of Securities should consult their own tax advisers with respect to the tax consequences of acquiring the Securities.

### *Taxation of Dividends*

The following sections summarise taxation of dividends paid by us on the Securities.

#### *Russian Resident Holders*

Payments of dividends by us to a Russian resident holder who is an individual, a legal entity or organisation resident in the Russian Federation for tax purposes (except for Special Holders) should generally be subject to Russian withholding income tax, and such tax should not exceed 9% of the gross dividend amount payable to each Russian resident holder.

However, in the absence of any interpretative guidance on the beneficial ownership concept in the Russian Federation and due to the fact that the Depository (and not the holders of the GDRs) is the legal owner of the ordinary shares underlying the GDRs under Russian law, we are likely to withhold income tax at a rate of 15% from dividend payments on the GDRs, notwithstanding the fact that the ultimate recipient of such dividends may be a Russian resident holder.

Payments of dividends by a Russian entity to a holder that is a Special Holder should generally be subject to Russian withholding tax at a rate of 15%. Special Holder is entitled to pay this tax to the Russian tax authorities on its own behalf (*i.e.*, without withholding of the tax by a Russian entity distributing the dividends to such Special Holder) if such Special Holder provides the Russian entity distributing the dividends as the Russian tax agent with special documentary evidence confirming the fact that this dividend income is attributable to an office of the Special Holder in the Russian Federation. Such evidence includes (a) a notarised copy of the form confirming registration of the holder with the Russian tax authorities and (b) notification from the Special Holder that such dividend income is attributable to the office of the Special Holder in the Russian Federation. The Russian Tax Code does not provide any formal guidance as to the required format of the notification. However, it appears that the document confirming the fact that this dividend income is attributable to the office of the holder in the Russian Federation can be issued by the Russian tax authorities at the Special Holder’s place of tax registration.

It is possible that payments of dividends on the Securities made by us to a Special Holder may be subject to Russian withholding income tax, not at 15%, but at a rate of up to 9% of the gross dividend amount. This lower

rate could apply to each such Special Holder of the Offer Shares and GDRs through an office in the Russian Federation if the applicable double tax treaty between the Russian Federation and the country of tax residence of such holder provides for the non-discrimination of tax residents of such country as compared to Russian tax residents. In such case, the rate applicable to Russian legal entities or organisations should be applied with respect to the gross dividend amount payable to such holder to the extent such Special Holder is entitled to benefit under such double tax treaty and provided further that such Special Holder satisfies the Russian tax documentation requirements (such as the requirement that an annual advance tax residency confirmation should be provided). However, there can be no assurance that such double tax treaty relief will be available to any Special Holder. In any event under both of the scenarios described above, as stated above, we are likely to withhold income tax at a rate of 15% from dividend payments made to Special Holders of GDRs.

Finally, with respect to dividends payable on the GDRs, there is a risk that investors that are Russian corporate tax residents may be required to pay additional Russian corporate income tax (i.e., in addition to the tax withheld from the dividend at source) on the amount of the dividend income received at the rate of 9% or 20% (the higher rate applies if the income received is not recognised as dividend income for Russian profits tax purposes). Similarly, Russian individual tax resident investors may be required to pay additional personal income tax on the amount of the dividend received under the GDRs at the rate of 9% or 13% (the higher rate applies if the income received is not recognised as dividend income for Russian personal income tax purposes). There is also no established procedure providing for the refund or credit of the tax withheld by the payer from dividends payable through the Depository to the Russian resident investors holding the GDRs.

Russian resident holders should therefore consult their own tax advisers with respect to the tax consequences of their receipt of dividend income with respect to the holding of the Securities.

#### *Non-Resident Holders*

In general, payments of dividends by a Russian entity to non-resident holders are subject to Russian withholding tax at a rate of 15%. Such Russian withholding tax may be subject to reduction pursuant to the terms of any applicable double tax treaty between the Russian Federation and the country of tax residence of the non-resident holders to the extent such non-resident holders are entitled to benefit from a double tax treaty and the corresponding tax treaty reliefs provided by such treaty. Accordingly, it is possible that payments of dividends on the Offer Shares or the GDRs made by us to non-resident holders may be subject to withholding taxation at a reduced rate if such reduction is provided for by an applicable double tax treaty, provided the Russian tax documentation requirements are satisfied. For non-resident legal entities and organisations, such documentation would include an annual confirmation of the holder's tax residency to be presented to the Russian tax resident acting as a tax agent prior to payment of such dividend income.

However, Russian tax rules applicable to the holders of GDRs are characterised by significant uncertainty and, until recently, an absence of interpretative guidance. The Ministry of Finance of the Russian Federation has expressed its opinion that non-resident holders of depository receipts should be treated as the beneficial owners of the dividends paid on the underlying shares for the purposes of double tax treaty provisions governing Russian withholding taxation of dividend income, provided that the tax residence of such holders of the depository receipts is duly confirmed. However, the Russian tax authorities have not provided official guidance addressing how a holder of GDRs should demonstrate its beneficial ownership of the dividends payable on the underlying shares. In the absence of any specific provisions in the tax legislation with respect to the concept of beneficial ownership and the taxation of the income of beneficial owners, it is unclear how the Russian tax authorities will ultimately treat holders of GDRs in this regard. In such circumstances, there can be no assurance that a non-resident holder of GDRs will be in a position to benefit from a reduced Russian withholding tax rate on dividend income from the underlying ordinary shares provided by an applicable double tax treaty. Consequently, in the absence of any interpretative guidance on the beneficial ownership concept in Russian tax law and due to the fact that the Depository (and not the holders of GDRs) is the legal owner of the ordinary shares underlying the GDRs under Russian law, we are likely to withhold tax at a rate of 15% from the dividends payable to non-resident holders of the GDRs, subject to possible reduction pursuant to the terms of any applicable double tax treaty.

However, considering, *inter alia*, the above uncertainty as to the treatment of holders of GDRs as the beneficial owners of the dividend income from the underlying shares and due to the fact that the Depository (and not the holders of the GDRs) is the legal owner of the ordinary shares underlying the GDRs under Russian law, no assurance can be provided that the above reduction in tax rate under the provisions of any applicable double tax treaty will be available for such non-individual non-resident holders in any case.



With respect to non-resident individual holders, procedures for advance treaty clearance are very uncertain under current Russian legislation. As a result, the possibility for non-resident individual holders to obtain a reduction of withholding income tax provided by any double tax treaty between the Russian Federation and the country of the tax residence of such non-resident individual holders is very unlikely. If non-resident individual holders do not obtain double tax treaty relief at the time the dividend is paid and income tax is withheld by a Russian payer of the income, such non-resident individual holders may apply for a refund within one year from the end of the tax period in which the tax was withheld. The documentation requirements to obtain such a refund would include an official confirmation of a non-resident individual holder's tax residence in a country having an effective double tax treaty with the Russian Federation which provides for a reduction of withholding income tax.

However, there can be no assurance that such double tax treaty relief or tax refund will be available to non-resident individual holders.

If the Russian tax authorities view dividends paid on GDRs to non-resident individual holders of GDRs as Russian-source income, there is a further risk that this income may be subject to tax in the Russian Federation a second time, resulting in a combined gross tax rate of up to 45% (*i.e.*, the 15% income tax withheld from dividend payments plus a further 30% Russian personal income tax payable by a non-resident individual on a self-assessed basis on the subsequent payment made by the Depository to such individual GDR holder, should such income be treated as a distribution of ordinary Russian-source income to the non-resident individual rather than a dividend distribution).

Non-resident holders should therefore consult their own tax advisers with respect to the tax consequences of their receipt of dividend income on the Securities.

### ***Taxation of Capital Gains***

The following sections summarise the taxation of capital gains in respect of the disposition of the Securities.

#### ***Russian Resident Holders***

A Russian resident holder is subject to all applicable Russian taxes and any documentation requirements that may be prescribed by law or practice in respect of capital gains arising from any disposal of the Securities. A Russian resident holder that is a legal entity or an organisation should generally be subject to Russian profits tax at a rate of 20% of the capital gain. A Special Holder is also subject to tax on any gain at the same rate and is entitled to pay the tax due directly to the Russian tax authorities (*i.e.*, without withholding of tax). However, when GDRs are disposed of by such a Special Holder over-the-counter (*i.e.*, not via a stock exchange) to a Russian resident holder which is not an individual, then, in order to pay the tax on its own behalf (*i.e.* without withholding), such a Special Holder should provide the Russian resident non-individual acquirer of the GDRs with documentary evidence confirming the fact that the income from the disposal of the GDRs is attributable to an office of the Special Holder in the Russian Federation. Such evidence includes (a) a notarised copy of the form confirming the holder's registration with the Russian tax authorities and (b) a notification from the Special Holder that such income from the disposal of the GDRs is attributable to the office of the Special Holder in the Russian Federation. The Russian Tax Code does not provide any formal guidance as to the required format of the notification. In particular, the document confirming the fact that this income from the disposal of the GDRs is attributable to the office of the Special Holder in the Russian Federation could be issued by the Russian tax authorities at the holder's place of tax registration.

A Russian resident holder who is an individual is generally subject to income tax at a rate of 13% on the amount of any capital gain. In certain circumstances if the disposal proceeds are payable by a Russian legal entity, individual entrepreneur or a Russian office of a foreign organisation, the payer may be required to withhold this income tax. If tax is not withheld by the payer, the resident individual holder would in all events be liable to pay the tax to the Russian tax authorities.

A capital gain arising from any disposal of the Securities is generally determined to be the gross proceeds from the disposal of the Securities less the cost of acquisition of such Securities and less expenses incurred by such resident holder in relation to the acquisition, holding and sale of the Securities (provided that the cost of acquisition of the Securities and the other expenses can be confirmed by appropriate documents).

*Russian resident holders, whether individuals, legal entities or organisations, should in all events consult their own tax advisers with respect to the tax consequences of gains derived from the disposal of the Securities.*

### *Non-Resident Holders*

The Russian profits tax consequences which apply for any legal entity or organisation which holds and disposes of securities through an office in the Russian Federation are described in the preceding section. The discussion which follows assumes that all disposals are made by a non-resident holder *other than* through an office in the Russian Federation.

Based on the assumption that less than 50% of our gross assets consist of (i) immovable property located in the Russian Federation; and (ii) financial instruments derived from shareholdings in Russian companies or organisations, which companies or organisations have more than 50% of their gross assets comprised by immovable property located in the Russian Federation, then the gross proceeds or capital gains from the disposal of the Offer Shares received by non-resident investors that are a legal entity or an organisation should not be subject to withholding tax in the Russian Federation, provided that such Offer Shares are disposed of other than through an office in the Russian Federation. The Russian Tax Code does not specify what document(s) evidence our satisfaction of the above assumption.

If the above assumption as to the portion of the Russian immovable property and related financial instruments in our assets is not correct, the gross proceeds from a disposal of the Offer Shares by a non-resident investor that is legal entity or an organisation (disposing the Offer Shares other than through an office in the Russian Federation) are subject to withholding tax in the Russian Federation at a rate of 20%, providing that the proceeds from such disposal are deemed to be received from a Russian source. Alternatively, the capital gains from the sale are subject to a 20% withholding tax. Capital gain means the difference between the sale price and the sum of the acquisition and disposal costs (which need to be evidenced by proper supporting documents) of the Offer Shares.

In accordance with recent amendments to the Russian Tax Code, which came into force in 2011, if a non-resident holder that is a legal entity or organisation disposes of the securities and such securities are recognised as marketable securities under the Russian Tax Code, the proceeds from such should not be subject to profits tax in the Russian Federation. Consequently, no Russian withholding income tax should be imposed on the proceeds from disposal of the Offer Shares to be received by an above non-resident holder to the extent the Offer Shares would be recognised as marketable securities under the requirements of the Russian Tax Code.

A non-resident holder that is a legal entity or organisation should generally not be subject to Russian withholding tax in respect of the disposal of the GDRs if such disposal is conducted on a foreign stock exchange and the GDRs are recognised as circulating on such foreign stock exchange.

If a non-resident holder that is a legal entity or organisation disposes of the GDRs over-the-counter and the proceeds of such disposal are deemed to be received from a Russian source, the gross proceeds from such disposal may be subject to withholding tax in the Russian Federation at a rate of 20%. Alternatively, the capital gains from the sale may be subject to a 20% withholding tax. As discussed above, the capital gain is the excess, if any, of the gross proceeds from the sale of the GDRs over the sum of the acquisition costs and holding and disposal costs (which need to be evidenced by proper supporting documents). Russian withholding tax would apply if more than 50% of our assets consist of immovable property located in the Russian Federation.

The liability to withholding tax described above is subject to any available double tax treaty relief. In order to confirm the applicability of the double tax treaty under which benefits are claimed, documentary evidence is required to be presented by a non-resident holder that is a legal entity or organisation to the Russian tax resident payer of the proceeds (who is required to act as a tax agent) prior to payment being. Non-resident holders that are legal entities or organisations should consult their own tax advisers with respect to this possibility.

A non-resident holder that is a legal entity or organisation should generally not be subject to any Russian taxes in respect of capital gains or other income realised on the disposal of GDRs outside the Russian Federation (including over-the-counter sales), provided that the proceeds of such disposal are not considered to be received from a source within the Russian Federation. Even if a sale or other disposal by a non-resident holder to another non-resident holder is regarded as received from a Russian source and subject to withholding income tax, there is currently no mechanism for withholding the Russian tax due. Non-resident holders that are legal entities or organisations should consult their own tax advisers with respect to the tax consequences of the receipt of proceeds from a disposal of GDRs to other non-resident holders.

A non-resident holder who is an individual will generally not be subject to any Russian taxes in respect of capital gains realised on the disposal of either Ordinary Shares or GDRs outside the Russian Federation so long as the

proceeds are not considered to be received from a source within the Russian Federation. If they are so considered, then the individual non-resident holder will be subject to tax at a rate of 30% of the capital gain, subject to any available double tax treaty relief. In certain circumstances, if the disposal proceeds are payable by a Russian legal entity, or individual entrepreneur or through a Russian office of a foreign organisation, the payer may be required to withhold this tax. If the tax is not withheld by the payer, the non-resident individual would be liable to pay the tax to the Russian tax authorities. Procedures for advance treaty clearance under the current Russian legislation with respect to non-resident individual holders are very uncertain. As a result, for non-resident individual holders, it is very unlikely that a reduction of withholding income tax provided by the double tax treaty between the Russian Federation and the country of the tax residence of such non-resident individual holder can be obtained. If a non-resident individual holder does not obtain double tax treaty relief at the time the proceeds from the disposal of the Securities are paid to such non-resident individual holder, and income tax is withheld by the Russian payer of such income, the non-resident individual holder may apply for a refund within one year from the end of the tax period in which the tax was withheld, as discussed below.

However, there can be no assurance that any available double tax treaty relief (or the refund of any taxes withheld) will be available for an individual non-resident holder. Non-resident holders who are individuals should consult their own tax advisers with respect to the tax consequences of the receipt of proceeds from a disposal of the Securities and the possibility of obtaining any double tax treaty relief or the refund of any taxes withheld.

### ***Tax Treaty Procedures***

To apply for double tax treaty relief, a holder that is not an individual and for which the possibility of such double tax treaty relief is available should provide the payer of the relevant item of income with a confirmation of its tax residency. Such confirmation should be presented before the date of payment and be certified by the competent authority in the holder's jurisdiction. Such confirmation is valid for the calendar year in which it is issued. It should be legalised or apostilled with a notarised Russian translation attached to it. In the absence of confirmation of tax residence, Russian tax residents acting as tax agents are required to withhold Russian income tax at the full rate from the proceeds representing taxable Russian source income, as provided for by the Russian Tax Code.

For a holder that is not an individual and for which double tax treaty relief is available, where Russian income tax was withheld at the source of payment, a refund of such tax is possible if requested within three years from the end of the tax period in which the tax was withheld. In order to obtain a refund, documentation confirming the right of such recipient of the income to double tax treaty relief is required.

For an individual holder for whom double tax treaty relief is available, where Russian tax was withheld at the source of payment, a request for a refund of such tax may be filed within one year after the end of the year in which the tax was withheld. In order to obtain a refund, documentation confirming the right of the recipient of the income to double tax treaty relief is required.

The Russian tax authorities may, in practice, require a wide variety of documentation confirming the right to benefit under a double tax treaty or the right to receive a zero tax rate under Russian domestic tax law. 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 difficulties.

### ***Stamp Duties***

No Russian stamp duty should be payable by the holders upon any of the transactions with the Securities discussed in this section of this Prospectus (*e.g.*, on a purchase or sale of the Securities), except for transactions involving the receipt of Securities by way of inheritance.

### **Certain U.S. Federal Income and Estate Tax Considerations**

**TO ENSURE COMPLIANCE WITH U.S. TREASURY DEPARTMENT CIRCULAR 230, PROSPECTIVE PURCHASERS ARE HEREBY NOTIFIED THAT: (A) ANY DISCUSSION OF U.S. FEDERAL INCOME TAX ISSUES IN THIS PROSPECTUS IS NOT INTENDED OR WRITTEN TO BE RELIED UPON, AND CANNOT BE RELIED UPON, BY PROSPECTIVE PURCHASERS FOR THE PURPOSE OF AVOIDING PENALTIES THAT MAY BE IMPOSED ON THEM UNDER THE U.S. INTERNAL REVENUE CODE OF 1986, AS AMENDED (THE "CODE"); (B) 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) PROSPECTIVE PURCHASERS SHOULD SEEK ADVICE BASED ON THEIR PARTICULAR CIRCUMSTANCES FROM AN INDEPENDENT TAX ADVISOR.**

The following description describes certain U.S. federal income and estate tax consequences for a U.S. Holder (as defined below) of acquiring, owning and disposing of Securities. This description applies only to holders that are initial purchasers of the Securities pursuant to the offering and that hold such Securities as “capital assets” for U.S. federal income tax purposes. This description assumes that the Depositary will not take any action inconsistent with the material terms of the Deposit Agreement. It does not purport to be a comprehensive description of all of the tax consequences that may be relevant to a decision to hold or dispose of Securities. In particular, this description does not address tax considerations applicable to a holder that may be subject to special tax rules, including, without limitation, a dealer in securities or currencies, a trader in securities that elects to use a mark-to-market method of accounting, a bank, a regulated investment company, a real estate investment trust, a holder subject to the alternative minimum tax, a pension fund, a partnership or other pass-through entity, a life-insurance company, a tax-exempt organisation, a person that holds Securities as part of a hedge, straddle or conversion transaction for tax purposes, a person whose functional currency for tax purposes is not the U.S. dollar, a person that owns or is deemed to own 10% or more of our voting stock or a “U.S. Holder” (as defined below) that is also a “Russian resident holder” (as defined in “Russian Tax Considerations—General”), or that holds or disposes of Securities through a permanent establishment in the Russian Federation. The disclosure also does not address the Medicare contribution tax imposed on certain net investment income in taxable years beginning after 31 December 2012, as well as any consequences of holding the Securities through an account with a foreign financial institution.

If an entity treated as a partnership for U.S. federal income tax purposes holds Securities, the tax treatment of each partner of the partnership generally will depend upon the status of the partner and the activities of the partnership. Prospective holders that are partners in a partnership holding Securities should consult their own tax advisors.

For the purposes of this discussion, “**U.S. Holder**” means a beneficial owner of a Security that is, for U.S. federal income tax purposes, (i) an individual citizen or resident of the United States, (ii) a corporation created or organised under the laws of the United States, any State thereof or the District of Columbia, (iii) an estate the income of which is subject to U.S. federal income tax without regard to its source, (iv) a trust if a court within the United States is able to exercise primary supervision over the administration of the trust and one or more U.S. persons have the authority to control all substantial decisions of the trust, or the trust has elected to be treated as a domestic trust or (v) a person otherwise subject to U.S. federal income tax on a net income basis with respect to the Securities.

Generally, U.S. Holders of the GDRs will be treated for U.S. federal income tax purposes as holding the ordinary shares represented by the GDRs. No gain or loss will be recognised upon the exchange of ordinary shares for GDRs or the exchange of GDRs for ordinary shares. A U.S. Holder’s tax basis in such ordinary shares will be the same as its tax basis in such GDRs, and the holding period in such ordinary shares will include the holding period in such GDRs.

This description is based on the tax laws of the United States, including the Code, its legislative history, existing and proposed regulations promulgated thereunder, published rulings, and court decisions, all as currently in effect. These laws are subject to change, possibly on a retroactive basis.

*Prospective purchasers should consult their own tax advisors concerning the U.S. federal, state, local, foreign and other tax consequences of acquiring, owning and disposing of Securities in light of their particular circumstances.*

### ***Taxation of Dividends***

Subject to the application of the passive foreign investment company rules discussed below, a U.S. Holder will recognise ordinary dividend income for U.S. federal income tax purposes in an amount equal to the amount of any cash and the value of any property we distribute as a distribution (other than certain *pro rata* distributions of our shares to all holders, including holders of Securities) to the extent that such distribution is paid out of its current or accumulated earnings and profits, as determined under U.S. federal income tax principles, when such distribution is received (or when received by the Depositary in the case of GDRs). We do not intend to maintain

calculations of earnings and profits under U.S. federal income tax principles. Therefore, a U.S. Holder should expect that distributions paid with respect to the Securities generally will be treated as dividends. Dividends on the Securities generally will be included in a U.S. Holder's gross income as ordinary income from foreign sources. Dividends will not be eligible for the dividends received deduction generally allowable to U.S. corporations under the Code. The amount of a dividend paid in a foreign currency that a U.S. Holder will be required to include in income will equal the U.S. dollar value of the foreign currency received, calculated by reference to the exchange rate in effect on the date of receipt (or the date of the Depositary's receipt in the case of GDRs). A U.S. Holder should not recognise any foreign currency gain or loss in respect of such distribution if the foreign currency is converted into U.S. dollars on the date the distribution is received. If the foreign currency is not converted into U.S. dollars on the date of receipt, however, gain or loss may be recognised upon a subsequent sale or other disposition of the foreign currency. Such foreign currency gain or loss (if any) generally will be treated as ordinary income or loss to such U.S. Holder and generally will be treated as U.S. source income or loss, which may be relevant in calculating the U.S. Holder's foreign tax credit limitation.

Subject to certain exceptions for short-term and hedged positions, the dividends received by certain non-corporate U.S. Holders before January 1, 2013 will be subject to taxation at reduced rates if the dividends are "qualified dividends". For such non-corporate U.S. Holders, the current maximum tax rate for qualified dividend income is 15%, and unless such rate is extended, beginning in 2013, dividends will be taxed at ordinary income rates. Dividends received with respect to Securities will be qualified dividends if (i) we are eligible for the benefits of a comprehensive income tax treaty with the United States that the Internal Revenue Service (the "IRS") has approved for purposes of the qualified dividend rules and (ii) we were not, in the year prior to the year in which the dividend was paid, and is not, in the year in which the dividend is paid, a passive foreign investment company. The application of the income tax treaty between the United States and the Russian Federation (the "U.S. Treaty") to us is unclear, and we may not be eligible for the benefits of the U.S. Treaty (which has been approved by the IRS for the purposes of the qualified dividend rules). The passive foreign investment company rules are discussed below.

Dividends received by U.S. Holders generally will be treated as income from sources outside of the United States, and generally will be treated separately along with other items of "passive category income" for purposes of determining the credit for foreign income taxes allowed under the Code. Subject to certain limitations, income tax withheld in connection with any distribution with respect to the Securities may be claimed as a credit against the U.S. federal income tax liability of a U.S. Holder if such U.S. Holder elects for that year to credit all foreign income taxes. Alternatively such withholding tax may be taken as a deduction against taxable income. Foreign tax credits generally will not be allowed for Russian withholding taxes imposed at a rate exceeding the rate applicable to a U.S. Holder under the U.S. Treaty (currently ten percent), assuming the U.S. Holder is eligible to claim benefits under the U.S. Treaty. Foreign tax credits also will not be allowed for withholding taxes imposed in respect of certain short-term or hedged positions and may not be allowed in respect of arrangements in which a U.S. Holder's expected economic profit, after non-U.S. taxes, is insubstantial. The rules governing foreign tax credits are complex, and U.S. Holders should consult their own tax advisors concerning the implications of these rules in light of their particular circumstances.

### ***Taxation of Dispositions***

Subject to the application of the passive foreign investment company rules discussed below, a U.S. Holder will generally recognise capital gain or loss on the sale or other taxable disposition of Securities in an amount equal to the difference between the U.S. dollar value of the amount realised on the disposition and such holder's tax basis in the Securities as determined in U.S. dollars. Any such capital gain or loss will be long-term capital gain or loss, subject to taxation at reduced rates for individual U.S. Holders, if the Securities were held for more than one year. The current maximum tax rate for long-term capital gains is 15%, and unless such rate is extended, is scheduled to increase to 20% beginning in 2013. The deductibility of capital losses is subject to limitations. Gain or loss realised by a U.S. Holder on the sale or other taxable disposition of Securities generally will be U.S.-source gain or loss for U.S. federal income tax purposes. Consequently, if Russian tax is imposed on such gain, a U.S. Holder will not be able to use the corresponding foreign tax credit, unless the holder has other foreign source income of the appropriate type (generally "passive category income" although in certain cases, "general category income") in respect of which the credit may be used. Alternatively, such Russian tax may be taken as a deduction against taxable income if the U.S. Holder does not take a credit for any foreign income tax during the taxable year.



### ***Passive Foreign Investment Company Rules***

We do not believe that we were a passive foreign investment company (“**PFIC**”) for our preceding tax year, and do not expect to be classified as a PFIC for our current tax year or in the foreseeable future. However, the determination of whether we are a PFIC is made annually and is based on the composition of our assets and income on certain dates. Therefore, it is possible that we could become a PFIC in the current or any future year due to our asset or income composition, as well as that of our subsidiaries, on the relevant testing dates. In general, a non-U.S. corporation will be classified as a PFIC for any taxable year if at least (i) 75% of its gross income is classified as “passive income” or (ii) 50% of the average quarterly value of its assets produce or are held for the production of passive income. In making this determination, the non-U.S. corporation is treated as earning its proportionate share of any income and owning its proportionate share of any assets of any company in which it holds a 25% or greater interest, by value. Under the PFIC rules, if we were considered a PFIC at any time that a U.S. Holder held our Securities, we would continue to be treated as a PFIC with respect to a U.S. Holder’s investment unless a U.S. Holder has made certain elections under the PFIC rules.

If we are classified as a PFIC at any time that U.S. Holders hold our Securities, U.S. Holders may be subject to materially adverse U.S. federal income tax consequences compared to an investment in a company that is not considered a PFIC, including being subject to greater amounts of U.S. tax and being subject to additional U.S. tax form filing requirements. U.S. Holders should consult their own tax advisors about the application of the PFIC rules in light of their particular circumstances.

### ***U.S. Federal Estate Tax***

For purposes of U.S. federal estate tax, Securities owned or treated as owned by an individual citizen or resident of the United States at the time of death will be included in that individual’s gross estate.

### ***Information Reporting and Backup Withholding***

The payment of dividends on, and proceeds from the sale or other disposition of, Securities to a U.S. Holder within the United States (or through certain U.S. related financial intermediaries) will generally be subject to information reporting unless the U.S. Holder is a corporation or other exempt recipient. Dividends and proceeds subject to information reporting also may be subject to backup withholding unless the U.S. Holder timely provides a taxpayer identification number and certifies that no loss of exemption from backup withholding has occurred. Backup withholding is not an additional tax. The amount of any backup withholding collected from a payment to a U.S. Holder will be allowed as a credit against the U.S. Holder’s U.S. federal income tax liability and may entitle the U.S. Holder to a refund, so long as the required information is properly furnished to the IRS.

U.S. Holders should consult their own tax advisors regarding application of the information reporting and backup withholding rules.

### ***United Kingdom Tax Considerations***

The following is a general summary of certain U.K. tax considerations relating to the ownership and disposal of the Securities. It is based on current U.K. tax law and published HM Revenue & Customs (“**HMRC**”) practice as at the date hereof, as well as the provisions of the 1994 double taxation treaty between the United Kingdom and the Russian Federation, as amended (the “**U.K. Treaty**”), each of which is subject to change, possibly with retrospective effect.

The summary applies only to persons who are resident (and, in the case of individuals, ordinarily resident and domiciled) in the United Kingdom for tax purposes and who are not resident for tax purposes in any other jurisdiction and do not have a permanent establishment or fixed base in any other jurisdiction with which the holding of the Securities is connected (“**U.K. Holders**”). Persons (a) who are not resident or ordinarily resident (or, if resident or ordinarily resident, are not domiciled) in the United Kingdom for tax purposes, including those individuals and companies who trade in the United Kingdom through a branch, agency or permanent establishment in the United Kingdom to which the Securities are attributable, or (b) who are resident or otherwise subject to tax in a jurisdiction outside the United Kingdom, are recommended to seek the advice of professional advisors in relation to their taxation obligations.

This summary is for general information only and is not intended to be, nor should it be considered to be, legal or tax advice to any particular investor. It does not address all of the tax considerations that may be relevant to specific investors in light of their particular circumstances or to investors subject to special treatment under U.K. tax law. In particular:

- this summary only applies to the absolute beneficial owners of the Securities and any dividends paid in respect of the underlying ordinary shares where the dividends are regarded for U.K. tax purposes as that person's own income (and not the income of some other person);
- this summary: (a) only addresses the principal U.K. tax consequences for investors who hold Securities as capital assets, (b) does not address the tax consequences which may be relevant to certain special classes of investor such as dealers, brokers or traders in shares or securities and other persons who hold Securities otherwise than as an investment, (c) does not address the tax consequences for holders that are financial institutions, insurance companies, collective investment schemes, pension schemes, charities or tax-exempt organisations, (d) assumes that the holder is not an one of our officers or employees (or of any related company) and has not (and is not deemed to have) acquired the Securities by virtue of an office or employment, and (e) assumes that the holder does not control or hold (and is not deemed to control or hold), either alone or together with one or more associated or connected persons, directly or indirectly (including through the holding of the Securities), an interest of 10% or more in our ordinary shares, voting power, rights to profits or capital, and is not otherwise connected with us.

This summary further assumes that (a) a holder of GDRs is, for U.K. tax purposes, absolutely beneficially entitled to the underlying ordinary shares and to the dividends on those ordinary shares, (b) the Offer Shares are not registered in a register kept in the U.K. by or on behalf of us, and they will not become so registered, and (c) dividends paid by us will be treated as income distributions for U.K. tax purposes.

**Potential investors in the Securities should satisfy themselves prior to investing as to the overall tax consequences, including, specifically, the consequences under U.K. tax law and HMRC practice of the acquisition, ownership and disposal of the Securities, in their own particular circumstances by consulting their own tax advisers.**

### *Taxation of Dividends*

#### *Withholding Tax*

Dividend payments in respect of the Securities may be made without withholding or deduction for or on account of U.K. tax.

#### *Income Tax*

Dividends received by individual U.K. Holders will be subject to U.K. income tax on the full amount of the dividend paid (before the deduction of any Russian withholding tax (see “—Russian Tax Considerations—Taxation of Dividends—Non-Resident Holders”) grossed up for the amount of the non-refundable U.K. dividend tax credit referred to below, with potential credit for Russian tax deducted at source (as described below).

The rate of U.K. income tax which is chargeable on dividends received in the tax year 2012/2013 by (i) additional rate taxpayers is 42.5 %, (ii) higher rate taxpayers is 32.5 %, and (iii) basic rate taxpayers is 10%. Individual U.K. Holders will be entitled to a non-refundable tax credit equal to one-ninth of the full amount of the dividend received from us (before the deduction of any Russian withholding tax), which will be taken into account in computing the gross amount of the dividend which is chargeable to U.K. income tax. The tax credit will be credited against the U.K. Holder's liability (if any) to U.K. income tax on the gross amount of the dividend. After taking into account the tax credit, the effective rate of tax (i) for additional rate taxpayers will be approximately 36 % of the dividend paid, (ii) for higher rate taxpayers will be 25 % of the dividend paid, and (iii) for basic rate taxpayers will be nil. An individual shareholder who is not subject to U.K. income tax on dividends received from us will not be entitled to claim payment of the tax credit in respect of such dividends. An individual's dividend income is treated as the top slice of their total income which is chargeable to U.K. income tax.

### *Corporation Tax*

A U.K. Holder within the charge to U.K. corporation tax should generally be entitled to exemption from U.K. corporation tax in respect of dividend payments. If the conditions for the exemption are not satisfied, or a U.K. Holder elects for an otherwise exempt dividend to be taxable, U.K. corporation tax will be chargeable on the gross amount of any dividends, subject to any applicable credit for Russian tax deducted at source (as described below). If potential investors are in any doubt as to their position, they should consult their own professional advisers.

### *Credit for Russian Tax*

Credit may be given for Russian tax withheld from dividends, subject to general rules regarding the calculation and availability of such credit, including a requirement to take all reasonable steps to minimise the amount of Russian tax on such dividends, including obtaining relief at source and any available refunds. See “—Russian Tax Considerations—Tax Treaty Procedures”. Where a dividend paid by us is treated as exempt from U.K. corporation tax, a corporate U.K. Holder will not be entitled to claim relief by way of credit in the United Kingdom in respect of any Russian tax paid by such holder, either directly or by deduction, in respect of that dividend.

### *Provision of Information*

Persons in the United Kingdom paying “foreign dividends” to, or receiving “foreign dividends” on behalf of, another person, may, in certain circumstances, be required to provide certain information to HMRC regarding the identity of the payee or the person entitled to the “foreign dividend”, and, in certain circumstances, such information may be exchanged with tax authorities in other countries. However, in accordance with guidance published by HMRC applicable for the 2012/2013 tax year, dividend payments in respect of the Securities should not be treated as falling within the scope of the requirement. There is no guarantee that equivalent guidance will be issued in respect of future years.

### *Taxation of Disposals*

A disposal or deemed disposal of Securities by an individual U.K. Holder may, depending on his or her individual circumstances, give rise to a chargeable gain or to an allowable loss for the purpose of U.K. capital gains tax. The principal factors that will determine the capital gains tax position on a disposal of Securities are the extent to which the holder realises any other capital gains in the tax year in which the disposal is made, the extent to which the holder has incurred capital losses in that or any earlier tax year and the level of the annual allowance of tax-free gains in that tax year (the “**annual exemption**”). The annual exemption for the 2012/2013 tax year is £10,600. If, after all allowable deductions, an individual U.K. Holder’s taxable income for the year exceeds the basic rate income tax limit, a taxable capital gain accruing on a disposal of Securities will be taxed at 28%. In other cases, a taxable capital gain accruing on a disposal of Securities may be taxed at 18% or 28% or at a combination of both rates.

An individual U.K. Holder who ceases to be resident or ordinarily resident in the United Kingdom for a period of less than five years and who disposes of his or her Securities during that period of temporary non-residence may be liable to U.K. capital gains tax on a chargeable gain accruing on such disposal on his or her return to the United Kingdom (subject to available exemptions or reliefs).

A disposal of Securities by a corporate U.K. Holder may give rise to a chargeable gain or an allowable loss for the purpose of U.K. corporation tax. Such a holder should be entitled to an indexation allowance, which applies to reduce capital gains to the extent that such gains arise due to inflation. The allowance may reduce a chargeable gain but will not create an allowable loss.

Any gains or losses in respect of currency fluctuations relating to the Securities would be brought into account on the disposal.

### *Credit for Russian Withholding Tax*

Certain capital gains may be subject to Russian withholding tax. See “—Russian Tax Considerations—Taxation of Capital Gains—Non-Resident Holders”. Credit against U.K. tax may be given for Russian tax withheld, subject to general rules regarding the calculation and availability of such credit, including a requirement to take all reasonable steps to minimise the amount of Russian tax on such capital gains. See “—Russian Tax Considerations—Tax Treaty Procedures”.

### ***Stamp Duty and Stamp Duty Reserve Tax***

No U.K. stamp duty will be payable in connection with a transfer of the Offer Shares if any instrument of transfer is executed outside the U.K. and does not relate to any property situated or any matter or thing done or to be done in the U.K. If any instrument of transfer were to be chargeable to UK stamp duty, in practice it should not be necessary to pay such U.K. stamp duty unless the instrument is required for any purpose in the United Kingdom (for example, as evidence in an English court of law). If it is necessary to pay U.K. stamp duty, it may also be necessary to pay interest and penalties.

No U.K. stamp duty reserve tax will be payable in respect of any agreement to transfer the Offer Shares.

No U.K. stamp duty or stamp duty reserve tax will be payable on the issue of the GDRs or their delivery into DTC, Euroclear or Clearstream (as applicable).

No U.K. stamp duty or stamp duty reserve tax will be payable on any transfer of the GDRs once they are issued into DTC, Euroclear or Clearstream (as applicable), where such transfer is effected in electronic book-entry form in accordance with the procedures of DTC, Euroclear or Clearstream (as applicable).

### ***Inheritance Tax***

U.K. inheritance tax may be chargeable on the death of, or in certain circumstances on a gift by, the owner of Securities, where the owner is an individual who is domiciled or is deemed to be domiciled in the United Kingdom. For inheritance tax purposes, a transfer of assets at less than full market value may be treated as a gift and particular rules apply to gifts where the donor receives or retains some benefit.

## SELLING AND TRANSFER RESTRICTIONS

### Selling Restrictions

#### *General*

No action has been or will be taken in any jurisdiction that would permit a public offering of the Securities, or possession or distribution of this Prospectus or any other offering material in any country or jurisdiction where action for that purpose is required. Accordingly, the Securities may not be offered or sold, directly or indirectly, and neither this Prospectus nor any other offering material or advertisement in connection with the Securities may be distributed or published in or from any country or jurisdiction except under circumstances that will result in compliance with any and all applicable rules and regulations of any such country or jurisdiction. Persons into whose possession this Prospectus comes should inform themselves about and observe any restrictions on the distribution of this Prospectus and the offer and sale of the Securities offered in the Offering, including those in the paragraphs below. Any failure to comply with these restrictions may constitute a violation of the securities laws of any such jurisdiction. This Prospectus does not constitute an offer to subscribe for or buy any of the Securities offered in the Offering to any person in any jurisdiction to whom it is unlawful to make such offer or solicitation in such jurisdiction.

#### *United States*

The Securities have not been and will not be registered under the Securities Act, and may not be offered or sold within the United States except in certain transactions exempt from the registration requirements of the Securities Act. The Securities are being offered and sold outside of the United States in reliance on Regulation S. The Underwriting Agreement provides that certain of the Joint Bookrunners may directly or through their respective U.S. broker-dealer affiliates, arrange for the offer and resale of the Securities within the United States only to QIBs in reliance on Rule 144A.

In addition, until 40 days after the commencement of the Offering of the Securities, an offer or sale of Securities within the United States by a dealer (whether or 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.

#### *United Kingdom*

Each of the Joint Bookrunners has represented and agreed that: (i) 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 FSMA) received by it in connection with the issue or sale of any Securities in circumstances in which section 21(1) of the FSMA does not apply to the Company; and (ii) it has complied and will comply with all applicable provisions of the FSMA with respect to anything done by it in relation to the Securities in, from or otherwise involving the United Kingdom.

#### *European Economic Area*

Each of the Joint Bookrunners has represented and agreed in relation to each Member State of the European Economic Area which has implemented the Prospectus Directive (each, a “**Relevant Member State**”), with effect from and including the date on which the Prospectus Directive is implemented in that Relevant Member State (the “**Relevant Implementation Date**”) that neither it nor any of its affiliates has made nor will make an offer to the public of any Securities which are the subject of the Offering contemplated herein in that Relevant Member State, except that it may make an offer of Securities to the public in that Relevant Member State with effect from and including the Relevant Implementation Date under the following exemptions under the Prospectus Directive, if they have been implemented in that Relevant Member State:

- (a) to legal entities which are qualified investors as defined in the Prospectus Directive;
- (b) to fewer than 100 or, if the Relevant Member State has implemented the relevant provision of the 2010 PD Amending Directive, 150, natural or legal persons (other than qualified investors as defined in the Prospectus Directive), as permitted under the Prospectus Directive, subject to obtaining the prior consent of the Joint Bookrunners for any such offer; or
- (c) in any other circumstances falling within Article 3(2) of the Prospectus Directive,

provided that no such offer of Securities shall result in a requirement for the publication by MegaFon or any Underwriter of a prospectus pursuant to Article 3 of the Prospectus Directive or supplement a prospectus pursuant to Article 16 of the Prospectus Directive.



For the purposes of this provision, the expression an “*offer of any Securities to the public*” in relation to any Securities in any Relevant Member State means the communication in any form and by any means of sufficient information of the terms of the offer and any Securities to be offered so as to enable an investor to decide to purchase any Securities, as the same may be varied in that Relevant Member State by any measure implementing the Prospectus Directive in that Relevant Member State; the expression “**Prospectus Directive**” means Directive 2003/71/EC (and amendments thereto, including the 2010 PD Amending Directive, to the extent implemented in the Relevant Member State), and includes any relevant implementing measure in each Relevant Member State and the expression “**2010 PD Amending Directive**” means Directive 2010/73/EU.

In the case of any Securities being offered to a financial intermediary, as that term is used in Article 3(2) of the Prospectus Directive, such financial intermediary will also be deemed to have represented, acknowledged and agreed that the Securities acquired by it have not been acquired on a non-discretionary basis on behalf of, nor have they been acquired with a view to their offer or resale to persons in circumstances which may give rise to an offer of any Securities to the public other than their offer or resale in a Relevant Member State to qualified investors who are not financial intermediaries as so defined or in circumstances in which the prior consent of the Joint Bookrunners has been obtained to each such proposed offer or resale. MegaFon, the Selling Shareholders, the Joint Bookrunners and their respective affiliates, and others will rely (and MegaFon and the Selling Shareholders each acknowledges that the Joint Bookrunners and their respective affiliates and others will rely) upon the truth and accuracy of the foregoing representations, acknowledgements, and agreements. Notwithstanding the above, a person who is not a qualified investor and who has notified the Joint Bookrunners of such fact in writing may, with the consent of the Joint Bookrunners, be permitted to subscribe for or purchase Securities.

### ***Russian Federation***

Each of the Joint Bookrunners has represented and agreed that the GDRs will not be offered, transferred or sold as part of their initial distribution in the Russian Federation, or 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.

### ***Cyprus***

Each Joint Bookrunner has represented, warranted and agreed and each further Joint Bookrunner appointed will be required to represent, warrant and agree that:

- (a) it has not offered or sold and will not offer or sell any Securities, except in conformity with the provisions of the Public Offer and Prospectus Law, Law 114(I)/2005 and the provisions of the Cyprus Companies Law, Cap. 113 (as amended);
- (b) it has not and will not offer or sell any GDRs other than in compliance with the provisions of the Investment Services and Activities and Regulated Markets Law, Law 144(I)/2007 (the “**Cyprus Investment Services Law**”); and
- (c) it has not and will not distribute copies of the Underwriting Agreement or this Prospectus or any other offering material to the information distribution channels or the public in Cyprus, nor (when distributed by a duly licensed investment firm established or operating through a branch in Cyprus) to any person in Cyprus other than a “professional client” as defined in the Cyprus Investment Services Law;
- (d) it has not used the material and disclosure statements in the Underwriting Agreement or in this Prospectus for solicitation purposes for or in connection with the acquisition of the Securities in circumstances under which is unlawful under Cyprus laws to make such an offer or solicitation; and
- (e) it will not be providing from or within Cyprus any “investment services”, “investment activities” and “non-core services” (as such terms are defined in the Cyprus Investment Services Law) in relation to the GDRs or will be otherwise providing investment services, investment activities and non-core services to residents or persons domiciled in Cyprus and will not be concluding in Cyprus any transaction relating to such investment services, investment activities and non-core services in contravention of the Cyprus Investment Services Law and/or any applicable regulations adopted pursuant thereto or in relation thereto.

## *Japan*

- (a) Neither the GDRs nor the Offer Shares have been and will be registered under the Final Instruments and Exchange Law, as amended (the “**FIEL**”). This Prospectus is not an offer of securities for sale, directly or indirectly, in Japan or to or for the benefit of, any resident of Japan (which term as used herein means any person resident in Japan, including any corporation or entity organised under the laws of Japan) or to others for reoffer or resale, directly or indirectly, in Japan or to, or for the benefit of, any resident of Japan, except pursuant to an exception from the registration requirements under the FIEL, and otherwise in compliance with, the FIEL and other relevant laws and otherwise in compliance with such law and any other applicable laws, regulations or ministerial guidelines of Japan.

## *Australia*

- (a) No prospectus or other disclosure document has been lodged with, or registered by the Australian Securities and Investments Commission in relation to the offering of the GDRs or the Offer Shares. This Prospectus does not constitute a prospectus or other disclosure document under the Corporations Act 2001 (the “**Corporations Act**”) and does not purport to include the information required for a prospectus or other disclosure document under the Corporations Act.
- (b) This document is being distributed in Australia by the Joint Bookrunners to persons (the “**Exempt Investors**”) who are “sophisticated investors” (within the meaning of section 708(8) of the Corporations Act, to “professional investors” (within the meaning of section 708(11) of the Corporations Act) and/or otherwise pursuant to one of more exemptions contained in section 708 of the Corporations Act. The entity receiving this document represents and warrants that if it is in Australia, it is either a professional or a sophisticated investor or a person to whom it is lawful to offer the GDRs or the Offer Shares without disclosure to investors under Chapter 6D of the Corporations Act and that it will not distribute this document to any other person.
- (c) Any of the GDRs or the Offer Shares applied for by Exempt Investors in Australia must not be offered for sale in Australia for 12 months from the date of issue, except in circumstances where disclosure to investors under Chapter 6D of the Corporations Act would not be required pursuant to an exemption under section 708 or 708A of the Corporations Act. This document is not supplied in connection with any offering or proposed offering of securities or financial products that require disclosure in accordance with Chapter 6D or Part 7.9 of the Corporations Act. Chapters 6D and 7 of the Corporations Act are complex. Any person acquiring the GDRs or the Offer Shares must observe such Australian on-sale restrictions and if in any doubt as to the application or effect of this legislation, should confer with its professional advisors.

## **Transfer Restrictions**

### ***Rule 144A GDRs***

Each purchaser of Securities in the Rule 144A Offering, by its acceptance of delivery of this Prospectus, will be deemed to have represented, agreed and acknowledged as follows:

1. The purchaser (i) is a QIB as that term is defined by Rule 144A under the Securities Act, (ii) is aware that, and each beneficial owner of such Securities has been advised that, the sale to it is being made in reliance on Rule 144A under the Securities Act or another exemption from, or transaction not subject to, the registration requirements of the Securities Act, (iii) is acquiring such Securities for its own account or for the account of one or more QIBs and (iv) if it is acquiring such Securities for the account of one or more QIBs, has sole investment discretion with respect to each such account and has full power to make the acknowledgements, representations and agreements herein on behalf of each such account.
2. The purchaser is aware that the Securities, purchased pursuant to Rule 144A under the Securities Act or another exemption from, or transaction not subject to, the registration requirements of the Securities Act, have not been and will not be registered under the Securities Act and are being offered in the United States only in transactions not involving any public offering in the United States and are “restricted securities” as defined in Rule 144(a)(3) under the Securities Act (“**Restricted Securities**”).
3. In the future, if the purchaser decides to offer, resell, pledge or otherwise transfer the GDRs purchased pursuant to Rule 144A under the Securities Act or another exemption from, or transaction not subject to, the registration requirements of the Securities Act, such GDRs may be offered, sold, pledged or otherwise transferred only in accordance with the following legend, which the GDRs, purchased

pursuant to Rule 144A under the Securities Act or another exemption from, or transaction not subject to, the registration requirements of the Securities Act, will bear unless otherwise determined by OJSC MegaFon and the Depositary in accordance with applicable law:

THIS RULE 144A MASTER GLOBAL DEPOSITARY RECEIPT AND THE ORDINARY SHARES OF OJSC “MEGAFON” REPRESENTED HEREBY (THE “SHARES”) HAVE NOT BEEN AND WILL NOT BE REGISTERED UNDER THE UNITED STATES SECURITIES ACT OF 1933, AS AMENDED (THE “SECURITIES ACT”) OR WITH ANY SECURITIES REGULATORY AUTHORITY OF ANY STATE OR OTHER JURISDICTION OF THE UNITED STATES. THE HOLDER HEREOF BY PURCHASING THE GDRs, AGREES FOR THE BENEFIT OF OJSC “MEGAFON” THAT THE GDRs AND THE SHARES REPRESENTED HEREBY MAY NOT BE OFFERED, SOLD, PLEDGED OR OTHERWISE TRANSFERRED EXCEPT (A) TO A PERSON WHOM THE SELLER AND ANY PERSON ACTING ON ITS BEHALF REASONABLY BELIEVE IS A QUALIFIED INSTITUTIONAL BUYER (“QIB”) (WITHIN THE MEANING OF RULE 144A UNDER THE SECURITIES ACT) IN A TRANSACTION MEETING THE REQUIREMENTS OF RULE 144A, (B) IN AN OFFSHORE TRANSACTION IN ACCORDANCE WITH RULE 903 OR RULE 904 OF REGULATION S UNDER THE SECURITIES ACT, OR (C) PURSUANT TO AN EXEMPTION FROM REGISTRATION PROVIDED BY RULE 144 UNDER THE SECURITIES ACT (IF AVAILABLE), IN EACH CASE IN ACCORDANCE WITH ANY APPLICABLE SECURITIES LAWS OF ANY STATE OR OTHER JURISDICTION OF THE UNITED STATES. THE HOLDER OF THE GDRS WILL, AND EACH SUBSEQUENT HOLDER IS REQUIRED TO, NOTIFY ANY SUBSEQUENT PURCHASER OF SUCH GDRs OF THE RESALE RESTRICTIONS REFERRED TO ABOVE. THE BENEFICIAL OWNER OF SHARES RECEIVED UPON CANCELLATION OF ANY RULE 144A GLOBAL DEPOSITARY RECEIPT MAY NOT DEPOSIT OR CAUSE TO BE DEPOSITED SUCH SHARES INTO ANY DEPOSITARY RECEIPT FACILITY IN RESPECT OF SHARES ESTABLISHED OR MAINTAINED BY A DEPOSITARY BANK, OTHER THAN A RULE 144A RESTRICTED DEPOSITARY RECEIPT FACILITY, SO LONG AS SUCH SHARES ARE “RESTRICTED SECURITIES” WITHIN THE MEANING OF RULE 144(a)(3) UNDER THE SECURITIES ACT. NO REPRESENTATION CAN BE MADE AS TO THE AVAILABILITY OF THE EXEMPTION PROVIDED BY RULE 144 UNDER THE SECURITIES ACT FOR RESALE OF THE SHARES OR ANY RULE 144A GLOBAL DEPOSITARY RECEIPTS.

4. For so long the ordinary shares are Restricted Securities, it will not deposit such ordinary shares into any depositary receipt facility in respect of shares established and maintained by a depositary bank other than a Rule 144A restricted depositary receipt facility.
5. OJSC MegaFon, the Selling Shareholders, the Joint Bookrunners and their affiliates, and others will rely upon the truth and accuracy of the foregoing acknowledgements, representations and agreements.

**Prospective purchasers are hereby notified that sellers of the Securities purchased within the United States pursuant to Rule 144A may be relying on the exemption from the provisions of Section 5 of the Securities Act provided by Rule 144A under the Securities Act.**

#### ***Regulation S GDRs***

Each purchaser of Securities in the Regulation S Offering, by its acceptance of the delivery of this Prospectus, will be deemed to have represented and agreed as follows (terms used in this paragraph that are defined in Regulation S are used herein as defined therein):

1. the purchaser is, at the time of the offer to it of Securities and at the time the buy order originated, outside the United States for the purposes of Rule 903 under the Securities Act;
2. the purchaser is aware that the Securities have not been and will not be registered under the Securities Act and are being offered outside the United States in reliance on Regulation S;
3. any offer, sale, pledge or other transfer made other than in compliance with the above-stated restrictions shall not be recognised by OJSC MegaFon;
4. OJSC MegaFon, the Selling Shareholders, the Joint Bookrunners and their affiliates and others will rely upon the truth and accuracy of the foregoing acknowledgements, representations and agreements; and
5. the purchaser understands that the Regulation S GDRs and the Master Regulation S GDR will bear a legend substantially to the following effect:

THIS REGULATION S MASTER GLOBAL DEPOSITARY RECEIPT AND THE ORDINARY SHARES OF OJSC “MEGAFON” REPRESENTED HEREBY (THE “SHARES”) HAVE NOT BEEN AND WILL NOT BE REGISTERED UNDER THE UNITED STATES SECURITIES ACT OF 1933, AS AMENDED (THE “SECURITIES ACT”), OR WITH ANY SECURITIES REGULATORY AUTHORITY OF ANY STATE OR OTHER JURISDICTION OF THE UNITED STATES AND MAY NOT BE OFFERED, SOLD, PLEDGED OR OTHERWISE TRANSFERRED EXCEPT IN ACCORDANCE WITH THE SECURITIES ACT AND IN ACCORDANCE WITH ANY APPLICABLE SECURITIES LAWS OF ANY STATE OR OTHER JURISDICTION OF THE UNITED STATES.

If a purchaser of Securities is acquiring such Securities 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 it has full power to make the foregoing representations and agreements on behalf of each account.

## SETTLEMENT AND DELIVERY

### Clearing and Settlement of GDRs

Custodial and depositary links have been established between Euroclear, Clearstream and DTC to facilitate the initial issue of the GDRs and cross-market transfers of the GDRs associated with secondary market trading.

### The Clearing Systems

#### *Euroclear and Clearstream*

Euroclear and Clearstream each hold securities for participating organisations and facilitate the clearance and settlement of securities transactions between their respective participants through electronic book-entry changes in accounts of such participants. Euroclear and Clearstream provide to their respective participants, among other things, services for safekeeping, administration, clearance and settlement of internationally traded securities and securities lending and borrowing. Euroclear and Clearstream participants are financial institutions throughout the world, including underwriters, securities brokers and dealers, banks, trust companies, clearing corporations and certain other organisations. Euroclear and Clearstream have established an electronic bridge between their two systems across which their respective customers may settle trades with each other. Indirect access to Euroclear or Clearstream is also available to others, such as banks, brokers, dealers and trust companies which clear through or maintain a custodial relationship with a Euroclear or Clearstream participant, either directly or indirectly.

Distributions of dividends and other payments with respect to book-entry interests in the GDRs held through Euroclear or Clearstream will be credited, to the extent received by the Depositary, to the cash accounts of Euroclear or Clearstream participants in accordance with the relevant system's rules and procedures.

#### *DTC*

DTC has advised us as follows: DTC is a limited-purpose trust company organised under the laws of the State of New York, a "banking organisation" within the meaning of the New York Banking Law, a member of the United States 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 holds securities for DTC participants and facilitates the clearance and settlement of securities transactions between DTC participants through electronic computerised book-entry changes in DTC participants' accounts. DTC participants include securities brokers and dealers, banks, trust companies, clearing corporations, and certain other organisations. Indirect access to the DTC system is also available to others such as securities brokers and dealers, banks, and trust companies that clear through or maintain a custodial relationship with a DTC participant, either directly or indirectly.

Holders of book-entry interests in the GDRs holding through DTC will receive, to the extent received by the Depositary, all distributions of dividends or other payments with respect to book-entry interests in the GDRs from the Depositary through DTC and DTC participants. Distributions in the United States will be subject to relevant U.S. tax laws and regulations. See "Taxation".

As DTC can act on behalf of DTC direct participants only, who in turn act on behalf of DTC indirect participants, the ability of beneficial owners who are indirect participants to pledge book-entry interests in the GDRs to persons or entities that do not participate in DTC, or otherwise take actions with respect to book-entry interests in the GDRs, may be limited.

#### *Registration and Form*

Book-entry interests in the GDRs held through Euroclear and Clearstream will be represented by the Regulation S Master GDR registered in the name of The Bank of New York Depository (Nominees) Limited, as nominee of The Bank of New York Mellon, London Branch, as common depositary for Euroclear and Clearstream. Book-entry interests in the GDRs held through DTC will be represented by the Rule 144A Master GDR registered in the name of Cede & Co., as nominee for DTC, which will be held by The Bank of New York Mellon in New York as custodian for DTC. As necessary, the Depositary will adjust the amounts of GDRs on the relevant register for the accounts of the common nominee and nominee, respectively, to reflect the amounts of GDRs held through Euroclear, Clearstream and DTC, respectively. Beneficial ownership in the GDRs will be held through financial institutions as direct and indirect participants in Euroclear, Clearstream and DTC.



The aggregate holdings of book-entry interests in the GDRs in Euroclear, Clearstream and DTC will be reflected in the book-entry accounts of each such institution. Euroclear, Clearstream and DTC, as the case may be, and every other intermediate holder in the chain to the beneficial owner of book-entry interests in the GDRs, will be responsible for establishing and maintaining accounts for their participants and customers having interests in the book-entry interests in the GDRs. The Depository will be responsible for maintaining a record of the aggregate holdings of GDRs registered in the name of the common nominee for Euroclear and Clearstream and the nominee for DTC. The Depository will be responsible for ensuring that payments received by it from us for holders holding through Euroclear and Clearstream are credited to Euroclear or Clearstream, as the case may be, and the Depository will also be responsible for ensuring that payments received by it from us for holders holding through DTC are received by DTC. The address for DTC is P.O. Box 5020, New York, New York 10274, United States. The address for Euroclear is 1 Boulevard du Roi Albert II, B-1210 Brussels, Belgium. The address for Clearstream is 42 Avenue J.F Kennedy, L-1855 Grand Duchy of Luxembourg, Luxembourg.

We will not impose any fees in respect of the GDRs; however, holders of book-entry interests in the GDRs may incur fees normally payable in respect of the maintenance and operation of accounts in Euroclear, Clearstream or DTC and certain fees and expenses payable to the Depository in accordance with the terms of the Deposit Agreement.

## **Global Clearance and Settlement Procedures**

### ***Initial Settlement***

The GDRs will be in global form evidenced by the two Master GDRs. Purchasers electing to hold book-entry interests in the GDRs through Euroclear and Clearstream accounts will follow the settlement procedures applicable to depositary receipts. DTC participants acting on behalf of purchasers electing to hold book-entry interests in the GDRs through DTC will follow the delivery practices applicable to depositary receipts.

### ***Transfer Restrictions***

For a description of the transfer restrictions relating to the GDRs, see “Terms and Conditions of the Global Depositary Receipts” and “Selling and Transfer Restrictions”.

### ***Trading between Euroclear and Clearstream Participants***

Secondary market sales of book-entry interests in the GDRs held through Euroclear or Clearstream to purchasers of book-entry interests in the GDRs through Euroclear or Clearstream will be conducted in accordance with the normal rules and operating procedures of Euroclear and Clearstream and will be settled using the normal procedures applicable to depositary receipts.

### ***Trading between DTC Participants***

Secondary market sales of book-entry interests in the GDRs held through DTC will occur in the ordinary way in accordance with DTC rules and will be settled using the procedures applicable to depositary receipts, 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 Purchaser***

When book-entry interests in the GDRs are to be transferred from the account of a DTC participant to the account of a Euroclear or Clearstream participant, the DTC participant must send to DTC a delivery free of payment instruction at least two business days prior to the settlement date. DTC will in turn transmit such instruction to Euroclear or Clearstream, as the case may be, on the settlement date. Separate payment arrangements are required to be made between the DTC participant and the relevant Euroclear or Clearstream participant. On the settlement date, DTC will debit the account of its DTC participant and will instruct the Depository to instruct Euroclear or Clearstream, as the case may be, to credit the relevant account of the Euroclear or Clearstream participant, as the case may be. In addition, on the settlement date, DTC will instruct the Depository to (1) decrease the amount of book-entry interests in the GDRs registered in the name of a nominee for DTC and represented by the Rule 144A Master GDR and (2) increase the amount of book-entry interests in the GDRs registered in the name of the common nominee for Euroclear and Clearstream and represented by the Regulation S Master GDR.

### ***Trading between Clearstream/Euroclear Seller and DTC Purchaser***

When book-entry interests in the GDRs are to be transferred from the account of a Euroclear or Clearstream participant to the account of a DTC participant, the Euroclear or Clearstream participant must send to Euroclear or Clearstream a delivery free of payment instruction at least one business day prior to the settlement date. Separate payment arrangements are required to be made between the DTC participant and the relevant Euroclear or Clearstream participant, as the case may be. On the settlement date, Euroclear or Clearstream, as the case may be, will debit the account of its participant and will instruct the Depository to instruct DTC to credit the relevant account of Euroclear or Clearstream, as the case may be, and will deliver such book-entry interests in the GDRs free of payment to the relevant account of the DTC participant. In addition, Euroclear or Clearstream, as the case may be, shall on the settlement date instruct the Depository to (1) decrease the amount of the book-entry interests in the GDRs registered in the name of the common nominee and evidenced by the Regulation S Master GDR and (2) increase the amount of the book-entry interests in the GDRs registered in the name of a nominee for DTC and represented by the Rule 144A Master GDR.

### **General**

Although the foregoing sets out the procedures of Euroclear, Clearstream and DTC in order to facilitate the transfers of interests in the GDRs among participants of Euroclear, Clearstream and DTC, none of Euroclear, Clearstream or DTC are under any obligation to perform or continue to perform such procedures, and such procedures may be discontinued at any time.

*None of OJSC MegaFon, the Joint Bookrunners, the Depository, the Custodian or our or their respective agents will have any responsibility for the performance by Euroclear, Clearstream or DTC or their respective participants of their respective obligations under the rules and procedures governing their operations.*

### **Clearing and Settlement of Offer Shares**

Each investor in the Offer Shares is required to pay for any Shares in U.S. dollars or rubles, as the case may be. In order to take delivery of the Offer Shares, an investor should either have a direct account with CJSC “Computershare Registrar”, our share registrar, or a deposit account with National Settlement Depository (Non-banking Credit Organisation, CJSC) (“NSD”) or any other depository that has an account with NSD or a direct account with our share registrar. However, Offer Shares held directly or through a depository having a direct account with our share registrar are ineligible for trading on MICEX. Only if the Offer Shares are deposited with NSD (or through another depository having an account at NSD), can they be traded on MICEX.

## **INFORMATION RELATING TO THE DEPOSITARY**

The Depositary was incorporated in Luxembourg on 15 December 1998 under the laws of The Grand Duchy of Luxembourg, as a société anonyme. The number of the registration certificate is R.C.S. Luxembourg B 67654. It is a wholly owned subsidiary of The Bank of New York Mellon Corporation, a New York bank holding company. The registered office of the Depositary is located at Vertigo Building, Polaris, 2-4 rue Eugene Ruppert L-2453, Luxembourg, Grand Duchy of Luxembourg. A copy of the Depositary's Articles of Association, as amended, together with copies of The Bank of New York Mellon Corporation's most recent financial statements and annual report are available for inspection at the Corporate Trust Office of the Depositary located at Vertigo Building, Polaris, 2-4 rue Eugene Ruppert, L-2453, Luxembourg, Grand Duchy of Luxembourg.

## **LEGAL MATTERS**

Certain legal matters with respect to the Offering will be passed upon for us in respect of the laws of England and the United States by Cleary Gottlieb Steen & Hamilton LLP and in respect of the laws of the Russian Federation by Cleary Gottlieb Steen & Hamilton LLC. Certain legal matters with respect to the Offering will be passed upon for the Joint Bookrunners in respect of the laws of England, United States, The Netherlands and the Russian Federation by Freshfields Bruckhaus Deringer LLP. Certain legal matters with respect to the Offering will be passed upon for MICL in respect of the laws of Cyprus by Mouaimis & Mouaimis LLC.

## INDEPENDENT AUDITORS

Our Audited Consolidated Financial Statements as of and for the years ended 31 December 2011, 2010 and 2009 included in this Prospectus have been audited by Ernst & Young LLC, independent auditors, as stated in their audit report appearing herein. Our Unaudited Interim Condensed Consolidated Financial Statements as of 30 September 2012 and for the three and nine months ended 30 September 2012 and 2011, have been reviewed by Ernst & Young LLC, in accordance with standards established by the American Institute of Certified Public Accountants, as stated in their report appearing herein. The address of Ernst & Young LLC is Sadovnicheskaya Naberezhnaya 77, Building 1, Moscow, 115035, Russian Federation. Ernst & Young LLC is a member of the Audit Chamber of Russia. Ernst & Young LLC does not have a material interest in OJSC MegaFon.

Ernst & Young LLC have consented to the inclusion in the Prospectus of their reports on the Financial Statements beginning on pages F-3 and F-45 in the form and context in which they are included and authorised the contents of the reports for the purposes of Prospectus Rule 5.5.4R (2)(f) and item 23.1 of Annex X of the Commission Regulation (EC) 809/2004 (the “**PD Regulation**”).

For the purposes of Prospectus Rule 5.5.4R(2)(f) Ernst & Young LLC are responsible for their reports beginning on pages F-3 and F-45 as part of the Prospectus and declare that they have taken all reasonable care to ensure that the information contained in their reports is, to the best of their knowledge, in accordance with the facts and contains no omission likely to affect its import. This declaration is included in the Prospectus in compliance with item 1.2 of Annex X to the Commission Regulation (EC) No 809/2004.



## GENERAL INFORMATION

1. It is expected that the GDRs will be admitted, subject only to the issue of the Regulation S Master GDR and the Rule 144A Master GDR, to the Official List on or about [●] 2012. Application has been made for the additional GDRs to be traded on the London Stock Exchange through its IOB. Prior to Admission to the Official List, dealings will be permitted by the London Stock Exchange in accordance with its rules on an if-and-when-issued basis. Transactions in GDRs will normally be effected for delivery on the third working day after the day of the transaction.
2. We have obtained all consents, approvals and authorisations required under Russian law in connection with the issue of the GDRs.
3. The circulation of the ordinary shares outside the Russian Federation in the form of GDRs was approved by the Russian Federal Service for Financial Markets on 27 September 2012.
4. Copies of the following documents will be available for inspection free of charge, during normal business hours on any weekday, at the registered offices of OJSC MegaFon from the date of publication of this Prospectus to Admission:
  - this Prospectus;
  - our Charter;
  - the Deposit Agreement;
  - the Deed Poll;
  - our Audited Consolidated Financial Statements as of and for the years ended 31 December 2011, 2010 and 2009, together with the independent auditors' report relating thereto; and
  - our Unaudited Interim Condensed Consolidated Financial Statements as of 30 September 2012 and for the three and nine months ended 30 September 2012 and 2011, together with the independent accountants' report relating thereto.

The registered office of OJSC MegaFon is located at 30 Kadashevskaya Embankment, Moscow, 115035, Russian Federation, and its telephone number is +7 499 755 2155.

5. If definitive certificates are issued in exchange for the Master GDRs, we will appoint an agent in the United Kingdom.
6. There has been no significant change in the financial or trading position of MegaFon since 30 September 2012, the end of the last financial period for which financial information has been published.
7. Save as described in “Business—Litigation”, “Risk Factors—Risks Relating to our Business and Industry—Changes in court practice concerning recovery of indebtedness from our subscribers' different accounts may adversely affect our business” and in the fourth, fifth and sixth paragraphs of “Risk Factors—Risks Relating to our Business and Industry—Any failure to obtain sufficient frequency, or renewals or extensions of our frequency allocations, for our networks, or any order to vacate part of the frequency spectrum we are allocated or that in any case, we currently use, could disrupt our business”, there have been no Governmental, legal or arbitration proceedings (including any such proceedings which are pending or threatened of which we are aware) during the last 12 months which may have, or have had in the recent past, significant effects on us or our Group's financial position or profitability.
8. We have no reason to suspect that the events and matters described in “Risk Factors—Allegations and/or findings of corruption and money-laundering against persons linked or alleged to have been linked with MegaFon in the past could adversely affect our reputation, which in turn could result in a reduction in the value of the Securities”, could have any adverse implications for the ownership of the assets of, or shares in, OJSC MegaFon.
9. The Offer Shares are denominated in rubles. The GDRs are not denominated in any currency and have no nominal value. The Offer Price was determined based on the results of the bookbuilding exercise conducted by the Joint Bookrunners. The results of the Offering will be made public by us through a press release and notice to the Regulatory Information Service promptly upon the closing of the Offering.
10. Holders of GDRs may contact The Bank of New York Mellon (Luxembourg) S.A., as Depositary for the GDRs with questions relating to the transfer of GDRs on the books of the Depositary, which shall be maintained at the Depositary's Corporate Trust Office located at Vertigo Building, Polaris, 2-4 rue Eugene Ruppert, L-2453, Luxembourg, Grand Duchy of Luxembourg.

11. The ISIN for the Rule 144A GDRs is US58517T1007, the Common Code for the Rule 144A GDRs is 084894150, the CUSIP number for the Rule 144A GDRs is 58517T100 and the SEDOL for the Rule 144A GDRs is B832YZ1. The CFI Code is ESVTFA.
12. The ISIN for the Regulation S GDRs is US58517T2096, the Common Code for the Regulation S GDRs is 084894044, the CUSIP number for the Regulation S GDRs is 58517T209 and the SEDOL for the Regulation S GDRs is B8PQQ77. The CFI Code is ESVTFA.
13. The ISIN for the Ordinary Shares is RU000A0JS942 and the SEDOL for the Ordinary Shares is B8PR8P2. The CFI Code is ESVXXR.
14. The London Stock Exchange trading symbol for the GDRs is MFON. The Offer Shares trade on MICEX under the symbol MFON.
15. As at the date hereof, OJSC MegaFon has a long-term corporate rating of BBB- from Standard and Poor's (outlook negative) and a long-term corporate rating of Baa3 from Moody's (under review for possible downgrade). Standard and Poor's and Moody's are established in the EU and registered under the CRA Regulation. As such, Standard and Poor's and Moody's 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. 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.
16. OJSC MegaFon is not aware of any person intending to subscribe for more than 5% of the Offering.

## GLOSSARY OF TERMS

“2G”—Second generation wireless technology which replaced first generation analogue cellular networks and which permits voice transmission and very limited data services.

“3G”—Third generation wireless technology which allows for higher transmission rates to wireless devices than 2G technology.

“4G”—Fourth generation wireless technology which provides greater access to data and services through enhanced download and upload speeds and enhanced use of spectrum, for example, LTE.

“AC&M Consulting”—AC&M Consulting are a management consulting and research agency specialising in telecommunications and media who cover Russian, CIS, Eastern European and Central Asian markets.

“ACRM”—Analytical Customer Relationship Manager, software developed by Siebel/Oracle. ACRM collects and analyses customer behavioural factors and can use this information to design automated targeted advertising campaigns via SMS.

“AF Telecom”—AF Telecom Holding Limited, the majority shareholder of OJSC MegaFon, and which is a telecommunications holding company owned by Garsdale, which is ultimately controlled by Mr Alisher Usmanov.

“Alfa Group”—A group of Russian companies that has interests in the banking, energy and telecommunications fields and is ultimately controlled by Mikhail Fridman and others.

“Altimo”—Altimo Holdings and Investments Limited, a member of the Alfa Group, which controls the Alfa Group’s telecommunications investments.

“AMPS”—Advanced Mobile Phone System, an analogue cellular system standard in the 800 and 900 MHz frequency bands.

“analogue”—Communications by transmission of continuously varying representations of the input signal, as compared to binary coding of words in digital transmission.

“Apple”—Apple Distribution International, an Irish affiliate of Apple Computer Inc.

“APPM”—Average price per minute calculated by taking ARPU for a given period, and dividing by MOU in that period.

“APPMb”—Average price per megabyte, calculated by taking ARPDU for a given period, and dividing by DSU in that period

“ARDPU”—Average monthly revenue per data services user, calculated by dividing our data services revenues for a given period by the average number of our data services users during that period, and further dividing the result by the number of months in that period.

“ARPU”—Average monthly revenue per user, which is calculated for a given period by dividing the aggregate of our wireless revenues from local subscribers, revenues from data transfer services and revenues from VAS, revenues from interconnection charges and roaming charges to other operators for the same period by the average number of our Subscribers during that period, and further dividing the result by the number of months in that period.

“B2B”—Our corporate client base, comprising SoHos, SMEs, and large corporations.

“B2C”—Our retail clients.

“B2G”—Our Government clients, including Government agencies, local administrations, public non-budgetary funds and municipal bodies.

“B2O”—Our operator (carrier) clients. Such clients are entities that have a licence to provide telecommunications services and use our resources to deliver such services to users.

“*base station*”—A fixed site with network equipment that is used for radio frequency communications with mobile stations, is part of a cell or a sector within a cell and is connected to an MSC, an MTSO or another part of a wireless system.

“*Big Three*”—A collective reference to the three largest universal telecommunications operators in the Russian Federation: MTS, MegaFon and VimpelCom.

“*bundled packages*”—A service available to subscribers where, in return for a fee, minutes of airtime, messages and/or data can be purchased in advance depending on the amount of such services a customer anticipates using.

“*CAMEL*”—Customised Applications for Mobile networks Enhanced Logic. CAMEL is an internationally accepted set of network standards which can be used to simplify the roaming experience for customers. Many operators around the world use these standards for interoperability.

“*CBR*”—The Central Bank of the Russian Federation.

“*CDMA*”—Code Division Multiple Access, a digital wireless transmission technology for use in wireless telephone communications, personal communications services and other wireless communications systems. CDMA is a spread spectrum technology in which calls are assigned a pseudo—random code to encode digital bit streams. CDMA is a Qualcomm-designed digital spread-spectrum technology, most commonly in the United States and a number of countries in Asia. In the Russian Federation, CDMA technology is used in two standards, IS-95 in the 800 MHz frequency range, or CDMA-800, and IMT-MC in the 450 MHz frequency range.

“*CDMA—450*”—A CDMA system in the 450 MHz frequency range.

“*cells*”—A discrete area within a wireless telecommunications system that is equipped with transmitters, receivers, and antennae, and is connected to switching gear and control equipment with a low—powered transmitter—receiver. Cell size varies depending on a number of factors, including terrain and capacity demands. By controlling transmission power, the radio frequencies assigned to one cell can be limited to the boundaries of that cell.

“*cellular system*”—A telephone system based on a grid of cells deployed at a specified frequency.

“*channel*”—A single path, either radio frequency or voice, for transmitting electrical signals.

“*churn rate*”—The number of Subscribers who cease to be Subscribers within a given period divided by the average number of Subscribers during that period.

“*CIS*”—The Commonwealth of Independent States, a regional organisation composed of former republics of the USSR. Its members include: Armenia, Azerbaijan, Belarus, Kazakhstan, Kyrgyzstan, Moldova, the Russian Federation, Tajikistan, Turkmenistan and Uzbekistan; and Ukraine as an associate member.

“*CJSC Northwest GSM*”—Predecessor of OJSC MegaFon which was incorporated on 17 June 1993.

“*CLIP*”—Calling Line Identification Presentation, which is popularly known as “caller ID”.

“*CLIR*”—Calling Line Identification Restriction, which gives subscribers the ability to block their mobile numbers from being displayed on the mobile phones of call recipients.

“*Currency Law*”—The Federal Law No. 173-FZ “On Currency Regulation and Currency Control” of 10 December 2003, as amended.

“*data service user*”—A Subscriber who has used any of our data transfer services within the preceding three months.

“*digital*”—A method of storing, processing and transmitting information through the use of distinct electronic or optical pulses that represent the binary digits 0 and 1. Digital transmission and switching technologies employ a sequence of discrete, distinct pulses to represent information, as opposed to the continuously variable analogue signal.

“*DSU*”—Average monthly data traffic per user, calculated by dividing the total number of megabytes transferred by our network during a given period by the average number of data services users during such period and dividing the result by the number of months in such period.

“*DWDM*”—Wavelength-division multiplexing. DWDM technology allows simultaneous transmission of multiple information channels through optical fibre at different carrier frequencies. This technology can be fitted to fibre-optic lines in order to substantially increase network capacity to up to 40Gbit/s per optical channel.

“*EDGE*”—Enhanced Design for Global Evolution, EDGE is an advanced GSM technology which enhances data services. EDGE/EGPRS is implemented as a bolt-on enhancement for certain types of 2G GSM/GPRS networks known as 2.5G, making it easier for existing GSM carriers to upgrade to it. EDGE can function on any network with GPRS deployed on it, provided the carrier implements the necessary upgrade.

“*FAS*”—The Federal Anti-Monopoly Service of the Russian Federation.

“*fibre-optic lines*”—Small-diameter glass fibres through which light is transmitted. Modulation of this transmitted light permits the transfer of information. These modulated signals are detected by light-sensitive semiconductor devices.

“*FOCL Big Ring*”—Our fibre-optic communication line “Big Ring”, which connects major cities in six macro-regions of the Russian Federation through a single backbone network which is approximately 5,000 kilometres long.

“*Foreign Strategic Investments Law*”—Federal Law No. 57-FZ, dated 29 April 2008, “On the Procedure for Making Foreign Investments in Business Enterprises Having Strategic Importance to Secure Defence and Security of the State”

“*frequency*”—The number of cycles per second, measured in hertz, of a periodic oscillation or wave in radio propagation.

“*GNCC*”—The Georgian National Communication Commission, regulatory body which has responsibility for overseeing the operations of telecommunications and broadcasting in Georgia.

“*GPRS*”—General Packet Radio Services, a technology standard for high-speed data transmission over GSM networks.

“*GSM*”—Global System for Mobile Communications, a standard for digital mobile telephone transmissions at frequencies of 900 MHz and 1800 MHz.

“*GSM-900*”—A GSM network in the 900 MHz frequency range.

“*GSM-1800*”—A GSM network in the 1800 MHz frequency range (formerly known as DCS—1800, Digital Communication Standard for Cellular Communications).

“*GSM-1900*”—A GSM network in the 1900 MHz frequency range.

“*hand-off*”—The process of transferring wireless telecommunications from one cell site to another as a mobile unit moves through the service area.

“*HSPA+*”—An enhanced version of HSDPA/HSUPA which increases network capacity by virtue of increasing the theoretical download speed up to 21 Mbps.

“*HSPDA*”—High-speed downlink package access, a feature that can be used with 3G technologies and which, in combination with a HSUPA feature, enables faster data transfers (of up to 14.4 Mbps) and increased capacity.

“*HSUPA*”—High-speed uplink package access, a feature that can be used with 3G technologies and which, in combination with a HSPDA feature, enables faster data transfers and increased capacity.

“*infrastructure*”—Infrastructure equipment consisting of base stations, base station controllers, antennae, switches, management information systems and other equipment that receives, transmits and processes signals from and to subscriber equipment and/or between wireless and fixed systems and the public switched telephone network.



*“interconnection”*—Any variety of hardware arrangements that permit the connection of telecommunications equipment to a communications common carrier network such as a public switched telephone network.

*“LTE”*—Long term evolution standard, a form of 4G technology based on GSM that was introduced by the 3rd Generation Partnership Project and will increase the capacity and speed of mobile telephone networks.

*“Macro-region” and “micro-region”*—The territory of the Russian Federation is currently administratively divided into 83 constituent units which are referred to in this Prospectus as “micro-regions”, and these 83 units in turn are part of eight official administrative divisions known as “Federal Districts”. When we refer to “macro-regions” in this Prospectus, we mean the territory covered by each of MegaFon’s eight branches. Such territory does not exactly coincide with the eight official Federal Districts. Our regional branches, and so the macro-regions for the purpose of this Prospectus, comprise: the Moscow macro-region (Stolichny branch, with headquarters in Moscow); NW macro-region (North-West branch, with headquarters in Saint Petersburg); Central macro-region (Central branch, with headquarters in Nyzhny Novgorod); Ural macro-region (Ural branch, with headquarters in Ekaterinburg); Volga macro-region (Volga branch, with headquarters in Samara); South macro-region (Kavkaz branch, with headquarters in Krasnodar); Siberia macro-region (Siberia branch, with headquarters in Novosibirsk); and Far East macro-region (Far East branch, with headquarters in Khabarovsk).

*“MHz”*—Megahertz, a unit of measure of frequency; 1 MHz is equal to one million cycles per second.

*“microwave links”*—An electromagnetic signal established between two base stations for data transmission.

*“Ministry of Communications”*—The Russian Ministry of Communications and Mass Communications, the ministry charged with regulating the Russian telecommunications industry.

*“MMS”*—Multimedia Messaging Service, which allows users to send messages including multimedia content such as images, videos, audio clips or rich text.

*“MOU”*—Average monthly minutes of usage per Subscriber, calculated by dividing the total number of minutes of usage during a given period by the average number of our Subscribers during such period and dividing the result by the number of months in such period.

*“MTS”*—OJSC Mobile TeleSystems, one of the Big Three telecommunications operators in the Russian Federation.

*“MTT”*—Mezhregion Transit Telecom, a Russian fixed-line operator.

*“Music Expert”*—Our service that recognises songs and informs the user of the name of the artist, song and album, as well as ways to download it.

*“MVNOs”*—Mobile virtual network operators. These are companies that provide mobile communications services using the infrastructure and radio frequencies of other operators.

*“network equipment”*—The infrastructure consisting of base stations, base station controllers, mobile switching centres and related information processing control points that manage communications between the mobile or fixed unit and the public switched telephone network. This is used interchangeably with “infrastructure” in this Prospectus.

*“NGN”*—Next Generation Network, a technology, which supports 3G and HSDPA/HSUPA interfaces.

*“NMT”*—Nordic Mobile Telephone, a standard for analogue mobile telephone transmissions at a frequency of either 450 or 900 MHz.

*“NMT-450”*—An NMT network in the 450 MHz frequency range.

*“post-paid plan”*—A contract offered to our key customers under which they are placed on a monthly billing plan under which he or she is billed in arrear, at the end of each monthly billing cycle.

*“pre-paid plan”*—A contract which allows customers to pay in advance for services they receive either through packages, a subscription fee or placing funds in their accounts.

“*RED*”—Radio electronic devices.

“*roaming*”—A service offered by wireless communications network operators which allows a subscriber to use his or her handset while in the service area of another carrier. Roaming requires an agreement between operators of different individual markets to permit customers of either operator to access the other’s system.

“*Roscommnadzor*”—The Federal Service for Supervision in the Sphere of Communications, Information Technologies and Mass Communications.

“*Rostelecom*”—OJSC Rostelecom, the dominant long distance telecommunications carrier in the Russian Federation in which Syvazinvest has a 43.4% interest.

“*SaaS*”—Software as a Service.

“*SAC*”—Subscriber Acquisition Cost.

“*Scartel*”—Scartel LLC, a Russian telecommunications provider which operates under the Yota brand.

“*Significant Operator*”—According to the Telecommunications Law, an operator which, together with any affiliates, has 25% or more of the overall traffic in a particular area. Interconnection fees of Significant Operators are subject to regulation by the Russian Government, and Significant Operators must provide access to other operators to their networks and must offer all other operators equal terms for access and transit of traffic, with the same level of quality as they provide for their own subscribers.

“*SIM card*”—Subscriber Identity Module card. Subscriber data is contained on a SIM card, which can be transferred from one wireless device to another.

“*Sistema*”—JSFC Sistema, a Russian holding company, which has a controlling interest in MTS.

“*SoHos*”—Small office/home office, a type of B2B customer.

“*Skylink*”—A Russian CDMA mobile operator, wholly owned by Rostelecom.

“*SME*”—Small and medium sized businesses, a type of B2B customer.

“*SMS*”—Short Messaging Service, a mobile messaging service that allows cellular customers to send and receive text messages.

“*spectrum*”—The range of electromagnetic frequencies.

“*State Commission on Radio Frequencies*”—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. The Commission’s main responsibilities include developing the state policy in the sphere of frequency allocation and use; allocating and determining the terms of use for radio frequency bands; and determining the radio frequency spectrum available for provision of telecommunication services.

“*Subscriber*”—In this Prospectus, Subscriber is defined as each SIM card that is connected to the network and that has had at least one chargeable traffic event (that is, use of voice, VAS or data transfer services) within the preceding three months, whether chargeable to the Subscriber or to a third party (for example, interconnection charges payable by other operators). Where an individual person holds more than one SIM card, each SIM card is included as a separate Subscriber.

“*Svyazinvest*”—OJSC Svyazinvest, a Russian telecommunications company, which has interests in a number of fixed-line and mobile operators, as well as a 43.4% interest in OJSC Rostelecom. The Russian Government has a 75% less one share interest in Syvazinvest.

“*switching equipment*”—Equipment completing a call by connecting it to the wire line telephone network or another wireless telephone unit. Incoming calls are received by the switch, which instructs the appropriate cell to complete the communications link by radio signal between the cell’s transmitter—receiver and the mobile telephone. The switch also records information on system usage and subscriber statistics.

“*Telecommunications Law*”—The Federal Law No. 126-FZ “On Communications of 7 July 2003, as amended, which applies to the activities of the telecommunications industry in the Russian Federation and became effective on 1 January 2004.

“*Telenor*”—One of the largest shareholders in VimpelCom, Telenor is Norway’s leading communications company and co-owner with Altimo of Kievstar (a leading Ukrainian telecommunications operator).

“*TeliaSonera Group*”—A group of companies including TeliaSonera AB and its subsidiaries, a major Scandinavian telecoms operator and shareholder of OJSC MegaFon.

“*UMTS*”—Universal Mobile Telecommunications Services. Universal Mobile Telecommunications System is a third generation (3G) technology. UMTS commonly uses WCDMA as an underlying air interface.

“*unbundled minutes*”—a service with which customers place funds into their account and are then charged for each minute or second of airtime that they use.

“*UTN*”—Unified Telecommunications Network, a centrally managed complex of telecommunications networks owned by different Russian companies and Government agencies

“*VAS*”—Value-added Services, additional services provided in addition to voice and data transmission, e.g. ring back tone.

“*VimpelCom*”—OJSC VimpelCom, one of the Big Three telecommunications operators in the Russian Federation.

“*VPN*”—Virtual Private Networks.

“*VSAT*”—Very small aperture terminal, a type of satellite used to provide voice services to customers in remote areas without terrestrial cables.

“*WAP*”—Wireless Application Protocol technology, an intelligent messaging service for digital mobile wireless devices and other mobile terminals that allows users to see internet content in special text format on special WAP-enabled GSM mobile wireless devices. MegaFon phased out WAP in March 2011.

“*WCDMA*”—Wideband Code Division Multiple Access, a variation of the CDMA principle with high transmission bandwidths.

“*WCDMA/UMTS*”—The 3G standard adopted in Europe and Japan. WCDMA/UMTS is an upgrade from GSM with GPRS or EDGE enhancements, offering data transmission at approximately 10 times faster than GPRS.

“*wireline telephone network*”—Conventional telephone system that uses wires or cables, rather than radio signals, to transmit information.

“*WiMAX*”—A wireless digital communications system using a variety of transmission modes, from point-to-multipoint links to portable and fully mobile internet access. The technology is based on the IEEE 802.16 standard. WiMAX can provide broadband wireless access up to 50 km for fixed stations, and 5—15 km for mobile stations.

“*XaaS*”—Anything as a Service. SaaS is an example of XaaS.

“*Yota*”—A Russian telecommunications brand operated by Scartel LLC. In February 2012, we entered into an MVNO agreement with Yota, for the joint development and provision of LTE/4G services in the Russian Federation pursuant to which we provide various LTE/4G services using Yota equipment.

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**MEGAFON**

Consolidated Financial Statements

*Years ended December 31, 2011, 2010 and 2009  
With Report of Independent Auditors*





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## Report of Independent Auditors

The Board of Directors and Shareholders  
OJSC MegaFon

We have audited the accompanying consolidated balance sheets of OJSC MegaFon and subsidiaries (“the Company”) as of December 31, 2011, 2010 and 2009, and the related consolidated statements of comprehensive income, shareholders’ equity, and cash flows for the years then ended. These financial statements are the responsibility of the Company’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. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. We were not engaged to perform an audit of the Company’s internal control over financial reporting. Our audits included 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 Company’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, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of OJSC MegaFon and subsidiaries at December 31, 2011, 2010 and 2009, and the consolidated results of their operations and their cash flows for the years then ended in conformity with accounting principles generally accepted in the United States.

May 14, 2012

/s/ Ernst & Young LLC

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MegaFon  
Consolidated Balance Sheets  
(In millions of Rubles)

	Note	December 31,		
		2011	2010	2009
<b>Assets</b>				
Current assets:				
Cash and cash equivalents	4	2,887	2,667	12,550
Short-term investments	5	84,509	63,554	49,114
Accounts receivable, net of allowances of 1,447, 1,029 and 861	6	9,547	6,859	4,050
Accounts receivable, related parties	23	104	95	35
Inventory	7	4,551	3,081	1,219
Prepaid income taxes		6,957	6,975	3,238
VAT receivable		1,779	2,562	2,037
Deferred tax assets	18	1,972	1,166	772
Prepaid expenses and other current assets	8	7,987	7,114	7,135
Total current assets		<u>120,293</u>	94,073	80,150
Long-term bank deposits	9	2,002	305	—
Property, plant and equipment, net of accumulated depreciation of 164,765, 130,876 and 99,993	10	223,718	194,872	147,231
Goodwill and intangible assets:				
Goodwill	3, 11	15,393	7,041	498
Intangible assets, net of accumulated amortization of 24,817, 20,638 and 17,101	11	19,672	19,245	16,869
Deferred tax assets	18	712	506	210
Deferred finance charges		729	665	665
Other non-current assets		949	760	557
Total assets		<u><u>383,468</u></u>	<u>317,467</u>	<u>246,180</u>

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

MegaFon  
Consolidated Balance Sheets (continued)  
(In millions of Rubles)

	Note	December 31,		
		2011	2010	2009
<b>Liabilities</b>				
Current liabilities:				
Accounts payable	12	9,621	6,521	4,530
Accounts payable to equipment suppliers		8,034	10,308	6,864
Accounts payable, related parties	23	465	404	502
Current portion of liability for marketing related licenses	11	402	382	287
Current portion of liability for deferred and contingent consideration	14	2,550	1,450	—
Accrued compensation		5,360	2,840	3,141
Subscribers' prepayments		7,895	7,303	7,083
Taxes payable	17	3,056	1,704	2,174
VAT payable		2,965	1,294	1,240
Current portion of deferred revenue		954	552	358
Current portion of long-term debt	13	7,415	12,171	7,811
Other current liabilities		1,256	845	645
Total current liabilities		<b>49,973</b>	45,774	34,635
Debt, less current portion	13	<b>36,294</b>	20,750	19,335
Deferred tax liabilities	18	<b>10,543</b>	8,256	2,070
Asset retirement obligations	10	<b>5,248</b>	4,304	3,303
Liability for marketing related licenses, less current portion	11	<b>621</b>	893	1,054
Liability for deferred and contingent consideration, less current portion	14	<b>1,829</b>	1,731	—
Deferred revenue, less current portion		<b>1,569</b>	1,968	1,568
Other non-current liabilities		<b>759</b>	665	301
Total liabilities		<b>106,836</b>	84,341	62,266
<b>Equity</b>				
MegaFon shareholders' equity:				
Ordinary shares (par value of 10 Rubles, 6,200,002 shares outstanding)		<b>581</b>	581	581
Reserve fund		<b>17</b>	17	17
Additional paid-in capital		<b>13,852</b>	13,855	13,870
Retained earnings		<b>261,950</b>	218,371	169,199
Accumulated other comprehensive loss		<b>(291)</b>	(261)	(255)
Total MegaFon shareholders' equity		<b>276,109</b>	232,563	183,412
Noncontrolling interests		<b>523</b>	563	502
Total equity		<b>276,632</b>	233,126	183,914
Total liabilities and equity		<b>383,468</b>	317,467	246,180

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

MegaFon

Consolidated Statements of Comprehensive Income  
(In millions of Rubles, except share and per share amounts)

	Note	Years ended December 31,		
		2011	2010	2009
<b>Revenues</b> (including related party amounts of 236, 357 and 299)	19, 23	<b>242,608</b>	215,515	181,883
Cost of revenues (including related party amounts of 1,382, 1,220 and 863)	20, 23	<b>58,896</b>	48,423	37,204
Sales and marketing expenses	21	<b>21,841</b>	19,471	17,361
Operating expenses (including related party amounts of 1,314, 1,080 and 852)	22, 23	<b>61,049</b>	49,847	39,126
Depreciation	10	<b>42,377</b>	35,035	28,269
Amortization	11	<b>5,299</b>	3,839	3,075
<b>Operating income</b>		<b>53,146</b>	58,900	56,848
Other income/(expense):				
Interest expense	10	<b>(706)</b>	(837)	(1,657)
Interest income		<b>3,591</b>	4,008	3,255
Other gain/(loss), net		<b>30</b>	18	(89)
Loss on derivatives, net	15	<b>(51)</b>	(203)	(300)
Foreign currency exchange loss, net		<b>(105)</b>	(700)	(2,192)
<b>Total other income/(expense), net</b>		<b>2,759</b>	2,286	(983)
<b>Income before income taxes and noncontrolling interests</b>		<b>55,905</b>	61,186	55,865
Provision for income taxes	18	<b>12,320</b>	11,962	10,565
<b>Net income</b>		<b>43,585</b>	49,224	45,300
Net income attributable to noncontrolling interests		<b>(6)</b>	(52)	(11)
<b>Net income attributable to MegaFon</b>		<b>43,579</b>	49,172	45,289
Weighted average number of ordinary shares outstanding—basic and diluted		<b>6,200,002</b>	6,200,002	6,200,002
Earnings per share—basic and diluted, Rubles		<b>7,029</b>	7,931	7,305
<b>Other comprehensive loss:</b>				
Foreign currency translation adjustment		<b>(39)</b>	(8)	(33)
Pension costs, net of tax of nil		<b>—</b>	—	27
<b>Other comprehensive loss</b>		<b>(39)</b>	(8)	(6)
<b>Total comprehensive income</b>		<b>43,546</b>	49,216	45,294
Comprehensive (income)/loss attributable to noncontrolling interests		<b>3</b>	(50)	(3)
<b>Comprehensive income attributable to MegaFon</b>		<b>43,549</b>	49,166	45,291

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



MegaFon  
Consolidated Statements of Cash Flows  
(In millions of Rubles)

	Years ended December 31,		
	2011	2010	2009
<b>Cash flows from operating activities:</b>			
Net income attributable to MegaFon	43,579	49,172	45,289
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation	42,377	35,035	28,269
Amortization	5,299	3,839	3,075
Net loss on derivatives	51	203	300
Net foreign exchange loss	105	700	2,192
Net income attributable to noncontrolling interests	6	52	11
Bad debt expense (Notes 6, 22)	1,437	1,182	1,122
Provision for deferred income taxes (Note 18)	850	3,240	10
Amortization of deferred finance charges	196	180	617
Changes in assets and liabilities:			
Accounts receivable	(3,870)	(1,927)	484
Inventory	(1,414)	(1,606)	1,156
Prepayments and other current assets	(1,053)	(3,555)	(4,770)
Accounts payable and accrued expenses	6,962	448	1,335
Deferred revenue	3	151	(4)
Subscribers' prepayments	392	18	609
VAT, net	2,375	(519)	(345)
Net cash provided by operating activities	<u>97,295</u>	<u>86,613</u>	<u>79,350</u>
<b>Cash flows from investing activities:</b>			
Purchases of property, plant and equipment and intangible assets	(73,332)	(63,860)	(46,036)
Proceeds from sale of property, plant and equipment	449	743	639
Acquisitions of subsidiaries, net of cash acquired of 274, 849 and 102 (Note 3)	(10,825)	(10,418)	(833)
Change in short-term investments and long-term deposits	(18,948)	(15,275)	(14,073)
Other investing activities	—	(11)	—
Net cash used in investing activities	<u>(102,656)</u>	<u>(88,821)</u>	<u>(60,303)</u>
<b>Cash flows from financing activities:</b>			
Proceeds from long-term debt	21,486	13,728	9,856
Repayments of long-term debt	(14,365)	(20,105)	(19,640)
Deferred finance charges paid	(260)	(208)	(333)
Payments of contingent consideration (Note 14)	(491)	—	—
Payments of liability for marketing related licenses (Note 11)	(385)	(329)	(407)
Purchase of noncontrolling interest in consolidated subsidiaries	(40)	(100)	—
Dividends paid to noncontrolling interests	—	(147)	(59)
Net cash provided/(used in) financing activities	<u>5,945</u>	<u>(7,161)</u>	<u>(10,583)</u>
Effect of exchange rate changes on cash and cash equivalents	(364)	(514)	(2,379)
<b>Net increase/(decrease) in cash and cash equivalents</b>	<b>220</b>	<b>(9,883)</b>	<b>6,085</b>
Cash and cash equivalents at beginning of year	<u>2,667</u>	<u>12,550</u>	<u>6,465</u>
<b>Cash and cash equivalents at end of year</b>	<b><u>2,887</u></b>	<b><u>2,667</u></b>	<b><u>12,550</u></b>
<b>Supplemental cash flow information:</b>			
Cash paid during the year for income taxes	10,914	11,858	10,897
Interest paid during the year, net of interest capitalized	114	158	2,636
Non-cash activities			
Deferred consideration for acquisition of subsidiaries (Notes 3, 14)	1,231	3,166	—
Revenue from in-kind services (Note 11)	170	71	18

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

MegaFon

Consolidated Statements of Shareholders' Equity  
(In millions of Rubles, except share amounts)

	MegaFon shareholders' equity								
	Ordinary shares Shares	Amount	Reserve fund	Additional paid-in capital	Retained earnings	Accumulated other comprehensive loss	Total attributable to MegaFon	Non- controlling interests	Total
<b>Balances at December 31, 2008</b>	<b>6,200,002</b>	<b>581</b>	<b>17</b>	<b>13,875</b>	<b>123,910</b>	<b>(257)</b>	<b>138,126</b>	—	<b>138,126</b>
Net income	—	—	—	—	45,289	—	45,289	11	45,300
Other comprehensive income	—	—	—	—	—	2	2	(8)	(6)
Acquisitions (Note 3)	—	—	—	—	—	—	—	583	583
Purchase of noncontrolling interests (Note 3)	—	—	—	(5)	—	—	(5)	(25)	(30)
Dividends paid to noncontrolling interests	—	—	—	—	—	—	—	(59)	(59)
<b>Balances at December 31, 2009</b>	<b>6,200,002</b>	<b>581</b>	<b>17</b>	<b>13,870</b>	<b>169,199</b>	<b>(255)</b>	<b>183,412</b>	<b>502</b>	<b>183,914</b>
Net income	—	—	—	—	49,172	—	49,172	52	49,224
Other comprehensive loss	—	—	—	—	—	(6)	(6)	(2)	(8)
Acquisitions (Note 3)	—	—	—	—	—	—	—	214	214
Purchase of noncontrolling interests	—	—	—	(15)	—	—	(15)	(56)	(71)
Dividends paid to noncontrolling interests	—	—	—	—	—	—	—	(147)	(147)
<b>Balances at December 31, 2010</b>	<b>6,200,002</b>	<b>581</b>	<b>17</b>	<b>13,855</b>	<b>218,371</b>	<b>(261)</b>	<b>232,563</b>	<b>563</b>	<b>233,126</b>
Net income	—	—	—	—	43,579	—	43,579	6	43,585
Other comprehensive loss	—	—	—	—	—	(30)	(30)	(9)	(39)
Purchase of noncontrolling interests	—	—	—	(3)	—	—	(3)	(37)	(40)
<b>Balances at December 31, 2011</b>	<b>6,200,002</b>	<b>581</b>	<b>17</b>	<b>13,852</b>	<b>261,950</b>	<b>(291)</b>	<b>276,109</b>	<b>523</b>	<b>276,632</b>

## MegaFon

### Notes to Consolidated Financial Statements (In millions of Rubles, unless otherwise indicated)

#### **1. Description of Business**

Open Joint Stock Company MegaFon (the “Company” or “MegaFon”) is a leading universal telecommunications operator in the Russian Federation (“Russia”) which provides a broad range of voice, data and other telecommunication services to businesses, other telecommunication service providers and retail subscribers. The Company has licenses to operate in all regions of Russia. The Company intends, wherever possible, to offer its integrated telecommunication services under the “MegaFon” brand, although some services still carry local brand names because of recent acquisitions. In addition to its operations in Russia, the Company provides mobile services through its subsidiaries in the Republic of Tajikistan (“Tajikistan”), the Republic of Abkhazia (“Abkhazia”) and the Republic of South Ossetia (“South Ossetia”).

In Russia, MegaFon has constructed and continues to operate a nationwide wireless communications network that operates under the dual band GSM 900/1800 standard. In May 2007, the Company was awarded a license for the provision of 3G wireless telephony services based on IMT-2000/UMTS standards throughout the entire territory of Russia that expires on May 21, 2017. As of December 31, 2011, the Company is providing and expanding 3G services in almost all of the regions throughout Russia.

The Company also holds licenses for local and long-distance telephony services, data transmission, broadband access services, and communication channels leasing covering the whole territory of the Russian Federation. The Company has its own land-line and leased satellite transmission network capacities.

#### **2. Summary of Significant Accounting Policies and Recent Accounting Pronouncements**

##### **Basis of Presentation**

The statutory accounting records of the Company and its subsidiaries, except for TT-Mobile, are maintained in Russian Rubles and except for TT-Mobile, Aquafon and Ostelecom, are prepared in accordance with the requirements of Russian accounting and tax legislation. Foreign subsidiaries of the Company maintain their accounting records in accordance with their local accounting and tax legislation. These consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (“US GAAP”). The accompanying consolidated financial statements differ from statutory financial statements used in Russia, Tajikistan, Abkhazia and South Ossetia as they reflect certain adjustments, recorded in the entities’ accounts, which are necessary to present the financial position, results of operations and cash flows in accordance with US GAAP.

The principal adjustments are related to (1) revenue recognition; (2) recognition of interest expense and other operating expenses; (3) deferred income taxes; (4) valuation and depreciation of property, plant and equipment and intangible assets; (5) business combinations; (6) consolidation and accounting for subsidiaries; (7) accounting for derivatives; (8) foreign currency translation; and (9) valuation allowances for unrecoverable assets.

The Company evaluated subsequent events up to May 14, 2012, the date these financial statements were available to be issued.

The accompanying consolidated financial statements are presented in millions of Rubles, except for share amounts or unless otherwise indicated.

##### **Use of Estimates in Preparation of Financial Statements**

The preparation of consolidated financial statements, in conformity with US GAAP, requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent liabilities as of the date of the financial statements and reported amounts of revenues and expenses during the reported period. Significant estimates, among others, include the allocation of purchase price to the fair value of net assets acquired in connection with business combinations, useful lives related to tangible and intangible assets, impairment of long-lived assets, deferred revenue, asset retirement obligations, recoverability of deferred tax assets, fair value of derivatives, income tax provision and allowance for doubtful accounts. Actual results could differ from these estimates.

**2. Summary of Significant Accounting Policies and Recent Accounting Pronouncements (continued)****Principles of Consolidation**

Wholly-owned and majority-owned subsidiaries where the Company has operating and financial control are consolidated. Consolidation is also required when the Company is a primary beneficiary of a variable interest entity.

All significant inter-company accounts and transactions are eliminated upon consolidation and net earnings/(losses) are reduced or increased by the amount of the net earnings/(losses) of subsidiaries attributable to noncontrolling interests.

**Business Combinations**

The Company applies the acquisition method of accounting and recognizes the assets acquired, the liabilities assumed and any noncontrolling interest in the acquired company at the acquisition date, measured at their fair values as of that date. Determining the fair value of assets acquired and liabilities assumed requires management's judgment and often involves the use of significant estimates and assumptions, including assumptions with respect to future cash inflows and outflows, discount rates, license and other asset lives and market multiples, among other items. Results of subsidiaries acquired and accounted for by the acquisition method have been included in operations from the relevant date of acquisition.

**Foreign Currency Translation**

The functional currency of the Company's subsidiaries domiciled in Russia, Abkhazia and South Ossetia is the Russian Ruble as a majority of their revenues, costs, property and equipment purchases, debt and trade liabilities are either priced, incurred, payable or otherwise measured in Rubles.

The functional currency of TT-Mobile, the Company's 75% owned subsidiary in Tajikistan, is the US dollar as a majority of its revenues, costs, property and equipment purchases, debt and trade liabilities is either priced, incurred, payable or otherwise measured in US dollars.

**Cash and Cash Equivalents**

Cash and cash equivalents comprise cash on hand and deposits in banks with original maturities of three months or less. The carrying value of cash and cash equivalents approximates fair value.

**Short-Term Investments**

Short-term investments comprise all highly liquid investments with original maturities of more than three months but less than twelve months. The carrying value of short-term investments approximates their fair value.

**Accounts Receivable**

Accounts receivable are stated net of allowance for bad debts. The Company makes judgments as to the recoverability of accounts receivable based on historical trends and future expectations. To determine the allowance for doubtful accounts, management reviews specific customer risks and the Company's analysis of the aged accounts receivable balances.

**Inventories**

Inventories, which primarily consist of telephone handsets, accessories, USB modems and SIM-cards, are stated at the lower of cost or market value. Cost is determined using the first-in, first-out method.

**Value-Added Tax**

Value Added Tax ("VAT") related to revenues is generally payable to the tax authorities on an accrual basis when invoices are issued to customers. VAT incurred on purchases may be offset, subject to certain restrictions,

**2. Summary of Significant Accounting Policies and Recent Accounting Pronouncements (continued)**

against VAT related to revenues, or can be reclaimed in cash from the tax authorities under certain circumstances. As of December 31, 2011, the VAT enacted statutory rate was 18% in Russia and Tajikistan and 10% in Abkhazia and South Ossetia.

Management periodically reviews the recoverability of VAT receivable and believes the amount reflected in the consolidated financial statements is fully recoverable within one year.

**Deferred Finance Charges**

Commissions, arrangement and commitment fees and related legal fees paid to secure a firm commitment from lenders, premiums paid to secure vendor financing, and other direct debt issuance costs incurred in connection with new borrowings are deferred and amortized over the terms of the related loans, using the effective-interest method. Costs capitalized in connection with revolving credit facilities are amortized on a straight-line basis over the period the revolving line of credit is available.

**Long-term deposits**

Time deposits intended to be held for more than twelve months from the balance sheet date, absent any withdrawal restrictions, are classified as non-current assets. The carrying value of long-term deposits approximates their fair value.

**Property, Plant and Equipment**

Property, plant and equipment is stated at cost, less accumulated depreciation and impairment, if any. Cost includes all costs directly attributable to bringing the asset to working condition for its intended use. Interest expense incurred during the construction phase is capitalized as part of property, plant and equipment until the asset is ready for use. Depreciation is recorded on a straight-line basis over the estimated useful life of the asset.

The estimated useful lives are as follows:

Buildings and structures	7 to 49 years
Switching equipment, including billing systems	3 to 7 years
Base stations, including software	7 years
Fiber-optic equipment	20 years
Other network equipment	5 to 7 years
Vehicles and office equipment	3 to 5 years

Leasehold improvements are depreciated over the shorter of the lease term or the estimated useful lives of the assets. The lease term includes renewals when such renewals are reasonably assured.

Repair and maintenance costs are expensed as incurred, while updates and improvements are capitalized.

At the time of retirement or other disposition of property, plant, and equipment, the cost and accumulated depreciation are removed from the accounts and any resulting gain or loss is recorded in the consolidated statement of comprehensive income.

**Asset Retirement Obligations**

The Company has certain legal obligations related to rented sites for base stations and masts, which include requirements to restore the real estate upon which the base stations and masts are located.

The Company records the fair value of a legal liability for an asset retirement obligation in the period it is incurred. This cost is initially capitalized and amortized over the corresponding estimated economic useful life of 25 years.



**2. Summary of Significant Accounting Policies and Recent Accounting Pronouncements (continued)**

Once the obligation is ultimately settled, any difference between the final cost and the recorded liability is recognized as a gain or loss on disposition. The Company annually evaluates whether there are any indicators which suggest that the estimated cash flows underlying the liability have changed materially. If such indicators exist the Company changes estimates of the timing and amount of the cash flows and accounts for the effect as an increase or a decrease in the carrying amount of the liability for an asset retirement obligation and the related asset retirement cost is capitalized as part of the carrying amount of the related long-lived asset.

**Goodwill**

Goodwill represents the excess of the consideration transferred plus the fair value of any noncontrolling interest in the acquired company at the acquisition date over the fair values of the identifiable net assets acquired and is not amortized, but tested for impairment at least annually.

**Intangible Assets**

Intangible assets, which are stated at cost, consist principally of operating licenses, frequencies, numbering capacity, customer base and marketing related licenses.

Operating licenses and frequencies provide the Company with the exclusive right to utilize certain radio frequency spectrum to provide wireless communication services. The Company capitalizes payments made to third party suppliers to acquire access to the resources and for use of telephone numbering capacity. These assets (except for GSM 900/1800 standard wireless licenses and marketing related licenses (see *Note 11*)) are generally amortized on a straight-line basis over their estimated useful lives, generally from four to ten years.

Customer base is amortized reflecting the pattern in which the economic benefits are consumed or otherwise used up. Other intangible assets, such as software and trademarks, are amortized on a straight-line basis over their estimated useful lives.

The Company continues to evaluate the amortization period to determine whether events or circumstances warrant revised amortization periods. Additionally, the Company considers whether the carrying value of such assets should be impaired based on the expected future economic benefits.

**Long-lived Assets Impairment**

Long-lived assets to be held and used by the Company are reviewed to determine whether an event or change in circumstances indicates that the carrying amount of the asset may not be recoverable. For long-lived assets to be held and used, the Company bases its evaluation on such impairment indicators as the nature of the assets, the future economic benefit of the assets, any historical or future profitability measurements, as well as other external market conditions or factors that may be present. If such impairment indicators are present or other factors exist that indicate that the carrying amount of the asset may not be recoverable, the Company determines whether impairment has occurred through the use of an undiscounted cash flows analysis of assets at the lowest level for which identifiable cash flows exist. If impairment has occurred, the Company recognizes a loss for the difference between the carrying amount and the fair value of the asset. No such losses were recognized in the years ended December 31, 2011, 2010 and 2009.

**Goodwill Impairment Assessment**

Goodwill is reviewed for impairment annually, at the beginning of the fourth quarter, and between annual evaluations if events occur or circumstances change that would more likely than not reduce the fair value of the reporting unit below its carrying amount. Such circumstances could include, but are not limited to 1) a significant adverse change in legal factors or in business climate, 2) unanticipated competition, or 3) an adverse action or assessment by a regulator. The Company determines whether impairment has occurred by assigning goodwill to the reporting units identified and comparing the carrying amount of the reporting unit, including goodwill, to the fair value of the reporting unit. The fair value of the reporting unit is estimated using a discounted cash flows approach. If goodwill impairment has occurred, the Company recognizes a loss for the difference between the

**2. Summary of Significant Accounting Policies and Recent Accounting Pronouncements (continued)**

carrying amount of reporting unit goodwill and its implied fair value. In calculating the implied fair value of reporting unit goodwill, the fair value of the reporting unit is allocated to all of the other assets and liabilities of that unit based on their fair values. The excess of the fair value of a reporting unit over the amount assigned to its other assets and liabilities is the implied fair value of goodwill. The Company's evaluation of goodwill completed during the years ended December 31, 2011, 2010 and 2009 resulted in no impairment losses.

**Revenue Recognition***Wireless Revenue*

The Company earns wireless revenues for usage of its cellular system, which include airtime charges from contract and prepaid subscribers, monthly contract fees, interconnect fees from other wireless and wireline operators, roaming charges and charges for Value Added Services ("VAS"). Interconnect revenue includes revenues from wireless and wireline operators that was earned from the services rendered for traffic termination from other operators. Roaming revenues include revenues from customers who roam outside their selected home coverage area and revenues from other mobile carriers for roaming by their customers using the network of the Company. VAS include SMS, MMS, GPRS, Ring Back Tone and other services.

The content revenue relating to VAS is presented net of related costs when the Company acts as an agent of the content providers while gross revenues and related costs are recorded when the Company is a primary obligor in the arrangement. Service revenue is generally recognized when the services are rendered. Revenues are stated net of value-added tax charged to customers.

The Company defers revenue resulting from fees paid by customers upon initial connection. Deferred revenues are subsequently recognized over the estimated average customer lives under tariff plans, which are periodically reassessed by management.

*Revenue Recognition for Arrangements with Multiple Deliverables*

The Company enters into multiple element revenue arrangements in which a customer may purchase a combination of equipment (e.g. USB modems, handsets) and telecommunication services (e.g. airtime, data, and other services).

In 2010, the Company allocated consideration received from subscribers to the separate units of accounting based on their relative fair values. The allocated revenue was recognized in accordance with the type of the element.

In October 2009, the Financial Accounting Standards Board ("FASB") Accounting Standards Codification™ ("ASC") issued Accounting Standards Update ("ASU") 2009-13, "*Multiple-Deliverable Revenue Arrangements*", which addresses how revenues should be allocated among all products and services included in the Company's multiple-element sales arrangements. ASU 2009-13 is effective prospectively for sales entered into or materially modified in fiscal years beginning on or after June 15, 2010. Accordingly, the Company adopted ASU 2009-13 for all sales entered into or significantly modified starting from January 1, 2011.

The revised guidance establishes a selling price hierarchy for determining the selling price of each product or service included in a multiple-element sale arrangement. The selling price used for each deliverable is based on vendor-specific objective evidence ("VSOE") if available, third-party evidence ("TPE") if vendor-specific objective evidence is not available, or estimated selling price if neither vendor-specific objective evidence nor third-party evidence is available. It replaces "fair value" with "selling price" in revenue allocation guidance and eliminates the residual method of allocation.

The adoption of ASU 2009-13 did not have a material impact on the Company's financial statements and is not expected to have a material impact on its financial statements in the future, because for substantially all of the multiple element arrangements the Company continues to use VSOE to determine the relative selling price of the service element of the arrangements and best estimate of the selling price to determine the relative selling price of the equipment element of the arrangements.

**2. Summary of Significant Accounting Policies and Recent Accounting Pronouncements (continued)**

Revenue allocated to the delivered equipment and related costs are recognized in the profit and loss account at the time of sale provided that other conditions for revenue recognition are met. Amounts allocated to telecommunication services are deferred and recognized as revenue over the period of rendering the services.

*Wireline Revenue*

The Company earns wireline revenues for usage of its fixed-line network, which include payments from individual, corporate and government subscribers for local and long-distance telephony and data service contracts. Charges are based upon usage (e.g., minutes of traffic processed), period of time (e.g., monthly service fees) or other established fee schedules. Revenue from service contracts is recognized when the services are rendered. Billings received in advance of service being rendered are deferred and recognized as revenue as the service is rendered.

**Advertising Costs**

Advertising costs are expensed as incurred (*see Note 21*).

**Government Pension Funds**

The Company contributes to the local state pension funds and social funds on behalf of its employees. The contributions are expensed as incurred. Contributions for the years ended December 31, 2011, 2010 and 2009 were 2,300, 1,619 and 1,084, respectively.

**Income Taxes**

Provisions are recorded in the consolidated financial statements for taxation of profits in accordance with Russian and other local legislation currently in force. The Company accounts for income taxes under the liability method. Deferred income taxes reflect the future tax consequences of temporary differences between the tax and financial statement bases of assets and liabilities and are measured using enacted tax rates applied to taxable income in the years in which those temporary differences are expected to be recovered or settled. A valuation allowance is provided when it is more likely than not that some or all of the deferred tax assets will not be realized in the future.

The Company accounts for uncertain tax positions and reflects liabilities for unrecognized income tax benefits together with corresponding interest and penalties in the consolidated statement of comprehensive income as income tax expense.

**Earnings per share**

Basic earnings per share are computed by dividing net earnings available to shareholders of the Company by the weighted average number of ordinary shares outstanding for the period. Diluted earnings per share equal basic earnings per share as there are currently no share arrangements with dilutive effects.

**Concentration of Credit Risk**

Financial instruments that potentially subject the Company to concentration of credit risk consist primarily of cash, cash equivalents, short-term investments, accounts receivable and long-term deposits. The Company deposits available cash with various banks in Russia. Deposit insurance is either not offered or only offered in *de minimis* amounts in respect of bank deposits within Russia. To manage the concentration of credit risk, the Company allocates available cash to domestic branches of international banks and a limited number of Russian banks. A majority of these Russian banks are either owned or controlled by the Russian Government. Management periodically reviews the creditworthiness of the banks in which it deposits cash, cash equivalents and short-term investments.

**2. Summary of Significant Accounting Policies and Recent Accounting Pronouncements (continued)**

The Company extends credit to certain counterparties, principally international and national telecommunications operators, for roaming services, and to certain dealers. The Company minimizes its exposure to the risk by ensuring that credit risk is spread across a number of counterparties, and by continuously monitoring the credit standing of counterparties based on their credit history and credit ratings reviews. Other preventive measures to minimize credit risk include obtaining advance payments, bank guarantees and other security.

**Fair Value Measurement**

US GAAP standards establish a three-level fair value hierarchy, which prioritizes the inputs used in measuring fair value. These levels include:

Level 1: Quoted prices for identical assets or liabilities in active markets that the entity has the ability to access as of the measurement date.

Level 2: Quoted prices for similar instruments in active markets; quoted prices for identical or similar instruments in markets that are non-active; inputs other than quoted prices that are observable and derived from or corroborated by observable market data.

Level 3: Valuations derived from valuation techniques in which one or more significant inputs are unobservable.

The Company, using available market information, appropriate valuation methodologies and management's estimates determines the approximate fair values of financial instruments.

**Derivative Instruments and Hedging Activities**

The Company records all derivative instruments on the balance sheet at their respective fair values. On the date a derivative contract is executed, and depending on the specific facts and circumstances, the derivative may be designated as a fair value hedge, cash flow hedge or foreign currency hedge of net investment in a foreign operation.

The Company has derivatives which it designated as cash flow hedges and derivatives which it did not designate as hedges (*see Note 15*).

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 comprehensive income. For derivative instruments that are not designated as hedges or do not qualify as hedged transactions, the changes in the fair value are reported in the consolidated statement of comprehensive income.

The Company uses derivatives to manage interest rate and foreign currency risk exposures. The Company does not hold or issue derivatives for trading purposes.

**Long-Term Incentive Program**

Certain employees of the Company have been granted phantom share options. The value ascribed to the full package of each grant is based on the value of the Company calculated using operating results and net debt of the Company. The awards are contingent on the recipients' continuing employment with the Company and are settled in cash. The vesting period is every two years over a four year period. The compensation cost under the program is calculated based on the estimated Company value and the number of awards expected to vest and be accrued over the vesting period (*see Note 16*).

**Comparative Information**

Certain prior year amounts have been reclassified to conform to the presentation adopted in the current year.

## 2. Summary of Significant Accounting Policies and Recent Accounting Pronouncements (continued)

### Recent Accounting Pronouncements

*Disclosures—Offsetting Assets and Liabilities.* In December 2011, the FASB issued ASU 2011-11, “*Disclosures about Offsetting Assets and Liabilities*”, which enhances disclosures by requiring improved information about financial instruments and derivative instruments that are either offset on the balance sheet or subject to an enforceable master netting arrangement or similar agreement. The amendment is effective for fiscal years beginning on or after January 1, 2013 and interim periods within those annual periods. The Company does not expect ASU 2011-11 to have a material impact on its financial statements.

*Goodwill Impairment Testing.* In August 2011, the FASB issued ASU 2011-08, “*Intangibles—Goodwill and Other (Topic 350): Testing Goodwill for Impairment*”, which allows an entity to first assess qualitative factors to determine whether it is necessary to perform the two-step quantitative goodwill impairment test. Under this amendment, an entity would not be required to calculate the fair value of a reporting unit unless the entity determines, based on a qualitative assessment, that it is more likely than not that its fair value is less than its carrying amount. The amendment includes a number of events and circumstances for an entity to consider in conducting the qualitative assessment. The amendment is effective for fiscal years beginning after December 15, 2011. Early adoption is permitted. The Company has adopted the amendment starting from the impairment review performed in the fourth quarter of 2011. The adoption of the guidance did not have a material impact on the Company’s financial statements.

In December 2010, the FASB issued ASU 2010-28, “*Intangibles—Goodwill and Other (Topic 350): When to Perform Step 2 of the Goodwill Impairment Test for Reporting Units with Zero or Negative Carrying Amounts*”, which modifies Step 1 of the goodwill impairment test for reporting units with zero or negative carrying amounts. For those reporting units, an entity is required to perform Step 2 of the goodwill impairment test if it is more likely than not that a goodwill impairment exists. In determining whether it is more likely than not that a goodwill impairment exists, an entity should consider whether there are any adverse qualitative factors indicating that an impairment may exist.

For public entities, the amendment is effective for fiscal years, and interim periods within those years, beginning on or after December 15, 2010. The adoption of the guidance did not have a material impact on the Company’s financial statements.

*Comprehensive Income.* In June 2011, the FASB issued ASU 2011-05, “*Comprehensive Income*”, which gives an entity the option to present total comprehensive income, the components of net income, and the components of other comprehensive income either in a single continuous statement of comprehensive income or in two separate but consecutive statements. In both choices, an entity is required to present each component of net income along with total net income, each component of other comprehensive income along with a total for other comprehensive income, and a total amount for comprehensive income. This ASU eliminates the option to present the components of other comprehensive income as part of the statement of changes in shareholders’ equity.

In December 2011, the FASB issued ASU 2011-12, “*Deferral of the Effective Date for Amendments to the Presentation of Reclassifications of Items Out of Accumulated Other Comprehensive Income in Accounting Standards Update No. 2011-05*”, which deferred the requirement to present on the face of the financial statements reclassification adjustments for items that are reclassified from other comprehensive income to net income while the FASB further deliberates this aspect of the proposal. ASU 2011-05, as amended by ASU 2011-12, is effective for public entities for fiscal years, and interim periods within those years, beginning on or after December 15, 2011 with early adoption permitted.

The Company has adopted this ASU as of January 1, 2009 and presented total comprehensive income, the components of net income, and the components of other comprehensive loss in a single continuous statement of comprehensive income.

*Fair Value Measurements.* In May 2011, the FASB issued ASU 2011-04, “*Fair Value Measurement (Topic 820): Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs*”, which clarifies Topic 820, “*Fair Value Measurements and Disclosures*”, but also includes some instances where a particular principle or requirement for measuring fair value or disclosing information about fair value measurements has changed.



**2. Summary of Significant Accounting Policies and Recent Accounting Pronouncements (continued)**

This ASU results in common principles and requirements for measuring fair value and for disclosing information about fair value measurements in accordance with US GAAP and International Financial Reporting Standards issued by the International Accounting Standards Board (IFRS).

The amendment is effective for interim and annual periods beginning after December 15, 2011. The Company is currently evaluating the impact of this ASU on its financial statements.

*Receivables.* In April 2011, the FASB issued ASU 2011-02, “*Receivables (Topic 310): A Creditor’s Determination of Whether a Restructuring is a Troubled Debt Restructuring*”, which provides additional guidance to assist creditors in determining whether a restructuring of a receivable meets the criteria to be considered a troubled debt restructuring. The amendment is effective for public entities for the first interim or annual period beginning on or after June 15, 2011.

Early adoption is permitted. The Company does not expect this amendment to have a material impact on its financial statements.

In July 2010, the FASB issued ASU 2010-20, “*Receivables (Topic 310): Disclosures about the Credit Quality of Financing Receivables and the Allowance for Credit Losses*”, which improves disclosure requirements that facilitate financial statement users’ evaluation of the nature of credit risk inherent in the entity’s portfolio of financing receivables, the allowance for credit losses and changes in the allowance for credit losses. ASU 2010-20 is effective for interim and annual reporting periods ending on or after December 15, 2011. The adoption of the guidance did not have a material impact on the Company’s financial statements.

**3. Business Combinations*****Acquisitions in 2011*****NetByNet**

In June 2011, the Company completed the acquisition of a 100% ownership interest in Fairlie Holding and Finance Limited, which holds a 100% interest in a group of subsidiaries that provide broadband internet, IP telephony, IP TV and other multimedia services in Russia under the NetByNet brand (“NetByNet”) for total consideration having a fair value of 8,731 as of the date of acquisition, consisting of cash consideration of 7,507 and contingent consideration of 1,224.

The primary reason for the acquisition was to facilitate the Company’s entry into the broadband internet market in Moscow, the Moscow region and the Central Federal District, where the Company did not previously provide broadband internet services for end-customers.

Contingent consideration consists of several payments due within approximately one year with the amounts due being linked to NetByNet’s operating results for, and additional acquisitions made in, the year ending December 31, 2011.

The Company estimated the fair value of the contingent consideration at 1,224 using a probability-weighted cash flow model. This fair value measurement is based on significant inputs not observable in the market and thus represents a Level 3 measurement.

The Company has consolidated the financial position and the results of operations of NetByNet from June 1, 2011.

As a part of liabilities assumed in the acquisition of NetByNet, the Company recognized tax contingencies of 560 which were included in non-current liabilities. In the fourth quarter of 2011 tax contingencies provision has been reduced by 493. This reduction has been recorded through goodwill as a measurement period adjustment (*Note 11*).

In January 2012, the principal shareholder of NetByNet joined the senior management of the Company and, in April 2012, became the Company’s CEO.

**3. Business Combinations (continued)****UgraTel**

In December 2011, the Company completed the acquisition of a 100% ownership interest in OJSC UgraTel (“UgraTel”), a provider of broadband internet and wireline telephony services in the Urals region of Russia, for a total cash consideration of approximately 2,421. The primary reason for the acquisition of UgraTel was to strengthen the Company’s position in the wireline market in the Urals Federal District.

The Company has consolidated the financial position of UgraTel from December 31, 2011.

The acquisitions of NetByNet and UgraTel were accounted for using the acquisition method. The valuation of certain assets and liabilities assumed for both the NetByNet and UgraTel acquisitions have not been finalized as of the date these consolidated financial statements were issued; thus, the provisional measurements of certain intangible assets, deferred taxes and goodwill are subject to change.

The goodwill recognized is attributable primarily to expected synergies from the acquisition and the value to be attributed to the workforces of NetByNet and UgraTel. Management is still assessing the allocation of goodwill among reporting units. None of the goodwill recognized is deductible for income tax purposes.

The weighted-average useful lives of NetByNet trademarks and customer base are 3.0 and 10.6 years, respectively. The weighted-average useful lives of UgraTel trademarks and customer base are 1.5 and 10.0 years, respectively.

The table below represents the preliminary allocation of the purchase price to the acquired net assets of NetByNet and UgraTel based on their estimated fair values.

	<u>NetByNet</u>	<u>UgraTel</u>
Cash and cash equivalents	190	58
Other current assets	201	101
Tangible assets:		
Telecommunications network	2,055	1,812
Other equipment	70	66
Identifiable intangible assets:		
Trademarks	295	53
Customer base	633	29
Computer software	32	9
Numbering capacity	5	4
Long-term deposits	—	2
Goodwill	<u>7,355</u>	<u>503</u>
<b>Total assets acquired</b>	<b><u>10,836</u></b>	<b><u>2,637</u></b>
Debt, including current portion	(1,218)	—
Current liabilities	(612)	(197)
Non-current liabilities	<u>(275)</u>	<u>(19)</u>
<b>Total liabilities assumed</b>	<b><u>(2,105)</u></b>	<b><u>(216)</u></b>
<b>Total consideration transferred</b>	<b><u>8,731</u></b>	<b><u>2,421</u></b>

**Other acquisitions**

Also in 2011, the Company acquired 100% ownership interests in a number of other alternative wireline and broadband internet service providers in certain regions of the Russian Federation.

The purchase price allocation of these companies had not been finalized as of the date of these financial statements as the Company had not completed the valuation of individual assets of these companies.

MegaFon

Notes to Consolidated Financial Statements (continued)

**3. Business Combinations (continued)**

The total consideration for Web Plus includes cash consideration of 47 and deferred contingent consideration of 7. Other acquisitions were made for cash consideration paid on the date of acquisition. The goodwill recognized is attributable primarily to the economic potential of the regions in which the acquired companies operate and expected synergies from the acquisitions. Management is still assessing the allocation of goodwill among reporting units. None of the goodwill recognized is deductible for income tax purposes.

The table below represents the preliminary allocation of the purchase price to the acquired net assets of the acquired operators based on their estimated fair values.

	<u>Web Plus</u>	<u>Nakhodka Telecom</u>	<u>ChebNet</u>	<u>Luchshe.Net</u>	<u>Total</u>
Month of acquisition	June	November	November	December	
Federal District	North-West	Far East	Volga	Central	
Net working capital	(120)	10	22	(103)	<b>(191)</b>
Tangible assets	177	80	236	169	<b>662</b>
Identifiable intangibles assets	—	30	328	90	<b>448</b>
Goodwill	—	83	188	223	<b>494</b>
Bargain purchase gain	(2)	—	—	—	<b>(2)</b>
Deferred tax liabilities	(1)	(7)	(104)	(39)	<b>(151)</b>
Non-current liabilities	—	—	(60)	(22)	<b>(82)</b>
<b>Total consideration</b>	<b><u>54</u></b>	<b><u>196</u></b>	<b><u>610</u></b>	<b><u>318</u></b>	<b><u>1,178</u></b>

The following amounts of revenue and earnings of companies acquired in 2011 since the acquisition date are included in the consolidated statement of comprehensive income for the year ended December 31, 2011:

	<u>NetByNet</u>	<u>UgraTel</u>	<u>Others</u>
Revenue	1,229	—	227
Net income/(loss)	<u>158</u>	<u>—</u>	<u>6</u>

**Acquisitions in 2010**

**Synterra**

In June 2010, the Company completed the acquisition of a 100% ownership interest in CJSC Synterra (“Synterra”), an alternative provider of integrated telecommunications services in Russia, from Synterra Cyprus Limited and Burnham Advisors Limited for the total purchase price of \$745 million, including cash consideration of approximately \$298 million (9,267 at the exchange rate as of June 2, 2010), deferred and contingent consideration in the notional amount of up to \$110 million (3,418 at the exchange rate as of June 2, 2010) and the net debt of Synterra as of the date of acquisition.

Synterra provides wireline services in Russia and holds licenses for local and long-distance telephony services, data transmission, wireless broadband access services, and communication channels leasing. The primary reason for the acquisition was to further strengthen the Company’s position in the wireline market and to realize future operating and cost synergies resulting from fixed-to-mobile convergence opportunities.

The acquisition-date fair values of each major class of consideration transferred are presented below:

Cash	<b>9,267</b>
Liability for deferred and contingent consideration	<b>3,166</b>
<b>Total consideration transferred</b>	<b><u>12,433</u></b>

Deferred and contingent consideration consists of an unconditional deferred payment amount of \$43 million (1,336 at the exchange rate as of June 2, 2010) and several contingent payments aggregating up to \$67 million (2,082 at the exchange rate as of June 2, 2010), payable on or prior to the third anniversary of the acquisition

**3. Business Combinations (continued)**

date. \$70 million (2,175 at the exchange rate as of June 2, 2010) out of the total \$110 million (3,418 at the exchange rate as of June 2, 2010) of deferred and contingent consideration bears interest at the rate of 2.75% per annum and the remaining \$40 million (1,243 at the exchange rate as of June 2, 2010) is interest-free. Contingent payments depend upon satisfaction of certain conditions. (Note 14)

**Metrocom**

In October 2010, the Company completed the acquisition of a 100% ownership interest in CJSC Metrocom (“Metrocom”), a wireline operator which owns a backbone network in Saint Petersburg, for approximately 2,000 cash consideration. The primary reason for the acquisition was to strengthen the Company’s position in the wireline market in Saint Petersburg.

The amounts of revenue and net income/(loss) of the acquired companies included in the Company’s accompanying consolidated statement of comprehensive income from the acquisition date to December 31, 2010 were as follows:

	<u>Synterra</u>	<u>Metrocom</u>
Revenue	6,656	180
Net income/(loss)	<u>42</u>	<u>(16)</u>

**Pro forma results of operations (unaudited)**

The following unaudited pro forma data for the years ended December 31, 2011, 2010 and 2009 assume that the 2011 and 2009 acquisitions occurred on January 1, 2009. These pro forma amounts are provided for information purposes only and are not necessarily indicative of the results of future operations, nor of the actual results that would have been achieved had the acquisitions taken place at the beginning of 2009.

	<u>(unaudited)</u> <u>Year ended December 31,</u>		
	<u>2011</u>	<u>2010</u>	<u>2009</u>
<b>Revenues</b>			
Synterra	n/a	4,879	12,731
Metrocom	n/a	759	1,286
NetByNet	839	1,456	1,062
UgraTel	952	841	755
Other acquisitions	575	734	734
Total pro forma revenues	<u>244,974</u>	<u>224,184</u>	<u>198,451</u>
<b>Net income</b>			
Synterra	n/a	(194)	1,466
Metrocom	n/a	(3)	108
NetByNet	(132)	(401)	(108)
UgraTel	73	101	54
Other acquisitions	(22)	6	(2)
Total pro forma net income	<u>43,498</u>	<u>48,681</u>	<u>46,807</u>
Pro forma earnings per share—basic and diluted (in Rubles per ordinary share)	<u>7,016</u>	<u>7,852</u>	<u>7,550</u>

**Acquisitions in 2009****AquaFon and Ostelecom**

In March 2009, the Company completed the acquisition of a 100% ownership interest in Debton Investment Limited (“Debton”) for approximately 932 cash consideration. As of the acquisition date, Debton owned 51% of CJSC AquaFon GSM (“AquaFon”), a wireless operator in Abkhazia, which owns GSM 900/1800 and UMTS licenses, frequencies and numbering capacity, and 51% of CJSC Ostelecom (“Ostelecom”), a company holding a wireless license and frequencies in South Ossetia. The Company has consolidated the financial position and the results of operations of Debton, including AquaFon and Ostelecom, from March 1, 2009.

MegaFon

Notes to Consolidated Financial Statements (continued)

**3. Business Combinations (continued)**

The primary reason for this acquisition was to facilitate the Company's entry into the wireless telephony market in Abkhazia and South Ossetia, where the Company did not previously have a license to conduct wireless services.

In December 2009, the Company through Debton acquired an additional 24% of the shares of Ostelecom for cash consideration of \$1 million (30 at the exchange rate as of the date of payment). The Company's overall indirect share stake in Ostelecom increased from 51% to 75%.

**4. Cash and Cash Equivalents**

Cash and cash equivalents as at December 31 are as follows:

	<u>2011</u>	<u>2010</u>	<u>2009</u>
Rubles	2,386	2,126	4,588
US dollars	406	228	3,180
Euros	95	313	4,782
<b>Total cash and cash equivalents</b>	<u><b>2,887</b></u>	<u><b>2,667</b></u>	<u><b>12,550</b></u>

**5. Short-Term Investments**

Short-term investments as at December 31 are as follows:

	<u>2011</u>	<u>2010</u>	<u>2009</u>
<b>Bank deposits denominated in</b>			
Rubles	26,641	32,280	21,851
US dollars	50,938	23,772	16,589
Euros	6,501	7,502	10,674
Norwegian kroner	429	—	—
<b>Total short-term investments</b>	<u><b>84,509</b></u>	<u><b>63,554</b></u>	<u><b>49,114</b></u>

**6. Accounts Receivable**

Accounts receivable as at December 31 are as follows:

	<u>2011</u>	<u>2010</u>	<u>2009</u>
Interconnection charges	4,848	2,160	1,871
Local subscribers	2,797	3,140	1,509
Dealers	2,153	1,396	819
Roaming charges receivable	298	393	390
Other receivables	898	799	322
Less: allowance for doubtful accounts	(1,447)	(1,029)	(861)
<b>Total accounts receivable</b>	<u><b>9,547</b></u>	<u><b>6,859</b></u>	<u><b>4,050</b></u>

The following summarizes the changes in the allowance for doubtful accounts for the years ended December 31:

	<u>2011</u>	<u>2010</u>	<u>2009</u>
Balance at the beginning of the year	1,029	861	511
Bad debt expense	1,437	1,182	1,122
Accounts receivable written off	(1,019)	(1,014)	(772)
<b>Allowance for doubtful accounts at the end of the year</b>	<u><b>1,447</b></u>	<u><b>1,029</b></u>	<u><b>861</b></u>



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Notes to Consolidated Financial Statements (continued)

**7. Inventory**

Inventory as at December 31 is as follows:

	<u>2011</u>	<u>2010</u>	<u>2009</u>
Handsets and accessories	2,220	1,380	260
USB modems	1,052	728	283
Information materials	406	298	186
SIM-cards	206	201	220
Other	667	474	270
<b>Total inventory</b>	<u><u>4,551</u></u>	<u><u>3,081</u></u>	<u><u>1,219</u></u>

**8. Prepaid Expenses and Other Current Assets**

Prepaid expenses and other current assets as at December 31 are as follows:

	<u>2011</u>	<u>2010</u>	<u>2009</u>
Prepayments for services	3,038	3,545	2,989
Interest receivable	3,006	987	1,195
VAT from advances paid for long-lived assets	698	423	473
Deferred expenses	415	459	356
Prepayments for inventory	300	1,104	751
Assets held for sale	154	—	—
Prepaid taxes, other than income	148	101	811
Derivatives ( <i>Note 15</i> )	—	196	412
Other	228	299	148
<b>Total prepaid expenses and other current assets</b>	<u><u>7,987</u></u>	<u><u>7,114</u></u>	<u><u>7,135</u></u>

**9. Long-Term Bank Deposits**

Long-term bank deposits as at December 31 are as follows:

	<u>2011</u>	<u>2010</u>	<u>2009</u>
Rubles	2,002	—	—
US dollars	—	305	—
<b>Total long-term bank deposits</b>	<u><u>2,002</u></u>	<u><u>305</u></u>	<u><u>—</u></u>

**10. Property, Plant and Equipment**

Property, plant and equipment as at December 31 is as follows:

	<u>2011</u>	<u>2010</u>	<u>2009</u>
Cost:			
Buildings, structures and leasehold improvements	52,931	44,029	33,746
Telecommunications network	272,352	231,559	176,318
Vehicles, office and other equipment	20,229	17,828	14,126
	<u>345,512</u>	293,416	224,190
Accumulated depreciation	(164,765)	(130,876)	(99,993)
Construction in-progress	42,971	32,332	23,034
<b>Property, plant and equipment, net</b>	<u><u>223,718</u></u>	<u><u>194,872</u></u>	<u><u>147,231</u></u>

Included in construction in-progress are advances to suppliers of network equipment of 5,338, 4,507 and 4,174 as at December 31, 2011, 2010 and 2009, respectively.

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Notes to Consolidated Financial Statements (continued)

**10. Property, Plant and Equipment (continued)**

Software and licenses for base stations and billing systems are included in the balances of telecommunications network assets. The net book value of such software was 7,324, 5,991 and 5,119 as at December 31, 2011, 2010 and 2009, respectively.

Interest capitalized was 1,224 (out of the total interest expense of 1,930), 799 (out of the total interest expense of 1,636) and 843 (out of the total interest expense of 2,500) for the years ended December 31, 2011, 2010 and 2009, respectively.

*Asset Retirement Obligations*

The following table describes the changes to the asset retirement obligations liability:

	<u>2011</u>	<u>2010</u>	<u>2009</u>
Asset retirement obligations at the beginning of the year:	<b>4,304</b>	3,303	2,349
Revision in estimated cash flows	—	47	404
Net increase in liability during the year	<b>453</b>	542	227
Accretion expense	<b>491</b>	412	323
<b>Asset retirement obligations at the end of the year</b>	<b><u>5,248</u></b>	<u>4,304</u>	<u>3,303</u>

The accretion expense was included in depreciation in the consolidated statements of comprehensive income.

**11. Goodwill and Intangible Assets**

The changes in the carrying value of goodwill for the years ended December 31, 2011, 2010 and 2009 are as follows:

	<u>2011</u>	<u>2010</u>	<u>2009</u>
Balance at the beginning of the year:	<b>7,041</b>	498	363
Acquisitions ( <i>Note 3</i> )	<b>9,050</b>	6,543	135
Measurement period adjustments ( <i>Note 3</i> )	<b>(698)</b>	—	—
<b>Balance at the end of the year</b>	<b><u>15,393</u></b>	<u>7,041</u>	<u>498</u>

Intangible assets as at December 31 are as follows:

	Average useful lives, years	Cost			Accumulated amortization		
		<u>2011</u>	<u>2010</u>	<u>2009</u>	<u>2011</u>	<u>2010</u>	<u>2009</u>
Operating licenses	10	<b>19,478</b>	19,483	19,470	<b>(14,959)</b>	(13,773)	(12,319)
Frequencies	6	<b>5,484</b>	4,773	3,861	<b>(1,500)</b>	(1,276)	(926)
Software	5	<b>7,254</b>	4,486	3,078	<b>(3,639)</b>	(2,103)	(1,329)
Marketing related intangible assets	3	<b>3,535</b>	3,535	3,317	<b>(668)</b>	(218)	(16)
Customer base	8	<b>2,907</b>	2,057	727	<b>(726)</b>	(560)	(283)
Numbering capacity	10	<b>1,798</b>	1,882	1,685	<b>(1,603)</b>	(1,550)	(1,417)
Trademarks	4	<b>671</b>	295	67	<b>(116)</b>	(26)	(5)
Other intangible assets	5	<b>3,362</b>	3,372	1,765	<b>(1,606)</b>	(1,132)	(806)
<b>Total intangible assets</b>		<b><u>44,489</u></b>	<u>39,883</u>	<u>33,970</u>	<b><u>(24,817)</u></b>	<u>(20,638)</u>	<u>(17,101)</u>

Amortization expense for the succeeding five years is expected to be as follows:

2012 – 3,850; 2013 – 3,431; 2014 – 2,908; 2015 – 1,254 and 2016 – 1,073.

**11. Goodwill and Intangible Assets (continued)***Operating licenses*

Operating licenses, primarily consisting of a single nationwide 3G license and several GSM 900/1800 standard licenses are integral to the wireless operations of the Company and any inability to extend existing licenses on the same or comparable terms could materially affect the Company's business. While operating licenses are issued for a fixed period, renewals of these licenses previously had occurred routinely and at nominal cost. The Company determines that there are currently no legal, regulatory, contractual, competitive, economic or other factors that could result in delays in license renewal, or even an outright refusal to renew. The weighted-average period until the next renewal date is approximately 2 years.

In July 2011, the Company reassessed the expected residual amortization period for its GSM 900/1800 standard wireless licenses from 2½ years to 10 years and changed the amortization method of these licenses from straight-line to sum-of-the-years'-digits basis. Such method of amortization reflects the pattern in which the economic benefits of these operating licenses are consumed or otherwise used up and assumes a gradual decrease in the number of GSM 900/1800 standard subscribers during the following 10 years.

These modifications are recorded as a change in accounting estimate and applied prospectively beginning July 1, 2011. The revision resulted in a decrease in amortization expense in the amount of 256 and a corresponding increase in net income of 205 for the year ended December 31, 2011.

The terms of the 3G license require the Company to meet certain conditions, including capital commitments and coverage requirements and is amortized on a straight-line basis over the same period as the GSM 900/1800 standard wireless licenses (*see Note 24*).

*Marketing Related Intangible Assets*

In April 2009, the Company and OJSC Rostelecom ("Rostelecom") entered into an agreement with the Organizational Committee of the 2014 XXII Olympic Winter Games and XI Paralympic Winter Games in Sochi to acquire rights and licenses to use the Olympic mascot, logos and other Olympic symbols and, in the case of the Company, to be referred to as "the General Mobile Partner of the 2014 XXII Olympic Winter Games". Under the agreement the Company committed to a payment of \$65 million (2,093 at the exchange rate as of December 31, 2011) in cash to be made in several installments from 2009 through 2014.

In addition, the Company and Rostelecom are jointly responsible to provide equal amounts of services in-kind of up to a combined total of \$130 million (4,185 at the exchange rate as of December 31, 2011) from 2009 through 2014. The management of the Company believes that the risk of non-performance by Rostelecom of its responsibilities under the agreement is remote.

The Company obtained the rights and licenses in 2009, at which time the Company assumed a liability with a net present value of future cash installments of 1,334 and deferred revenue with a fair value of 1,516 (Level 3).

The recognition of the intangible asset is treated as a non-cash item to the extent of the amount of the liability and deferred revenue recorded. The intangible asset is amortized using the reverse sum-of-the-years'-digits method over a period of approximately 5 years.

The fair value of deferred revenue recognized by the Company was estimated using the Discounted Cash Flow ("DCF") analysis (Level 3). The basis for the Company's cash flow assumptions included forecasted amounts and timing of services to be provided under the agreement. The Company used 7% as a discount rate.

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Notes to Consolidated Financial Statements (continued)

**11. Goodwill and Intangible Assets (continued)**

The following table presents a reconciliation of the beginning and ending balances of liabilities for marketing related assets:

	<u>Liability for marketing related assets</u>	<u>Deferred revenue</u>
Balance at January 1, 2011	1,275	1,542
Accrued interest	91	—
Payments	(385)	—
Revenue recognized in earnings	—	(170)
Foreign currency exchange adjustment	42	—
Balance at December 31, 2011	1,023	1,372
Less current portion	(402)	(288)
<b>Non-current portion</b>	<b><u>621</u></b>	<b><u>1,084</u></b>
Balance at January 1, 2010	1,341	1,524
Additions	114	89
Accrued interest	83	—
Payments	(329)	—
Revenue recognized in earnings	—	(71)
Foreign currency exchange adjustment	66	—
Balance at December 31, 2010	1,275	1,542
Less current portion	(382)	(128)
<b>Non-current portion</b>	<b><u>893</u></b>	<b><u>1,414</u></b>
Balance at January 1, 2009	—	—
Additions	1,690	1,542
Accrued interest	27	—
Payments	(407)	—
Revenue recognized in earnings	—	(18)
Foreign currency exchange adjustment	31	—
Balance at December 31, 2009	1,341	1,524
Less current portion	(287)	(76)
<b>Non-current portion</b>	<b><u>1,054</u></b>	<b><u>1,448</u></b>

**12. Accounts Payable**

Accounts payable as at December 31 are as follows:

	<u>2011</u>	<u>2010</u>	<u>2009</u>
Interconnection charges	<b>2,329</b>	1,668	1,229
Dealers	<b>2,258</b>	1,134	996
Content providers	<b>900</b>	514	463
Channels rental	<b>686</b>	542	331
Rent and utilities	<b>726</b>	566	417
Advertising	<b>584</b>	317	288
Network repairs and maintenance	<b>484</b>	221	137
Payables for inventory	<b>471</b>	426	104
Roaming charges payable	<b>363</b>	446	142
Other payables	<b>820</b>	687	423
<b>Total accounts payable</b>	<b><u>9,621</u></b>	<b><u>6,521</u></b>	<b><u>4,530</u></b>

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## Notes to Consolidated Financial Statements (continued)

**13. Long-Term Debt**

Long-term debt as at December 31 is as follows:

	<u>Classification</u>	<u>Currency</u>	<u>Nominal Annual Effective Interest Rate</u>	<u>Maturity</u>	<u>2011</u>	<u>2010</u>	<u>2009</u>
(1) China Development Bank and Bayerische Landesbank	Equipment finance	US dollar	LIBOR plus 1.1% to 2.7%	2012 – 2016	<b>25,042</b>	10,017	4,732
(2) BNP Paribas London branch and Nordea Bank Finland	Equipment finance	US dollar	2.91% to 4.54%	2012 – 2016	<b>9,239</b>	8,034	6,472
(3) Bayerische Landesbank, Bayerische Landesbank Filiale Di Milano, Commerzbank Aktiengesellschaft	Equipment finance	Euro	3.74% and EURIBOR plus 0.35%	2012 – 2015	<b>3,490</b>	4,655	6,383
(4) Nordea Bank Moscow	Bank loan	US dollar	LIBOR plus 2.0%	2015	<b>1,610</b>	1,524	—
(5) Cisco Systems Finance International	Equipment finance	US dollar	3.50% to 4.11%	2012 – 2016	<b>1,219</b>	—	—
(6) Fortis Bank, Nordea Bank Finland and Skandinaviska Enskilda Banken	Equipment finance	US dollar	1.92%	2013 – 2018	<b>1,078</b>	—	—
(7) UniCredit Bank Moscow	Bank loan	US dollar	LIBOR plus 3.5%	2012 – 2013	<b>805</b>	4,762	—
(8) Nordic Investment Bank, Nordea Bank Finland and Bayerische Landesbank	Revolving credit facility	US dollar	LIBOR plus 0.85% to 2.2%	2012	<b>358</b>	1,016	1,680
(9) Japan Bank for International Cooperation	Equipment finance	US dollar	6.87% and LIBOR plus 0.45%	2012	<b>161</b>	457	756
(10) Citibank N.A. London branch and ING Bank N.V. loans	Equipment finance	Euro	4.27%	Repaid in 2011	—	1,824	4,896
(11) Sberbank	Bank loan	Rubles	7.5%	Repaid in 2010	—	—	127
(12) Citibank International Plc., ING BHF-Bank Aktiengesellschaft, and ING Bank N.V. loans	Equipment finance	Euro	4%	Repaid in 2010	—	—	701
Other loans					<b>707</b>	632	1,399
Total long-term debt					<b>43,709</b>	32,921	27,146
Less current portion					<b>(7,415)</b>	(12,171)	(7,811)
<b>Non-current portion</b>					<b>36,294</b>	20,750	19,335



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Notes to Consolidated Financial Statements (continued)

**13. Long-Term Debt (continued)**

See also *Note 26 'Subsequent Events'* regarding the Company's recapitalization transactions in April 2012.

As at December 31, 2011, the Company has an amount due to certain equipment suppliers of 1,480 at the exchange rate as of December 31, 2011. The Company intends to pay this amount using the proceeds from certain debt facilities available to the Company (*Items (1) and (2) above*). In the accompanying consolidated balance sheet as at December 31, 2011 the Company has classified the amount due to these equipment suppliers as short-term and long-term debt according to the applicable repayment schedules.

The following is the summary of aggregate maturities of long-term debt at December 31, 2011:

2012	7,415
2013	8,112
2014	7,685
2015	11,742
2016	8,133
Thereafter	622
<b>Total</b>	<b><u>43,709</u></b>

At December 31, 2011, the Company's debt is denominated in the following currencies:

	<u>Borrowing currency</u>	<u>Millions of Rubles</u>
Rubles	667	667
US dollars (in millions)	1,204	38,768
Euros (in millions)	103	4,274
<b>Total long-term debt</b>		<b><u>43,709</u></b>

*Covenant Requirements*

Certain of the debt facilities referred to above (*Items (1), (2), (3), (4), (5), (6), (8), (9) and (10) above*) place various restrictions on the Company with regards to taking on debt, negative pledges, mergers and acquisitions, and material changes in the business without prior consent from the lenders. These debt facilities also require the Company to meet various financial and non-financial covenants, including several restrictions relating to financial condition.

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## Notes to Consolidated Financial Statements (continued)

**13. Long-Term Debt (continued)**

As at December 31, 2011, the Company's total undrawn credit facilities related to the following agreements:

	<u>Classification</u>	<u>Currency</u>	<u>Nominal Annual Effective Rate</u>	<u>Commitment fee rates</u>	<u>Availability period</u>	<u>Available amount</u>
China Development Bank	Equipment finance	US dollar	LIBOR plus 2.4%	0.30%	2012 – 2014	<b>33,204</b>
Gazprombank	Revolving credit facility	Ruble	Either fixed (6% to 9%) or floating (MosPrime3M plus 1.5% to MosPrime3M plus 2.5%)	0.15%	2012 – 2016	<b>15,000</b>
UniCredit Bank Moscow	Bank loan	Ruble	Depends on the tenor of the loan selected on each drawdown and market conditions and can either be fixed or floating	No fees	2012 – 2015	<b>11,000</b>
Nordea Bank	Bank loan	Ruble	Either fixed (5.1% to 9.1%) or floating (MosPrime3M plus 1.75% to MosPrime3M plus 2%)	0.40%	2012 – 2016	<b>5,500</b>
Fortis Bank, Nordea Bank Finland and Skandinaviska Enskilda Banken	Equipment finance	US dollar	1.92%	0.18%	2012 – 2013	<b>3,422</b>
Cisco Systems Finance International	Equipment finance	US dollar	4.11%	No fees	2012	<b>338</b>
<b>Total</b>						<b><u>68,464</u></b>

**14. Liability for deferred and contingent consideration**

The following table presents movements in liability for deferred and contingent consideration (Level 3):

	<u>Synterra</u>	<u>NetByNet</u>	<u>Web Plus</u>	<u>Total</u>
Balance at January 1, 2011	3,181	—	—	<b>3,181</b>
Acquisitions ( <i>Note 3</i> )	—	1,429	7	<b>1,436</b>
Accrued interest	133	—	—	<b>133</b>
Payments	(491)	—	—	<b>(491)</b>
Adjustment to contingent consideration (included in earnings)	(62)	9	—	<b>(53)</b>
Measurement period adjustments	—	(205)	—	<b>(205)</b>
Foreign currency exchange adjustment	178	199	1	<b>378</b>
Balance at December 31, 2011	2,939	1,432	8	<b>4,379</b>
Less current portion	(1,110)	(1,432)	(8)	<b>(2,550)</b>
<b>Non-current portion</b>	<b><u>1,829</u></b>	<b><u>—</u></b>	<b><u>—</u></b>	<b><u>1,829</u></b>
Balance at January 1, 2010	—	—	—	<b>—</b>
Acquisitions ( <i>Note 3</i> )	3,166	—	—	<b>3,166</b>
Accrued interest	76	—	—	<b>76</b>
Foreign currency exchange adjustment	(61)	—	—	<b>(61)</b>
Balance at December 31, 2010	3,181	—	—	<b>3,181</b>
Less current portion	(1,450)	—	—	<b>(1,450)</b>
<b>Non-current portion</b>	<b><u>1,731</u></b>	<b><u>—</u></b>	<b><u>—</u></b>	<b><u>1,731</u></b>

**15. Derivative Financial Instruments and Fair Value Measurement**

In the normal course of business, the Company is exposed to certain risks related to fluctuations in interest rates and foreign currency exchange rates. The Company uses derivative contracts, primarily interest rate swaps and foreign currency swaps, to manage those risks.

*Foreign currency derivatives*

In 2010, the Company entered into a number of dual-currency deposits with various banks. The dual-currency deposits are financial instruments which combine features of a time deposit and a sold foreign currency put option. The dual-currency deposits are settled either in the original deposit currency (Euro or US Dollar) or in another pre-agreed currency (Ruble, US Dollar or Euro). The purpose of entering into these financial instruments was yield enhancement on the Company's foreign currency cash investments.

The respective embedded derivative financial instrument, which is the put option, is bifurcated and measured at fair value using the Black-Scholes model (Level 2). For accounting purposes, the Company reports all gains and losses from the change in fair value of these derivative financial instruments directly in the consolidated statements of comprehensive income.

In the third quarter of 2006 and the second quarter of 2007, the Company entered into several long-term fixed-to-fixed rate cross-currency swaps. These derivative financial instruments were used to limit exposure to changes in foreign currency exchange rates on certain long-term debt denominated in foreign currencies.

The swaps effectively converted, using the then-effective foreign currency exchange rates, some of the Company's outstanding fixed-to-fixed rate long-term US dollar and Euro denominated loans into synthetically equivalent Ruble long-term loans with fixed rates ranging from 3.95% to 6.65%. The carrying amount of such long-term loans was 972 as at December 31, 2010. These long-term loans were repaid in 2011. For accounting purposes, the Company has chosen not to designate these derivatives as hedging instruments and, therefore has reported all gains and losses from the change in fair value (Level 2) of these derivative financial instruments directly in the consolidated statements of comprehensive income.

Gains/(losses) on derivatives for the years ended December 31 are as follows:

	<u>2011</u>	<u>2010</u>	<u>2009</u>
Put options sold	—	65	655
Foreign currency swaps	<u>(51)</u>	<u>(268)</u>	<u>(955)</u>
<b>Total loss on derivatives, net</b>	<u><u>(51)</u></u>	<u><u>(203)</u></u>	<u><u>(300)</u></u>

The derivatives are valued using standard valuation techniques. The principal technique used to value these instruments is through comparing the foreign currency exchange rates at the time that the derivatives were acquired to the forward exchange rates quoted in the existing market which is inactive as of the valuation date. The key inputs include interest rate yield curves, foreign exchange spot and forward rates. The fair value of these derivatives includes the effects of the counterparty's non-performance risk, including credit risk.

Fair values of these derivative financial instruments in the consolidated balance sheets as at December 31 are presented below:

<u>Derivative instruments</u>	<u>Balance sheet classification</u>	<u>2011</u>	<u>2010</u>	<u>2009</u>
Put options sold	Other current assets	—	—	6
Foreign currency swaps	Other current assets	—	<b>196</b>	406
	Other non-current assets	—	—	328
<b>Total derivatives</b>		<u><u>—</u></u>	<u><u>196</u></u>	<u><u>740</u></u>

**15. Derivative Financial Instruments and Fair Value Measurement (continued)**

The derivatives have been fully settled in 2011.

*Interest rate swaps*

The Company's objective in using interest rate derivatives is to add certainty and stability to its interest expense and to manage its exposure to interest rate movements. To accomplish this objective, the Company primarily uses interest rate swaps as part of its interest rate risk management strategy. Interest rate swaps involve the receipt of variable-rate amounts from a counterparty in exchange for the Company making fixed-rate payments over the life of the agreements without the exchange of the underlying principal amount of long-term debt.

In 2011, the Company entered into a number of interest rate swap agreements with total notional amount of 56.5 million Euros (2,354 at the exchange rate as of December 31, 2011) and \$245.5 million (7,904 at the exchange rate as of December 31, 2011), of which all, but \$45.5 million (1,465 at the exchange rate as of December 31, 2011), were designated as cash flow hedges of interest rate risk.

Interest rate swaps are recorded on the balance sheet at fair value (Level 2). The effective portion of changes in the fair value of derivatives designated and qualifying as cash flow hedges is recorded in other comprehensive income/(loss) and is subsequently reclassified into earnings in the period that the hedged forecast transaction affects earnings. The ineffective portion of the change in fair value of the derivatives is recognized directly in earnings. For derivative instruments that are not designated as hedges or do not qualify as hedged transactions, the changes in the fair value are reported in the consolidated statement of comprehensive income.

As at December 31, 2011 the fair value of the Company's interest rate swaps was immaterial. The fair value of the swaps is based on a forward yield curve and represents the estimated amount the Company would receive or pay to terminate these agreements at the reporting date, taking into account current interest rates, creditworthiness, nonperformance risk, and liquidity risks associated with current market conditions.

*Fair value measurements*

The carrying value of financial instruments, including cash, cash equivalents, accounts receivable and accounts payable approximates the fair value of these items due to the short-term nature of these amounts.

As of December 31, 2011, 2010 and 2009, the fair value of fixed and variable rate long-term loans (based on future cash flows discounted at current market rates) was as follows at December 31:

	2011		2010		2009	
	Carrying amount	Fair value	Carrying amount	Fair value	Carrying amount	Fair value
Long-term debt	<u>43,709</u>	<u>44,102</u>	<u>32,921</u>	<u>33,235</u>	<u>27,146</u>	<u>26,240</u>

The Company, using available market information and appropriate valuation methodologies, where they exist, has determined the estimated fair values of financial instruments. However, judgment is necessarily required to interpret market data to determine the estimated fair value.

Accordingly, the estimates presented herein are not necessarily indicative of the amounts the Company could realize in a current market exchange. While management has used available market information in estimating the fair value of financial instruments, the market information may not be fully reflective of the value that could be realized in the current circumstances.

The Company, in connection with its current activities, is exposed to various financial risks, such as foreign currency risks, interest rate risks and credit risks. The Company manages these risks and monitors their exposure on a regular basis.

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Notes to Consolidated Financial Statements (continued)

**16. Long-Term Incentive Program**

In April 2008, the Company's Board of Directors approved a long-term motivation and retention program. The program provides that certain key executive and senior level employees will be eligible for awards of phantom share options. The phantom share options have been awarded under the 2008 Grant, the 2009 Grant and the 2010 Grant. Under all grants, the value ascribed to the full package of phantom share options for which options may be awarded is 1.1% of the value of the Company, which in turn is calculated as six times operating income before depreciation and amortization (OIBDA) reduced by debt, net of cash and cash equivalents and short-term investments (net debt). The awarded phantom share options vest every two years over a four-year period and are contingent upon the recipient's continuing employment with the Company and increase in the value of the Company. The in-the-money phantom share options are settled in cash upon vesting.

The following table summarizes information as at December 31, 2011 regarding outstanding phantom share options exercisable upon maturity:

	Number of phantom share options granted (in millions)	Total unrecognized compensation cost	Compensation expense, inclusive of all related taxes for the year ended December 31,		
			2011	2010	2009
2008 Grant	4,068	74	<b>308</b>	344	719
2009 Grant	4,530	181	<b>155</b>	524	15
2010 Grant	4,349	396	<b>500</b>	43	—
<b>Total</b>	<u>12,947</u>	<u>651</u>	<u><b>963</b></u>	<u>911</u>	<u>734</u>

The total amounts of obligation included in accrued compensation liability of the accompanying consolidated financial statements as at December 31, 2011, 2010 and 2009 were 1,604, 1,026 and 546, respectively.

In April 2012, 4,532 million phantom share options have been awarded under the 2011 Grant.

**17. Taxes Payable**

Taxes payable as at December 31 are as follows:

	2011	2010	2009
Property tax	<b>814</b>	680	835
Unified Service Fund	<b>617</b>	558	489
Income tax	<b>372</b>	29	449
Social charges	<b>1,035</b>	314	336
Personal income tax	<b>132</b>	100	55
Other	<b>86</b>	23	10
<b>Total taxes payable</b>	<u><b>3,056</b></u>	<u>1,704</u>	<u>2,174</u>

**18. Income Taxes**

The following presents the significant components of the Company's provision for income taxes for the years ended December 31:

	2011	2010	2009
Current income taxes	<b>11,470</b>	8,722	10,555
Deferred income tax expense	<b>850</b>	3,240	10
<b>Total provision for income taxes</b>	<u><b>12,320</b></u>	<u>11,962</u>	<u>10,565</u>

Income taxes represent the Company's provision for profit tax. Profit tax is calculated at 20% of taxable profit for the years ended December 31, 2011, 2010 and 2009, respectively.



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Notes to Consolidated Financial Statements (continued)

**18. Income Taxes (continued)**

The reconciliation between the provision for income taxes reported in the consolidated financial statements versus the provision for income taxes computed by applying the Russian enacted statutory tax rate to income before income taxes and noncontrolling interests is as follows:

	<u>2011</u>	<u>2010</u>	<u>2009</u>
Income before income taxes and noncontrolling interests	<b>55,905</b>	61,186	55,865
Statutory income tax rate	<b>20%</b>	20%	20%
Theoretical provision for income taxes	<b>11,181</b>	12,237	11,173
Non-deductible expenses	<b>691</b>	579	596
Effect of income tax preferences (Recognized)/unrecognized tax benefits	<b>(565)</b>	(220)	(628)
Net change in valuation allowance	<b>437</b>	(530)	(340)
Effect of intragroup capital gains/(losses)	<b>293</b>	462	—
Other differences	<b>115</b>	(578)	—
	<b>168</b>	12	(236)
<b>Provision for income taxes reported in the consolidated financial statements</b>	<b><u>12,320</u></b>	<u>11,962</u>	<u>10,565</u>

The effect of income tax preferences, in the table above, represents the impact of lower income tax rates for the Company under applicable regional laws of the Russian Federation. These laws provide that income tax exemptions up to 6.5% are granted to entities which make capital investments, agreed with regional administrations, within the respective region and participate in various social projects. These exemptions are granted on an annual basis.

The effect of capital gains and losses, in the table above, represents the tax consequences of intragroup transactions with shares of subsidiaries.

As at December 31, 2011, the tax years from 2007 to 2011 remained subject to examination by the tax authorities.

The amounts reported in the accompanying consolidated financial statements at December 31 consisted of the following:

	<u>2011</u>	<u>2010</u>	<u>2009</u>
Deferred tax assets:			
Revenue recognition	<b>802</b>	726	426
Loss carry-forwards	<b>1,473</b>	1,164	135
Accrued compensation and social contributions	<b>1,135</b>	579	608
Accrued expenses	<b>697</b>	883	499
Other assets	<b>260</b>	263	169
Less: valuation allowance	<b>(755)</b>	(462)	—
<b>Total deferred tax assets</b>	<b><u>3,612</u></b>	<u>3,153</u>	<u>1,837</u>
Deferred tax liabilities:			
Intangible assets	<b>1,337</b>	1,645	1,453
Property, plant and equipment	<b>9,640</b>	7,707	1,074
Derivative financial instruments	<b>22</b>	37	148
Other liabilities	<b>472</b>	348	250
<b>Total deferred tax liabilities</b>	<b><u>11,471</u></b>	<u>9,737</u>	<u>2,925</u>
Net deferred tax liabilities	<b>7,859</b>	6,584	1,088
Add non-current deferred tax assets	<b>712</b>	506	210
Add current deferred tax assets	<b>1,972</b>	1,166	772
<b>Total long-term deferred tax liabilities</b>	<b><u>10,543</u></b>	<u>8,256</u>	<u>2,070</u>

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Notes to Consolidated Financial Statements (continued)

**18. Income Taxes (continued)**

For income tax purposes of the Russian Federation and Tajikistan, certain of the Company's subsidiaries have loss carry-forwards incurred from 2002 through 2011, which may be carried forward to offset future taxable income for ten and three years, respectively. The use of these carry-forwards is not restricted in 2011 or in future years. As at December 31, 2011, these subsidiaries had carry-forwards available aggregating approximately 7,078 with a related tax benefit of 1,473 of which 105 expires in 2013, 188 in 2014, 73 in 2019, 767 in 2020, 298 in 2021 and 42 in 2025.

As of December 31, 2011, 2010 and 2009, the Company recognized and recorded in prepaid income taxes an income tax benefit of 3,963, 2,323 and nil, respectively, related to acceleration of depreciation of property, plant and equipment for tax purposes. The recognition of the income tax benefit decreased the tax basis of property, plant and equipment with corresponding increase in the related non-current deferred tax liability. In spite of the current litigation with the tax authorities, the Company believes that this tax position meets the more-likely-than-not recognition criterion.

A reconciliation of the beginning and ending amount of unrecognized tax benefits is as follows:

	<u>2011</u>	<u>2010</u>	<u>2009</u>
Balance at beginning of year	15	—	—
Additions based on tax positions related to current year	21	—	—
Additions based on tax positions related to prior years	518	5	—
Additions based on tax of acquired entities	150	10	—
Reduction in tax positions related to prior years	(435)	—	—
<b>Balance at end of year</b>	<u>269</u>	<u>15</u>	<u>—</u>

As of December 31, 2011, 2010 and 2009, the Company included accruals for uncertain tax positions in the amount of 269, 15 and nil, respectively, as a reduction of prepaid income taxes.

No penalties or interest have been accrued in relation to unrecognized tax benefits as the Company has prepaid income tax in excess of the provisions for unrecognized tax benefits.

**19. Revenues**

Revenues for the years ended December 31 are as follows:

	<u>2011</u>	<u>2010</u>	<u>2009</u>
Wireless revenues	218,994	202,837	178,824
Wireline revenues	15,194	7,496	674
Sales of handsets and equipment	8,420	5,182	2,385
<b>Total revenues</b>	<u>242,608</u>	<u>215,515</u>	<u>181,883</u>

**20. Cost of Revenues**

Costs of revenues for the years ended December 31 are as follows:

	<u>2011</u>	<u>2010</u>	<u>2009</u>
Cost of services	47,644	41,648	33,128
Cost of handsets and accessories sold	11,252	6,775	4,076
<b>Total cost of revenues</b>	<u>58,896</u>	<u>48,423</u>	<u>37,204</u>

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Notes to Consolidated Financial Statements (continued)

**21. Sales and Marketing Expenses**

Sales and marketing expenses for the years ended December 31 are as follows:

	<u>2011</u>	<u>2010</u>	<u>2009</u>
Advertising	7,432	6,924	6,200
Commissions to dealers for connection of new subscribers	9,061	8,465	7,763
Commissions to dealers for cash collection from subscribers	5,348	4,082	3,398
<b>Total sales and marketing expenses</b>	<b><u>21,841</u></b>	<b><u>19,471</u></b>	<b><u>17,361</u></b>

**22. Operating Expenses**

Operating expenses for the years ended December 31 are as follows:

	<u>2011</u>	<u>2010</u>	<u>2009</u>
Salaries and social charges	23,604	19,061	13,514
Rent and utilities	14,040	11,231	8,919
Operating taxes	5,829	5,177	4,388
Network repairs and maintenance	5,162	4,322	3,502
Radio frequency fees	3,527	2,963	2,651
Office maintenance	1,743	1,407	1,324
Bad debt expense	1,437	1,182	1,122
Professional services	1,967	1,361	697
Vehicle costs	650	555	544
Materials and supplies	321	189	234
Insurance	113	111	152
Other expenses	2,656	2,288	2,079
<b>Total operating expenses</b>	<b><u>61,049</u></b>	<b><u>49,847</u></b>	<b><u>39,126</u></b>

Rent represents expenses relating to the operating lease of premises for offices, base stations and switches.

**23. Related Party Transactions**

The Company has entered into certain transactions with its shareholders and their affiliates. The outstanding receivable and payable balances and the annual revenues and costs are as follows:

	<u>As at December 31,</u>		
	<u>2011</u>	<u>2010</u>	<u>2009</u>
<b>Accounts receivable, related parties</b>			
TeliaSonera	42	61	29
Alfa Group	38	17	2
AF Telecom Holding	24	17	4
<b>Total accounts receivable, related parties</b>	<b><u>104</u></b>	<b><u>95</u></b>	<b><u>35</u></b>

	<u>As at December 31,</u>		
	<u>2011</u>	<u>2010</u>	<u>2009</u>
<b>Accounts payable, related parties</b>			
TeliaSonera	92	118	167
Alfa Group	—	—	4
AF Telecom Holding	373	286	302
Other	—	—	29
<b>Total accounts payable, related parties</b>	<b><u>465</u></b>	<b><u>404</u></b>	<b><u>502</u></b>

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Notes to Consolidated Financial Statements (continued)

**23. Related Party Transactions (continued)**

	<u>For the years ended December 31,</u>		
	<u>2011</u>	<u>2010</u>	<u>2009</u>
<b>Revenues</b>			
TeliaSonera	235	290	295
Alfa Group	—	3	—
AF Telecom	<u>1</u>	<u>64</u>	<u>4</u>
<b>Total revenues, related parties</b>	<u><b>236</b></u>	<u><b>357</b></u>	<u><b>299</b></u>
<b>Cost of revenues</b>			
TeliaSonera	954	1,191	863
AF Telecom	<u>428</u>	<u>29</u>	<u>—</u>
<b>Total cost of revenues, related parties</b>	<u><b>1,382</b></u>	<u><b>1,220</b></u>	<u><b>863</b></u>
<b>Operating expenses</b>			
TeliaSonera	1	15	—
Alfa Group	155	71	25
AF Telecom	<u>1,158</u>	<u>994</u>	<u>827</u>
<b>Total operating expenses, related parties</b>	<u><b>1,314</b></u>	<u><b>1,080</b></u>	<u><b>852</b></u>

The outstanding balances and transactions with TeliaSonera relate to operations with a shareholder of the Company, TeliaSonera, its consolidated subsidiaries, its direct owners and their consolidated subsidiaries. The Company has roaming settlements with Turkcell Iletisim, Azercell Telekom B.M, Latvijas Mobilais SIA, Somoncom JV, Indigo Tajikistan, GSM Kazakhstan LLP, Elion Ettevotted Aktsiaselts, Omnitel Telecommunications Network, Omnitel Lithuania, AS EMT, NetCom GSM, FE Coscom LLC, Geocell Ltd., Moldcell S.A., Xfera Moviles S.A., and wireline interconnection agreement with TeliaSonera International Carrier Russia.

The outstanding balances and transactions with Alfa Group relate to operations with a shareholder of the Company, Allaction Limited, its consolidated subsidiaries, its direct owners and their consolidated subsidiaries. The Company has an agreement with Altimo for provision of legal and personnel services and also maintains bank deposit accounts with Alfa Bank. The amounts on deposit as at December 31, 2011, 2010 and 2009 were 7,239, 6,553 and 3,202, respectively.

The outstanding balances and transactions with AF Telecom relate to operations with a shareholder of the Company, AF Telecom Holding LLC (“AF Telecom”), its consolidated subsidiaries, its direct owners and their consolidated subsidiaries. MegaFon has an agreement with Telecominvest for provision of legal and personnel services. The Company purchased billing system and related support services from Peterservice in the amount of 2,013 during 2011, 1,759 during 2010 and 1,465 during 2009. Also, in 2011, MegaFon conducted operations with Centre Media Technology, a content and service provider and a subsidiary of Telecominvest.

In 2011 the Company acquired 100% of shares of Web Plus from Telecominvest for a total consideration of 54 (see Note 3).

**24. Commitments, Contingencies and Uncertainties**

*Leases*

The Company has various cancelable and non-cancelable operating lease agreements for land, equipment and office. Future minimum lease payments under non-cancelable operating leases with terms of one year or more, as at December 31, 2011, are as follows:

2012	93
2013	88
2014	74
2015	46
2016 and thereafter	<u>118</u>
<b>Total</b>	<u><b>419</b></u>

**24. Commitments, Contingencies and Uncertainties (continued)***Russian Environment and Current Economic Situation*

Russia continues economic reforms and development of its legal, tax and regulatory frameworks as required for a market economy. The future stability of the Russian economy is largely dependent upon these reforms and developments and the effectiveness of economic, financial and monetary measures undertaken by the Russian government.

The Russian economy is vulnerable to market downturns and economic slowdowns elsewhere in the world. In 2011 the Russian Government continued to take measures to support the economy in order to overcome the consequences of the global financial and liquidity crisis. Despite some indications of recovery there continues to be uncertainty regarding further economic growth, significant capital flight, access to capital and the cost of such capital, which could negatively affect the Company's future financial position, results of operations and business prospects.

While management believes it is taking appropriate measures to support the sustainability of the Company's business in the current circumstances, unexpected further deterioration in the areas described above could negatively affect the Company's results and financial position in a manner not currently determinable.

*Telecom licenses capital commitments*

In May 2007, MegaFon was awarded a license that expires on May 21, 2017, for the provision of 3G wireless communications services for the entire territory of the Russian Federation. The 3G license was granted subject to certain capital and other commitments. The three major conditions are that the Company build a specified number of base stations that support 3G standards, start commercial exploitation of the 3G technology in each region of the Russian Federation over the period from May 2008 through May 2010, and also build a certain number of base stations by the end of the third, fourth and fifth years from the date of granting of the license. As of February 29, 2012, the Company is in full compliance with these license conditions, including constructing the number of base stations required at this time.

*Taxation*

Russian tax, currency and customs legislation are subject to varying interpretations and changes, which can occur frequently. Management's interpretation of such legislation as applied to transactions and activities of the Company may be challenged by the relevant regional and federal authorities. Recent events within Russia suggest that the tax authorities are taking a more assertive position in their interpretation and enforcement of the legislation and assessments and as a result, it is possible that transactions and activities that have not been challenged in the past may now be challenged. Therefore, significant additional taxes, penalties and interest may be assessed. Fiscal periods remain open to review by the authorities in respect of taxes for the three calendar years preceding the current year. Under certain circumstances reviews may cover longer periods.

During the year ended December 31, 2011 tax audits have been completed for Synterra and a few of its subsidiaries for the years 2007-2009. As a result of these tax audits, the tax authorities claimed 312 of additional taxes mainly related to income tax. The Company paid the amount of additional taxes. However, the Company has started legal proceedings to recover 298 of above additional taxes and believes that it is more likely than not that the tax positions stated in the income tax returns will be sustained.

*Litigation*

The Company is not a party to any material litigation, although in the ordinary course of business, some of the Company's subsidiaries may be party to various legal and tax proceedings, and subject to claims, certain of which relate to the developing markets and evolving fiscal and regulatory environments in which they operate. In the opinion of management, the Company's and its subsidiaries' liability, if any, in all pending litigation, other legal proceedings or other matters, will not have a material effect on the financial condition, results of operations or liquidity of the Company.



**24. Commitments, Contingencies and Uncertainties (continued)***Apple Commitment*

In August 2008, the Company entered into a two-year fixed commitment with Apple Sales International (“Apple”), an Irish affiliate of Apple Computer Inc., to purchase a total of one million unlocked iPhone handsets over a two-year period for further resale in Russia. The Company fulfilled this requirement with respect to the fourth quarter of 2008, but due to the significantly reduced handset demand caused by the economic crisis in Russia, the Company experienced difficulty re-selling these iPhones. While the Company placed several orders for iPhone handsets thereafter, none of these orders fulfilled the minimum quarterly requirement for the applicable quarters.

The contract with Apple terminated in August 2010 and, since such date, Apple has not asserted any claim against the Company with respect to any alleged non-fulfillment of its obligation to purchase iPhone handsets, and the Company has no basis to believe that any such claim will be asserted.

**25. Segment Information**

The Company conducts its business activities in three operating segments, which are wireless, wireline and retail, of which only the wireless segment meets quantitative thresholds as a reportable segment.

Less than 1% of the Company’s revenues and results are generated by segments outside of Russia. No single customer represents 10% or more of the consolidated revenues.

**26. Subsequent Events**

The Company originally issued its 2011 and 2010 financial statements on February 29, 2012 through which subsequent events have been evaluated. The Company has further evaluated subsequent events up to May 14, 2012, the date these financial statements for the three years ended December 31, 2011 were available to be issued.

In April 2012, the Company’s shareholders agreed to a series of transactions to permit the payment of the Company’s first dividend and re-organize the shareholding structure. The principal impacts of these agreements on the Company’s financial position were as follows:

- the special dividend, paid on April 24, 2012, resulted in an aggregate distribution of 151,863 to the shareholders (or 24,494 Rubles per ordinary share);
- the Company re-purchased (through MegaFon Investments (Cyprus) Limited (“MIFC”), a wholly-owned subsidiary of the Company) from Allaction Limited, part of the Alfa Group of companies, 892,797 (or 14.4%) of the Company’s ordinary shares for \$2,164 million (69,672 at the exchange rate as of December 31, 2011) on April 24, 2012.

The transactions described above were financed from the Company’s existing cash and short-term investments, and additional borrowings of approximately \$4,227 million, net of repayments (136,108 at the exchange rate as of December 31, 2011).

As a result of the payment of the dividend and the re-purchase of 14.4% of its ordinary shares, and notwithstanding the additional new borrowings described below, the Company has substantially depleted its working capital, including available cash and short-term investments. As of May 14, 2012, the Company believes it will continue to be able to generate significant operating cash flows and have access to undrawn lines of credit of approximately 96,000 that can be used to cover capital and operating expenditures. Additionally, the Company can defer capital expenditures if necessary in order to meet short-term liquidity requirements. Accordingly, management believes that cash flows from operating and financing activities will be sufficient for the Company to meet its obligations as they become due.

As a result of the above transactions and increases in indebtedness, the Company has initiated a number of activities in anticipation of further re-capitalizing the Company’s financial position.

**26. Subsequent Events (continued)***Planned Debt Transactions*

In April 2012, the Company's Board of Directors approved the issuance of up to \$3 billion (96,588 at the exchange rate as of December 31, 2011) in medium term notes in the international bond markets, terms to be determined immediately prior to the time of actual issuance.

In addition, in February 2012, the Company filed for registration, and in March 2012, the Federal Service on Financial Markets of the Russian Federation registered the issuance of up to 30 billion Rubles bonds.

*Other capital raising options*

In April 2012, the Company's Board of Directors approved a number of capital raising options. While the Company believes that financing options will be available, the timing and ultimate completion of any financing will be dependent on a number of factors beyond its control. Accordingly, there is no guarantee that the Company will be able to obtain financing on favorable terms or otherwise.

*Short-term and long-term debt*

- (1) Eurobond Bridge Facility with Barclays Bank PLC, BNP Paribas and Citibank N.A., London branch ("Bridge Facility")

On April 17, 2012, the Company entered into a \$2 billion (64,392 at the exchange rate as of December 31, 2011) Bridge Facility with Barclays Bank PLC, BNP Paribas and Citibank N.A., London branch to facilitate the payment of dividends and repurchase of the Company's shares described above. The Bridge Facility carries interest at a rate of LIBOR plus 1.5% which is increased by 0.5% every three months. The Bridge Facility matures on April 17, 2013 but is subject to mandatory earlier repayment upon the completion of certain debt or capital raising transactions. The availability period of the Bridge Facility ended on May 14, 2012.

A payment of \$6 million (193 at the exchange rate as of December 31, 2011) as an arrangement fee was made for the Bridge Facility. The Company is required to make payments equal to 0.2% and 0.5% of the aggregate amount outstanding under the Bridge Facility as of the date which falls three and six months after the date of the agreement, respectively.

As of May 14, 2012, the date these consolidated financial statements were available to be issued, the Company drew \$1.5 billion (48,294 at the exchange rate as of December 31, 2011) under the Bridge Facility.

- (2) VTB Bank Credit Facility

On April 18, 2012, the Company entered into a revolving credit facility with VTB Bank ("VTB Credit Facility") for up to 30,000. The VTB Credit Facility carries varying interest rates depending on the loan tenor chosen by the Company.

As of May 14, 2012, the VTB Credit Facility was fully drawn for a one-year period subject to an interest rate of MosPrime3m plus 2.2% which is payable every three months.

- (3) Gazprombank Credit Facility

On April 18, 2012, the Company and Gazprombank modified the terms of the existing revolving credit facility agreement ("Gazprombank Credit Facility") by increasing the debt limit on the facility from 15,000 to 30,000. The Gazprombank Credit Facility is subject to fees of 0.15% per annum on the amount of the unutilized balance.

On April 18 2012, the Company drew the entire 30,000 at an interest rate of 9.05% per annum which is payable every three months. The interest rate can be changed by Gazprombank unilaterally in an event of revision of the refinancing rate by the Central Bank of Russia. The principal is due for repayment in September 2016. On April 25, 2012, the Company prepaid 23,700.

**26. Subsequent Events (continued)****(4) Sberbank Credit Facilities**

On April 19, 2012, the Company entered into two credit facility agreements with Sberbank, one for up to \$1 billion (32,196 at the exchange rate as of December 31, 2011) and the other for up to \$1.5 billion (48,294 at the exchange rate as of December 31, 2011) (together, the “Sberbank Credit Facilities”).

As of May 14, 2012, the Company has fully drawn the \$1 billion Credit Facility and the \$1.5 billion Credit Facility was drawn in the amount of \$600 million (19,317 at the exchange rate as of December 31, 2011).

The principal purpose of the Bridge Facility, the VTB Credit Facility, the Gazprombank Credit Facility and the Sberbank Credit Facilities is the funding of the dividend payout and the re-purchase of shares by the Company. Any excess will be used to fund operating, investment and financial activities. The covenants of these Credit Facilities are substantially consistent with those which the Company has in its other existing loan agreements.

**(5) Other**

On April 6, 2012, the Company drew down and subsequently, on April 24, 2012, repaid in full 11,000 of the revolving credit facility with UniCredit Bank Moscow which carried interest at a rate of 8.87% per annum.

Also, on April 6, 2012, the Company drew down 5,500 under the agreement with Nordea Bank at MosPrime1m plus 2.95% per annum. On May 5, 2012, the Company repaid the amount borrowed under the agreement in full.

On April 11, 2012, the Company drew down \$41 million (1,321 at the exchange rate as of December 31, 2011) under the credit facility agreement with Fortis Bank, Nordea Bank Finland and Skandinaviska Enskilda Banken at a rate of 1.92% per annum. This credit facility can only be used to purchase Nokia Siemens Networks (“NSN”) equipment.

In January, February and April 2012, the date these consolidated financial statements were available to be issued, the Company drew approximately \$94 million (3,026 at the exchange rate as of December 31, 2011) under the credit facility agreement with China Development Bank at a rate of LIBOR plus 2.4% per annum. This credit facility can only be used to purchase Huawei equipment.

*Voting Agreement*

In accordance with a Voting Agreement executed between the Company’s shareholders and MICL on April 24, 2012, TeliaSonera Group, one of the Company’s shareholders, will direct the voting of the shares in the Company held by MICL on any issues other than the appointment or removal of the CEO and the planned redemption and cancellation by the Company from MICL of two shares held by MICL, until the first to occur of (a) the completion of an initial public offering (“IPO”) of the Company, (b) the date at which the TeliaSonera Group or AF Telecom Group reduce their interest in the Company below 25% plus one share, or (c) December 31, 2014. In certain circumstances this period can be extended beyond this date.

*Put and Call Option Agreement*

On April 24, 2012, the shareholders of the Company signed an agreement (the “Put and Call Option Agreement”) to the effect that, if an IPO of the Company has not been consummated by December 31, 2014, Sonera Holding B.V., a member of TeliaSonera Group, will have the right to sell to MICL (the “Put Option”) and MICL will have the right to buy from Sonera Holding B.V. (the “Call Option”) the lesser of (a) such number of shares in the Company as are equal to approximately 10.6% of the Company and (b) such number of shares in the Company by which the total number of shares in the Company that are directly or indirectly owned by the TeliaSonera Group in aggregate exceeds 25% plus one share of the entire issued share capital of the Company (the “Option Shares”). The price payable to exercise the Put and Call Options will be based on the fair value of the Company’s shares as determined at the date of exercise. Telecominvest Holdings Limited, a company controlled by AF Telecom Group, at its sole discretion can elect to purchase any or all of the Option Shares under the Put and Call Options.

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Notes to Consolidated Financial Statements (continued)

**26. Subsequent Events (continued)**

Sonera Holding B.V., Telecominvest Holdings Limited or MICL may only exercise the Put and Call Options during the period from January 1, 2015 to February 1, 2015.

The Company has given a guarantee to Sonera Holding B.V. of the performance of MICL's obligations under the Put and Call Option Agreement.

*Unaudited Pro Forma Information*

The unaudited pro forma financial information has been prepared on the basis of assumptions described below. The following unaudited pro forma consolidated balance sheet presents the Company's financial position as if each of the transactions specified below had been completed on December 31, 2011. The unaudited pro forma consolidated balance sheet has been prepared for informational purposes only and does not necessarily indicate the financial position that would have existed had the relevant transactions taken place on December 31, 2011, or which may result in the future.

Pro Forma Adjustments:

- A. Withdrawal of bank deposits
- B. Debt financing, net of repayments. Facilities denominated in US Dollars are translated at the exchange rate as of December 31, 2011.

	<u>Currency</u>	<u>Drawn</u>	<u>Fees Paid</u>	<u>Net proceeds</u>
<i>Short-term and current portion of long-term debt</i>				
Bridge Facility	US Dollar	48,294	(193)	48,101
VTB	Ruble	<u>30,000</u>	<u>—</u>	<u>30,000</u>
<b>Subtotal</b>		<b>78,294</b>	<b>(193)</b>	<b>78,101</b>
<i>Debt, less current portion</i>				
Gazprombank	Ruble	6,300	—	6,300
Sberbank	US Dollar	<u>51,514</u>	<u>(434)</u>	<u>51,080</u>
<b>Subtotal</b>		<b>57,814</b>	<b>(434)</b>	<b>57,380</b>
<b>Total</b>		<b><u>136,108</u></b>	<b><u>(627)</u></b>	<b><u>135,481</u></b>

- C. Payment of the special dividend
- D. Re-purchase of the Company's ordinary shares

## MegaFon

## Notes to Consolidated Financial Statements (continued)

**26. Subsequent Events (continued)**

Unaudited Pro Forma Consolidated Balance Sheet at December 31, 2011

	<u>December 31,</u> <u>2011</u>	<u>(A)</u>	<u>(B)</u>	<u>(C)</u>	<u>(D)</u>	<u>Pro Forma</u> <u>Total</u>
<b>Assets</b>						
Current assets:						
Cash and cash equivalents	2,887	84,979	135,481	(151,863)	(69,672)	1,812
Short-term investments	84,509	(82,979)				1,530
Accounts receivable, net	9,547					9,547
Accounts receivable, related parties	104					104
Inventory	4,551					4,551
Prepaid income taxes	6,957					6,957
VAT receivable	1,779					1,779
Deferred tax assets	1,972					1,972
Prepaid expenses and other current assets	7,987		193			8,180
<b>Total current assets</b>	<u>120,293</u>	<u>2,000</u>	<u>135,674</u>	<u>(151,863)</u>	<u>(69,672)</u>	<u>36,432</u>
Long-term bank deposits	2,002	(2,000)				2
Property, plant and equipment, net	223,718					223,718
Goodwill	15,393					15,393
Intangible assets	19,672					19,672
Deferred tax assets	712					712
Deferred finance charges	729		434			1,163
Other non-current assets	949					949
<b>Total assets</b>	<u>383,468</u>	<u>—</u>	<u>136,108</u>	<u>(151,863)</u>	<u>(69,672)</u>	<u>298,041</u>
<b>Liabilities</b>						
Current liabilities:						
Accounts payable	9,621					9,621
Accounts payable to equipment suppliers	8,034					8,034
Accounts payable, related parties	465					465
Current portion of liability for marketing related licenses	402					402
Current portion of liability for deferred and contingent consideration	2,550					2,550
Accrued compensation	5,360					5,360
Subscribers' prepayments	7,895					7,895
Taxes payable	3,056					3,056
VAT payable	2,965					2,965
Deferred revenue	954					954
Current portion of long-term debt	7,415		78,294			85,709
Other current liabilities	1,256					1,256
<b>Total current liabilities</b>	<u>49,973</u>	<u>—</u>	<u>78,294</u>	<u>—</u>	<u>—</u>	<u>128,267</u>
Debt, less current portion	36,294		57,814			94,108
Deferred tax liabilities	10,543					10,543
Asset retirement obligations	5,248					5,248
Liability for marketing related licenses, less current portion	621					621
Liability for deferred and contingent consideration	1,829					1,829
Deferred revenue, less current portion	1,569					1,569
Other non-current liabilities	759					759
<b>Total liabilities</b>	<u>106,836</u>	<u>—</u>	<u>136,108</u>	<u>—</u>	<u>—</u>	<u>242,944</u>
<b>Equity</b>						
MegaFon shareholders' equity:						
Ordinary shares	581					581
Treasury shares	—				(69,672)	(69,672)
Reserve fund	17					17
Additional paid-in capital	13,852					13,852
Retained earnings	261,950			(151,863)		110,087
Accumulated other comprehensive loss	(291)					(291)
Total MegaFon shareholders' equity	<u>276,109</u>	<u>—</u>	<u>—</u>	<u>(151,863)</u>	<u>(69,672)</u>	<u>54,574</u>
Noncontrolling interests	523					523
<b>Total equity</b>	<u>276,632</u>	<u>—</u>	<u>—</u>	<u>(151,863)</u>	<u>(69,672)</u>	<u>55,097</u>
<b>Total liabilities and equity</b>	<u>383,468</u>	<u>—</u>	<u>136,108</u>	<u>(151,863)</u>	<u>(69,672)</u>	<u>298,041</u>



**26. Subsequent Events (continued)**

*Scartel agreement*

In February 2012, MegaFon entered into a mobile virtual network operator (“MVNO”) agreement with Scartel LLC (“Scartel”), which operates under the “Yota” brand, for the joint development and provision of fourth-generation (“4G”) technology networks under Long Term Evolution (“LTE”) standard in Russia.

The MVNO agreement enables the Company to provide 4G services to its customers using the LTE network of Scartel and enables Scartel to use network infrastructure of MegaFon to provide voice services to its customers.

In March and April 2012, the Company prepaid Scartel an amount of \$50 million (1,610 at the exchange rate as of December 31, 2011) for the provision of future interconnection services under the MVNO agreement.

*Interest rate swaps*

Subsequent to December 31, 2011, the Company entered into additional interest rate swap agreements with total notional amount of \$475 million (15,293 at the exchange rate as of December 31, 2011), of which all were designated as cash flow hedges of interest rate risk.

*Other subsequent events*

Subsequent to December 31, 2011, a portion of the Company’s liabilities under contingent payment arrangements totaling approximately \$45 million (1,449 at the exchange rate as of December 31, 2011) have become obligations to a related party. Such amounts are scheduled to be settled before June 30, 2012.



**MEGAFON**

Condensed Consolidated Financial Statements  
(Unaudited)

*Three and nine months ended September 30, 2012 and 2011  
With Report of Independent Accountants*



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## Report of Independent Accountants

The Board of Directors and Shareholders  
OJSC MegaFon

We have reviewed the condensed consolidated balance sheet of OJSC MegaFon and subsidiaries as of September 30, 2012, and the related condensed consolidated statements of comprehensive income and cash flows for the three and nine months ended September 30, 2012 and 2011. This condensed financial information is the responsibility of the Company's management.

We conducted our reviews in accordance with standards established by the American Institute of Certified Public Accountants. A review of interim financial information consists principally of applying analytical procedures and making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an audit conducted in accordance with auditing standards generally accepted in the United States of America, the objective of which is the expression of an opinion regarding the financial information taken as a whole. Accordingly, we do not express such an opinion.

Based on our reviews, we are not aware of any material modifications that should be made to the condensed financial information referred to above for it to be in conformity with accounting principles generally accepted in the United States of America.

We have previously audited, in accordance with auditing standards generally accepted in the United States of America, the consolidated balance sheets of OJSC MegaFon and subsidiaries as of December 31, 2011, 2010 and 2009, and the related consolidated statements of comprehensive income, shareholders' equity, and cash flows for the years then ended (not presented herein); and in our report dated May 14, 2012, we expressed an unqualified opinion on those consolidated financial statements. In our opinion, the information set forth in the accompanying condensed consolidated balance sheet as of December 31, 2011, is fairly stated, in all material respects, in relation to the consolidated balance sheet from which it has been derived.

November 8, 2012

/s/ Ernst and Young LLC

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MegaFon  
Condensed Consolidated Balance Sheets  
(In millions of Rubles)

	Note	September 30, 2012 (Unaudited)	December 31, 2011
<b>Assets</b>			
Current assets:			
Cash and cash equivalents		17,012	2,887
Short-term investments		2,213	84,509
Accounts receivable, net of allowances of 1,487 and 1,447		10,177	9,626
Inventory		4,924	4,551
Prepaid income taxes		4,313	6,957
VAT receivable		1,910	1,779
Deferred tax assets		2,266	1,972
Prepaid expenses and other current assets		<u>6,694</u>	<u>8,012</u>
Total current assets		<b>49,509</b>	120,293
Long-term bank deposits		2	2,002
Property, plant and equipment, net of accumulated depreciation of 193,568 and 164,765		<b>213,824</b>	223,718
Goodwill and intangible assets:			
Goodwill	3, 4	<b>23,950</b>	15,393
Intangible assets, net of accumulated amortization of 28,177 and 24,817		<b>17,876</b>	19,672
Deferred tax assets		<b>784</b>	712
Deferred finance charges	10	<b>1,255</b>	729
Other non-current assets	14	<b>2,132</b>	949
Total assets		<b><u>309,332</u></b>	<u>383,468</u>

*The accompanying notes are an integral part of these unaudited condensed consolidated financial statements.*

*See report of independent accountants*



MegaFon  
Condensed Consolidated Balance Sheets (continued)  
(In millions of Rubles)

	Note	September 30, 2012 (Unaudited)	December 31, 2011
<b>Liabilities</b>			
Current liabilities:			
Accounts payable		12,383	9,997
Accounts payable to equipment suppliers		3,850	8,115
Current portion of liability for marketing related licenses		506	402
Current portion of liability for deferred and contingent consideration	12	2,845	2,550
Accrued compensation		4,012	5,360
Subscribers' prepayments		7,288	7,903
Taxes payable		3,235	3,056
VAT payable		7,649	2,965
Deferred revenue		1,201	954
Short-term loans and current portion of long-term debt	10	28,494	7,415
Other current liabilities		<u>2,336</u>	<u>1,256</u>
Total current liabilities		<b>73,799</b>	49,973
Debt, less current portion	10	<b>130,620</b>	36,294
Deferred tax liabilities		<b>10,637</b>	10,543
Asset retirement obligations		<b>5,567</b>	5,248
Liability for marketing related licenses, less current portion		<b>261</b>	621
Liability for deferred and contingent consideration, less current portion		<b>—</b>	1,829
Deferred revenue, less current portion		<b>1,193</b>	1,569
Other non-current liabilities		<b>628</b>	759
Total liabilities		<b>222,705</b>	106,836
<b>Equity</b>			
MegaFon shareholders' equity:			
Ordinary shares (par value of 0.1 Rubles, 620,000,000 and 620,000,200 shares issued; 530,720,500 and 620,000,200 shares outstanding)	9	<b>581</b>	581
Treasury shares (89,279,500 ordinary shares at cost)	9	<b>(63,883)</b>	—
Reserve fund		<b>17</b>	17
Additional paid-in capital		<b>13,852</b>	13,852
Retained earnings	9	<b>135,987</b>	261,950
Accumulated other comprehensive loss		<b>(557)</b>	(291)
Total MegaFon shareholders' equity		<b>85,997</b>	276,109
Noncontrolling interests		<b>630</b>	523
Total equity		<b>86,627</b>	276,632
Total liabilities and equity		<b>309,332</b>	383,468

*The accompanying notes are an integral part of these unaudited condensed consolidated financial statements.*

*See report of independent accountants*

MegaFon

Condensed Consolidated Statements of Comprehensive Income  
(In millions of Rubles, except share and per share amounts)  
(Unaudited)

	Note	Three months ended September 30,		Nine months ended September 30,	
		2012	2011	2012	2011
<b>Revenues</b>	5	<b>71,234</b>	63,433	<b>201,098</b>	177,146
Cost of revenues	6	<b>17,349</b>	15,423	<b>50,145</b>	42,266
Sales and marketing expenses	7	<b>5,306</b>	6,498	<b>15,727</b>	15,230
Operating expenses	8	<b>16,441</b>	14,965	<b>49,288</b>	44,060
Depreciation		<b>11,921</b>	10,243	<b>35,489</b>	31,253
Amortization		<b>1,951</b>	1,238	<b>4,594</b>	3,728
<b>Operating income</b>		<b>18,266</b>	15,066	<b>45,855</b>	40,609
Other income/(expense):					
Interest expense	10	<b>(2,543)</b>	(271)	<b>(4,549)</b>	(726)
Interest income		<b>155</b>	831	<b>1,047</b>	2,606
Other gain/(loss), net		<b>58</b>	122	<b>(9)</b>	83
Gain/(loss) on derivatives, net		<b>—</b>	13	<b>—</b>	(27)
Foreign currency exchange gain/ (loss), net		<b>2,594</b>	(341)	<b>(8,758)</b>	(406)
<b>Total other income/(expense), net</b>		<b>264</b>	354	<b>(12,269)</b>	1,530
<b>Income before income taxes and noncontrolling interest</b>		<b>18,530</b>	15,420	<b>33,586</b>	42,139
Provision for income taxes	2	<b>3,552</b>	2,980	<b>7,593</b>	8,276
<b>Net income</b>		<b>14,978</b>	12,440	<b>25,993</b>	33,863
Net (gain)/loss attributable to noncontrolling interest		<b>(52)</b>	35	<b>(93)</b>	46
<b>Net income attributable to MegaFon shareholders</b>		<b>14,926</b>	12,475	<b>25,900</b>	33,909
Weighted average number of ordinary shares outstanding—basic and diluted	9	<b>530,720,500</b>	620,000,200	<b>567,866,069</b>	620,000,200
<b>Earnings per share—basic and diluted, Rubles</b>	9	<b>28</b>	20	<b>46</b>	55
<b>Other comprehensive income/(loss):</b>					
Foreign currency translation adjustment, net of tax of nil		<b>87</b>	71	<b>54</b>	129
Change in fair value of derivatives, net of tax of nil		<b>(138)</b>	—	<b>(306)</b>	—
<b>Other comprehensive income/(loss)</b>		<b>(51)</b>	71	<b>(252)</b>	129
<b>Total comprehensive income</b>		<b>14,927</b>	12,511	<b>25,741</b>	33,992
Comprehensive (income)/loss attributable to noncontrolling interest		<b>(74)</b>	17	<b>(107)</b>	14
<b>Comprehensive income attributable to MegaFon shareholders</b>		<b>14,853</b>	12,528	<b>25,634</b>	34,006

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

See report of independent accountants

MegaFon  
Condensed Consolidated Statements of Cash Flows  
(In millions of Rubles)  
(Unaudited)

	Note	Nine months ended September 30,	
		2012	2011
<b>Net cash provided by operating activities</b>		<b>82,170</b>	74,510
<b>Cash flows from investing activities:</b>			
Purchases of property, plant and equipment and intangible assets		(33,589)	(50,419)
Proceeds from sale of property, plant and equipment		294	332
Acquisitions of subsidiaries, net of cash acquired of 240 and 192	3	(8,439)	(7,362)
Change in short-term investments and long-term bank deposits		<u>79,381</u>	<u>(20,491)</u>
Net cash provided by/(used in) investing activities		<b>37,647</b>	(77,940)
<b>Cash flows from financing activities:</b>			
Proceeds from short-term and long-term debt	10	<b>207,547</b>	18,330
Repayments of short-term and long-term debt	10	(93,645)	(10,029)
Deferred finance charges paid	10	(991)	(191)
Payments of contingent consideration	12	(1,490)	(491)
Payments of liabilities for marketing related licenses		(283)	(276)
Purchase of treasury shares	9	(63,883)	—
Dividends paid	9	<u>(151,863)</u>	—
Net cash provided by/(used in) financing activities		<b>(104,608)</b>	7,343
Effect of exchange rate changes on cash and cash equivalents		<u>(1,084)</u>	<u>(348)</u>
<b>Net increase in cash and cash equivalents</b>		<b>14,125</b>	3,565
Cash and cash equivalents at the beginning of the period		<u>2,887</u>	<u>2,667</u>
<b>Cash and cash equivalents at the end of the period</b>		<u><b>17,012</b></u>	<u>6,232</u>

*The accompanying notes are an integral part of these unaudited condensed consolidated financial statements.*

*See report of independent accountants*

## MegaFon

### Notes to Unaudited Condensed Consolidated Financial Statements (In millions of Rubles, unless otherwise indicated)

#### 1. Financial Presentation and Disclosures

Open Joint Stock Company MegaFon (the “Company” or “MegaFon”) is a leading universal telecommunications operator in the Russian Federation (“Russia”) and provides a broad range of voice, data and other telecommunication services to businesses, other telecommunication service providers and retail subscribers, with licenses to operate in all regions of Russia. The Company intends, wherever possible, to offer its integrated telecommunication services under the “MegaFon” brand, although some services still carry local brand names because of recent acquisitions. In addition to its operations in Russia, the Company provides mobile services through its subsidiaries in the Republic of Tajikistan (“Tajikistan”), the Republic of Abkhazia (“Abkhazia”) and the Republic of South Ossetia (“South Ossetia”).

In Russia, MegaFon has constructed and continues to operate a nationwide wireless communications network that operates on the dual band GSM 900/1800 standard. In May 2007, the Company was awarded a license that expires on May 21, 2017, for the provision of 3G wireless telephony services based on IMT-2000/UMTS standards throughout the entire territory of Russia. In July 2012, the Company was awarded a license which expires in July 2022 for the provision of fourth-generation (“4G”) technology services under Long Term Evolution (“LTE”) standard throughout the entire territory of Russia. As of September 30, 2012, the Company is providing and expanding 3G services in almost all of the regions in which it operates throughout Russia and has commenced providing 4G/LTE services in certain cities throughout Russia under a mobile virtual network operator (“MVNO”) agreement with LLC Scartel (“Scartel”), a related party (*see Note 14*).

The Company also holds licenses for local and long-distance telephony services, data transmission, broadband access services, and communication channels leasing covering the whole territory of Russia. The Company has its own land-line and leased satellite transmission network capacities.

The accompanying condensed financial statements of the Company have been prepared in accordance with generally accepted accounting principles in the United States of America (“US GAAP”) for interim financial reporting and do not include all disclosures required by US GAAP. The Company omitted certain disclosures which would substantially duplicate the disclosures contained in its 2011 audited consolidated financial statements, such as accounting policies and details of accounts which have not changed significantly in amount or composition. Additionally, the Company has provided disclosures where significant events have occurred subsequent to the issuance of its 2011 audited consolidated financial statements. Management believes that the disclosures are adequate to make the information presented not misleading if these financial statements are read in conjunction with the Company’s 2011 audited consolidated financial statements and the notes related thereto. In the opinion of management, the financial statements reflect all adjustments of a normal and recurring nature necessary to present fairly the Company’s consolidated financial position, results of operations and cash flows for the interim periods.

The results of operations for the three and nine months ended September 30, 2012 are not indicative of the operating results for the full year (e.g. seasonality).

These financial statements include information updated and subsequent events evaluated through November 8, 2012, the date these interim condensed consolidated financial statements were available to be issued.

#### 2. Summary of Significant Accounting Policies and Recent Accounting Pronouncements

##### *Income Taxes*

Provision for income taxes is made in the financial statements for taxation of profits in accordance with local tax legislation currently in force. The Company accounts for income taxes using the liability method required by the FASB in ASC 740, “*Income Taxes*”. For interim reporting purposes, the Company also follows the provisions of accounting standard ASC 270, “*Interim Reporting*”, which requires the Company to account for income taxes based on the Company’s estimate of the effective tax rate expected to be applicable for the full fiscal year on a current year-to-date basis.

*See report of independent accountants*

## 2. Summary of Significant Accounting Policies and Recent Accounting Pronouncements (continued)

The rate so determined is based on the currently enacted tax rate applicable to the Company, and includes estimates of the annual tax effect of items that do not have tax consequences and the realization of certain deferred tax assets.

The difference between income tax expense reported in the accompanying condensed consolidated financial statements and income before taxes for the nine months ended September 30, 2012 and 2011, multiplied by the statutory tax rate, is mainly due to non-deductibility of certain expenses for income tax purposes, recognized tax benefits and preferences and taxable gains from intragroup borrowings since April 2012.

### *Treasury Shares*

Ordinary shares repurchased by the Company are recorded at cost as treasury shares and reduce total equity in the Company's consolidated financial statements.

### *Earnings per Ordinary Share*

Basic earnings per share are computed by dividing income available to shareholders by the weighted-average number of ordinary shares outstanding during the period. The Company does not have any potentially dilutive securities, therefore diluted earnings per share equal basic earnings per share.

### *Comparative Information*

Certain prior year amounts have been reclassified to conform to the presentation adopted in the current year.

### *Recent Accounting Pronouncements*

**Technical Corrections and Improvements.** In October 2012, the FASB issued ASU 2012-04 "*Technical Corrections and Improvements*". This ASU contains amendments which were made to clarify the Codification, correct unintended application of guidance, or make minor improvements to the Codification that are not expected to have a significant effect on current accounting practice. Additionally, the amendments are intended to make the Codification easier to understand and the fair value measurement guidance easier to apply by eliminating inconsistencies and providing needed clarifications.

The amendments in this ASU that do not have transition guidance are effective upon issuance. For public entities, the amendments that are subject to the transition guidance will be effective for fiscal periods beginning after December 15, 2012. Early adoption is permitted. The adoption of this ASU did not have a material impact on the Company's financial statements.

**Intangibles—Goodwill and Other.** In July 2012, the FASB issued ASU 2012-02 "*Intangibles—Goodwill and Other (Topic 350): Testing Indefinite-Lived Intangible Assets for Impairment*". This ASU states that an entity has the option first to assess qualitative factors to determine whether the existence of events and circumstances indicates that it is more likely than not that an indefinite-lived intangible asset is impaired. If, after assessing the totality of events and circumstances, an entity concludes that it is not more likely than not that an indefinite-lived intangible asset is impaired, then the entity is not required to take further action. However, if an entity concludes otherwise, then it is required to determine the fair value of the indefinite-lived intangible asset and perform the quantitative impairment test by comparing the fair value with the carrying amount in accordance with Codification Subtopic 350-30, "*Intangibles—Goodwill and Other, General Intangibles Other than Goodwill*".

Under the guidance in this ASU, an entity also has the option to bypass the qualitative assessment for any indefinite-lived intangible asset in any period and proceed directly to performing the quantitative impairment test. An entity will be able to resume performing the qualitative assessment in any subsequent period.

*See report of independent accountants*

**2. Summary of Significant Accounting Policies and Recent Accounting Pronouncements (continued)**

The amendments in this ASU are effective for annual and interim impairment tests performed for fiscal years beginning after September 15, 2012. Early adoption is permitted. The Company does not expect this ASU to have a material impact on its financial statements.

**Fair Value Measurements.** In May 2011, the FASB issued ASU 2011-04, “*Fair Value Measurement (Topic 820): Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in US GAAP and IFRSs*”, which clarifies Topic 820, “*Fair Value Measurements and Disclosures*”, but also includes some instances where a particular principle or requirement for measuring fair value or disclosing information about fair value measurements has changed.

This ASU results in common principles and requirements for measuring fair value and for disclosing information about fair value measurements in accordance with US GAAP and International Financial Reporting Standards issued by the International Accounting Standards Board (“IFRS”).

The amendment is effective for public entities for interim and annual periods beginning after December 15, 2011. The adoption of the guidance did not have a material impact on the Company’s financial statements.

**3. Business Combinations****VAS Media**

In September 2012, the Company completed the acquisition of a 100% ownership interest in Felebior Holding Limited (“VAS Media”), which holds a 100% interest in a group of subsidiaries that supply multi-media content, ring tones, geo-positioning services, mobile payments and other value-added services (“VAS”) in Russia for a cash consideration of 9,207, of which 528 was effectively a settlement of pre-existing payable for VAS Media services. Before the acquisition VAS Media partnered with the Company on a variety of projects, such as provision of MegaFon branded VAS to MegaFon customers.

The primary reason for the acquisition was to strengthen the Company’s position in VAS market and to accelerate the development, implementation and launch of new services by the Company.

At the time of acquisition of VAS Media, a member of the Company’s Board of Directors and the spouse of the Company’s member of management beneficially owned an aggregate of approximately 13% of Felebior Holding Limited. In addition, at the time of that acquisition, other sellers of significant interests in Felebior Holding Limited have from time to time been associates of AF Telecom, a shareholder of the Company. The transaction was unanimously approved by Board of Directors of the Company.

The acquisition of VAS Media was accounted for using the acquisition method. The valuation of certain acquired assets and liabilities assumed has not been finalized as of the date these consolidated financial statements were available to be issued; thus, the provisional measurements of certain intangible assets, deferred taxes and goodwill are subject to change.

The table below represents the preliminary allocation of the purchase price to the acquired net assets of VAS Media based on their estimated fair values.

	<b>VAS Media</b>
Cash and cash equivalents	240
Other current assets	305
Property, plant and equipment	36
Intangible assets	6
Goodwill	8,544
Other non-current assets	183
<b>Total assets acquired</b>	<b>9,314</b>
Current liabilities	(633)
Non-current liabilities	(2)
<b>Total liabilities assumed</b>	<b>(635)</b>
<b>Total consideration transferred</b>	<b><u>8,679</u></b>

*See report of independent accountants*



**3. Business Combinations (continued)**

The goodwill recognized is attributable primarily to expected synergies from the acquisition and the value to be attributed to the workforce of VAS Media. Management is still assessing the allocation of goodwill among reporting units. None of the goodwill recognized is deductible for income tax purposes.

The Company has consolidated the financial position and the results of operations of VAS Media from September 1, 2012. Cost of revenues for the year ended December 31, 2011 were 2,518 and for the eight months ended August 31, 2012 were 2,582 related to services the Company received from VAS Media. The amounts of revenue and net income of VAS Media included in the Company's accompanying condensed consolidated statement of comprehensive income from September 1 to September 30, 2012 were 397 and 67, respectively. These amounts are shown before elimination of intercompany transactions, which were mainly revenues from services provided by VAS Media to the Company of 367.

The pro forma combined results of operations data presented below assume that the VAS Media acquisition had been made as of January 1, 2011. These pro forma amounts are provided for information purposes only and are not necessarily indicative of the results of future operations, nor of the actual results that would have been achieved had the acquisition taken place as of January 1, 2011.

	Three months ended September 30,		Nine months ended September 30,	
	2012	2011	2012	2011
Pro forma revenue	<b>71,459</b>	63,676	<b>202,295</b>	177,456
Pro forma net income	<b>15,331</b>	12,735	<b>27,001</b>	34,629
Pro forma EPS, Rubles	<b>29</b>	21	<b>48</b>	56

**4. Goodwill**

The changes in the carrying value of goodwill for the nine months ended September 30, 2012 are as follows:

	<u>2012</u>
Balance at January 1, 2012:	15,393
Measurement period adjustments	13
Acquisitions ( <i>Note 3</i> )	<u>8,544</u>
<b>Balance at the end of the period</b>	<b><u>23,950</u></b>

There were no indicators of impairment for the Company's goodwill or long-lived assets, and the Company was not required to record any impairment charges. The Company considers all current information in determining the need for impairment loss; however, future changes in events or circumstances, such as a continuation or worsening of the current economic instability, or increased competition, could result in decreases in the fair value of its goodwill and may require the Company to record impairment charges in future periods.

In June 2011, the Company completed the acquisition of a 100% ownership interest in Fairlie Holding and Finance Limited, which holds a 100% interest in a group of subsidiaries that provide broadband internet, IP telephony, IP TV and other multimedia services in Russia under the NetByNet brand ("NetByNet") for total consideration having a fair value of 8,731 as of the date of acquisition, consisting of cash consideration of 7,507 and contingent consideration of 1,224. This fair value measurement is based on significant inputs not observable in the market and thus represents a Level 3 measurement.

The primary reason for the acquisition was to facilitate the Company's entry into the broadband internet market in Moscow, the Moscow region and the Central Federal District, where the Company did not previously provide broadband internet services for end-customers.

As of September 30, 2012, the Company's management believes that the carrying amount of the NetByNet reporting unit approximates its fair value. However, if the Company does not achieve planned cost savings assumed in the original fair value calculation, the Company may recognize an impairment loss.

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MegaFon

Notes to Unaudited Condensed Consolidated Financial Statements (continued)

**5. Revenues**

Revenues for the three and nine months ended September 30 are as follows:

	Three months ended September 30,		Nine months ended September 30,	
	2012	2011	2012	2011
Wireless revenues	<b>63,067</b>	57,007	<b>178,608</b>	161,054
Wireline revenues	<b>4,560</b>	4,029	<b>13,394</b>	10,555
Sales of handsets and accessories	<b>3,607</b>	2,397	<b>9,096</b>	5,537
<b>Total revenues</b>	<b>71,234</b>	63,433	<b>201,098</b>	177,146

**6. Cost of Revenues**

Cost of revenues for the three and nine months ended September 30 are as follows:

	Three months ended September 30,		Nine months ended September 30,	
	2012	2011	2012	2011
Cost of services	<b>14,096</b>	12,674	<b>41,437</b>	34,025
Cost of handsets, accessories and SIM-cards sold	<b>3,253</b>	2,749	<b>8,708</b>	8,241
<b>Total cost of revenues</b>	<b>17,349</b>	15,423	<b>50,145</b>	42,266

**7. Sales and Marketing Expenses**

Sales and marketing expenses for the three and nine months ended September 30 are as follows:

	Three months ended September 30,		Nine months ended September 30,	
	2012	2011	2012	2011
Advertising	<b>2,145</b>	1,804	<b>6,165</b>	5,037
Commissions to dealers for connection of new subscribers	<b>1,888</b>	2,877	<b>6,069</b>	6,322
Commissions to dealers for cash collection from subscribers	<b>1,273</b>	1,817	<b>3,493</b>	3,871
<b>Total sales and marketing expenses</b>	<b>5,306</b>	6,498	<b>15,727</b>	15,230

**8. Operating Expenses**

Operating expenses for the three and nine months ended September 30 are as follows:

	Three months ended September 30,		Nine months ended September 30,	
	2012	2011	2012	2011
Salaries and social charges	<b>6,494</b>	5,487	<b>19,461</b>	17,222
Rent and utilities	<b>4,102</b>	3,587	<b>11,871</b>	10,315
Operating taxes	<b>1,768</b>	1,449	<b>5,053</b>	4,263
Network repairs and maintenance	<b>1,330</b>	1,476	<b>3,789</b>	3,817
Radio frequency fees	<b>974</b>	903	<b>3,012</b>	2,633
Office maintenance	<b>435</b>	460	<b>1,329</b>	1,166
Bad debt expense	<b>392</b>	346	<b>1,205</b>	1,085
Professional services	<b>265</b>	285	<b>1,114</b>	963
Vehicle costs	<b>155</b>	163	<b>480</b>	460
Materials and supplies	<b>49</b>	60	<b>167</b>	197
Insurance	<b>21</b>	27	<b>66</b>	83
Other expenses	<b>456</b>	722	<b>1,741</b>	1,856
<b>Total operating expenses</b>	<b>16,441</b>	14,965	<b>49,288</b>	44,060

Rent represents expenses related to the lease of premises for offices, base stations and switches.

*See report of independent accountants*

## 9. Shareholders' Equity

### *Ordinary Shares*

In August 2012, Federal Commission for Financial Markets, the Russian market's regulator, registered a 1-to-100 split of the Company's shares. As a result, the total amount of authorized and issued shares of the Company became 620,000,000, each with a par value of 0.1 Rubles. Accordingly, all share and per share amounts for all periods presented in these unaudited condensed consolidated financial statements and notes thereto, have been adjusted retroactively, where applicable, to reflect this share split.

In July 2012, the Company retired 200 of its treasury shares held by MegaFon Investments (Cyprus) Limited ("MICL"), a wholly-owned subsidiary of the Company.

### *Equity Transactions*

In April 2012, the Company's shareholders agreed to a series of transactions to permit the payment of the Company's first dividend and re-organize the shareholding structure. The principal impacts of these agreements on the Company's financial position were as follows:

- the special dividend, paid on April 24, 2012, resulted in an aggregate distribution of 151,863 to the shareholders (or 245 Rubles per ordinary share);
- on April 24, 2012, the Company re-purchased (through MICL) from Allaction Limited, part of the Alfa Group of companies, 89,279,700 or 14.4% of the Company's ordinary shares for 63,883, including transaction costs.

The transactions described above were financed from the Company's existing cash and short-term investments, and additional borrowings of approximately 142,400, net of repayments (*see Note 10*).

As a result of the dividend payment and the re-purchase of 14.4% of its ordinary shares, and the additional new borrowings (*see Note 10*), the Company has substantially depleted its working capital, including available cash and short-term investments. As of November 8, 2012, the Company believes it will continue to be able to generate significant operating cash flows and have access to undrawn lines of credit of approximately 79,000 that can be used to cover capital and operating expenditures. Additionally, the Company can defer capital expenditures if necessary in order to meet short-term liquidity requirements. Accordingly, management believes that cash flows from operating and financing activities will be sufficient for the Company to meet its obligations as they become due.

In April 2012, the Company's Board of Directors approved a number of other capital raising options. While the Company believes that financing options will be available, the timing and ultimate completion of any financing will be dependent on a number of factors beyond its control. Accordingly, there is no guarantee that the Company will be able to obtain financing on favorable terms or otherwise.

### *Voting Agreement*

In accordance with a Voting Agreement executed between the Company's shareholders and MICL on April 24, 2012, TeliaSonera Group, one of the Company's shareholders, will direct the voting of the shares in the Company held by MICL on any issues other than the appointment or removal of the CEO until the first to occur of (a) the completion of an initial public offering ("IPO") of the Company, (b) the date at which the TeliaSonera Group or AF Telecom Group reduce their interests in the Company below 25% plus one share, or (c) December 31, 2014. In certain circumstances this period can be extended beyond this date.

### *Put and Call Option Agreement*

On April 24, 2012, the shareholders of the Company signed an agreement (the "Put and Call Option Agreement") to the effect that, if an IPO of the Company has not been consummated by December 31, 2014, Sonera Holding B.V., a member of TeliaSonera Group, will have the right to sell to MICL (the "Put Option") and MICL will

*See report of independent accountants*

MegaFon

Notes to Unaudited Condensed Consolidated Financial Statements (continued)

**9. Shareholders' Equity (continued)**

have the right to buy from Sonera Holding B.V. (the "Call Option") the lesser of (a) such number of shares in the Company as are equal to approximately 10.6% of the Company and (b) such number of shares in the Company by which the total number of shares in the Company that are directly or indirectly owned by the TeliaSonera Group in aggregate exceeds 25% plus one share of the entire issued share capital of the Company (the "Option Shares"). The price payable to exercise the Put and Call Options will be based on the fair value of the Company's shares as determined at the date of exercise. Telecominvest Holdings Limited, a company controlled by AF Telecom Group, at its sole discretion can elect to purchase any or all of the Option Shares under the Put and Call Options.

Sonera Holding B.V., Telecominvest Holdings Limited or MICL may only exercise the Put and Call Options during the period from January 1, 2015 to February 1, 2015. The Company has given a guarantee to Sonera Holding B.V. of the performance of MICL's obligations under the Put and Call Option Agreement.

The Company assesses the fair values of the Put and Call Options as immaterial.

**10. Short-Term and Long-Term Debt**

Short-term and long-term debt is as follows:

<u>Lender</u>	<u>Currency</u>	<u>Nominal Annual Effective Rate</u>	<u>Maturity</u>	<u>September 30, 2012</u>	<u>December 31, 2011</u>
<b>Bank Loans:</b>					
(1) VTB Bank	Ruble	MosPrime plus 2.20%	2013	<b>30,000</b>	—
(2) Sberbank	Ruble	9.02 %	2015-2016	<b>46,693</b>	—
(3) Sberbank	Ruble	8.71 %	2014-2015	<b>29,512</b>	—
(4) Gazprombank	Ruble	9.05%	2016	<b>6,300</b>	—
(5) Nordic Investment Bank	Euro	EURIBOR plus 2.05%	2019	<b>3,198</b>	—
(6) Nordea Bank Moscow	U.S. dollar	LIBOR plus 2.0%	2015	<b>1,546</b>	<b>1,610</b>
(7) UniCredit Bank Moscow	U.S. dollar	LIBOR plus 3.5%	2012-2013	<b>464</b>	<b>805</b>
<b>Equipment Financings:</b>					
(8) China Development Bank and Bayerische Landesbank	U.S. Dollar	LIBOR plus 1.1% to 2.7%	2012-2016	<b>26,945</b>	<b>25,042</b>
(9) BNP Paribas, London branch and Nordea Bank Finland	U.S. dollar	2.91% to 4.54%	2012-2016	<b>6,965</b>	<b>9,239</b>
(10) Bayerische Landesbank, Bayerische Landesbank Filiale Di Milano, Commerzbank Aktiengesellschaft	Euro	3.74% and EURIBOR plus 0.35%	2012-2015	<b>2,715</b>	<b>3,490</b>
(11) Cisco Systems Finance International	U.S. dollar	3.50% to 4.11%	2012-2017	<b>1,239</b>	<b>1,219</b>
(12) Fortis Bank, Nordea Bank Finland and Skandinaviska Enskilda Banken	U.S. dollar	1.92%	2013-2017	<b>2,893</b>	<b>1,078</b>
Other				<b>644</b>	<b>1,226</b>
Total long-term debt				<b>159,114</b>	<b>43,709</b>
Less current portion				<b>(28,494)</b>	<b>(7,415)</b>
<b>Non-current portion</b>				<b>130,620</b>	<b>36,294</b>

(1) VTB Bank

In April 2012, the Company entered into a revolving credit facility with VTB Bank ("VTB Credit Facility") for up to 30,000. The VTB Credit Facility was fully drawn for a one-year period subject to an interest rate of 3-months MosPrime plus 2.2% which is payable every three months.

*See report of independent accountants*

**10. Short-Term and Long-Term Debt (continued)**

Subsequently, in October 2012 the Company issued ruble-denominated bonds in an aggregate principal amount of 10,000, which was applied immediately in prepayment in part of the VTB Credit Facility. The bonds bear interest at a rate of 8.05% per annum, payable semi-annually. The bonds are due in 2022, subject to a two-year put option. The portion of the VTB Credit Facility in the amount of 10,000, which was refinanced is included in long-term debt in the accompanying condensed consolidated balance sheets.

**(2,3) Sberbank**

In April 2012, the Company entered into two credit facility agreements with Sberbank, one for up to the Ruble equivalent of \$1 billion (30,917 at the exchange rate as of September 30, 2012) and the other for up to the Ruble equivalent of \$1.5 billion (46,375 at the exchange rate as of September 30, 2012) (together, the “Sberbank Credit Facilities”).

As of September 30, 2012, the Company has fully drawn both the \$1 billion Credit Facility in an amount of 29,512 and the \$1.5 billion Credit Facility in the amount of 46,693. A payment of 564 as an arrangement fee was made for the Sberbank Credit Facilities.

**(4) Gazprombank**

In April 2012, the Company and Gazprombank modified the terms of the existing revolving credit facility agreement (“Gazprombank Credit Facility”) by increasing the debt limit on the facility from 15,000 to 30,000. The Gazprombank Credit Facility is subject to fees of 0.15% per annum on the amount of the unutilized balance.

On April 18, 2012, the Company drew the entire 30,000 and subsequently, on April 25, 2012, voluntarily repaid 23,700. The Gazprombank Credit Facility carries an interest rate of 9.05% per annum which is payable every three months. The interest rate can be changed by Gazprombank unilaterally in an event of revision of the refinancing rate by the Central Bank of Russia. The principal is due for repayment in September 2016.

The principal purpose of the VTB Credit Facility, the Sberbank Credit Facilities, the Gazprombank Credit Facility and the Bridge Facility (see in “Other” below) is the funding of the dividend payout and the re-purchase of shares by the Company. Any excess will be used to fund operating, investment and financial activities. The covenants of these Credit Facilities are substantially consistent with those which the Company has in its other existing loan agreements.

**(5) Nordic Investment Bank**

In June 2012, the Company entered into a credit facility with Nordic Investment Bank (“NIB Credit Facility”) for up to 80 million Euros. The NIB Credit Facility carries interest at a rate of EURIBOR plus 2.05% per annum. The NIB Credit Facility is subject to payment of a commitment fee of 0.4% per annum on the amount of the unutilized balance and a front-end fee of 0.25% on the principal amount. The NIB Credit Facility can only be used for updating the network of the Company in the Moscow region and other regions of Russia preparing for the launch of 4G/LTE. In September 2012, the Company fully drew Nordic Investment Bank facility in the amount of 80 million Euros (3,198 at the exchange rate as of September 30, 2012).

**(8) China Development Bank and Bayerische Landesbank**

In April and June 2012, the Company drew an aggregate amount of \$107 million (3,308 at the exchange rate as of September 30, 2012) under the credit facility agreement with China Development Bank which bears interest at a rate of LIBOR plus 2.4% per annum. This credit facility can only be used to purchase Huawei equipment.

**(12) Fortis Bank, Nordea Bank Finland and Skandinaviska Enskilda Banken**

In April and September 2012, the Company drew down \$63 million (1,948 at the exchange rate as of September 30, 2012) under its credit facility agreement with Fortis Bank, Nordea Bank Finland and Skandinaviska Enskilda Banken which bears interest at a rate of 1.92% per annum. This credit facility can only be used to purchase Nokia Siemens Networks equipment.

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**10. Short-Term and Long-Term Debt (continued)**

## Other

In April 2012, the Company entered into a Bridge Facility with Barclays Bank PLC, BNP Paribas and Citibank N.A., London branch (“Bridge Facility”) to facilitate the payment of dividends and repurchase of the Company’s shares described above. The Bridge Facility carried interest at a rate of LIBOR plus 1.5% which is increased by 0.5% every three months. The Bridge Facility was subject to mandatory earlier repayment upon the completion of certain debt or capital raising transactions. A payment of 241 as an arrangement fee was made for the Bridge Facility. In April 2012, the Company drew \$1.5 billion (46,375 at the exchange rate as of September 30, 2012) under the Bridge Facility. In June and July 2012, the Company voluntarily repaid the Bridge Facility using part of the proceeds from the Sberbank Credit Facilities (*see Notes 10 (2, 3) above*).

On April 6, 2012, the Company drew down and subsequently, on April 24, 2012, repaid in full 11,000 under its revolving credit facility with UniCredit Bank Moscow which carried interest at a rate of 8.87% per annum.

Also, in April 2012, the Company drew down 5,500 under its agreement with Nordea Bank at an interest rate of 1-month MosPrime plus 2.95% per annum. In May 2012, the Company repaid the amount borrowed under the agreement in full.

**11. Cash Flow Hedges of Interest Rate Risk**

The Company’s objective in using interest rate derivatives is to add certainty and stability to its interest expense and to manage its exposure to interest rate movements. To accomplish this objective, the Company primarily uses interest rate swaps as part of its interest rate risk management strategy. Interest rate swaps designated as cash flow hedges involve the receipt of variable-rate amounts from a counterparty in exchange for the Company making fixed-rate payments over the life of the agreements without the exchange of the underlying principal amount of long-term debt.

As at September 30, 2012 and December 31, 2011, the Company had the following outstanding interest rate derivatives stated at their notional amounts that were designated as cash flow hedges of interest rate risk:

	<u>September 30, 2012</u>		<u>December 31, 2011</u>	
	<u>Millions of original currency</u>	<u>Millions of Rubles</u>	<u>Millions of original currency</u>	<u>Millions of Rubles</u>
Euro-denominated interest rate swaps	45	1,799	57	2,375
USD-denominated interest rate swaps	693	21,425	693	22,312

Interest rate swaps are recorded on the balance sheet at fair value (Level 2). The effective portion of changes in the fair value of derivatives designated and qualifying as cash flow hedges is recorded in other comprehensive income/(loss) and is subsequently reclassified into earnings in the period that the hedged forecast transaction affects earnings. The ineffective portion of the change in fair value of the derivatives is recognized directly in earnings. For derivative instruments that are not designated as hedges or do not qualify as hedged transactions, the changes in the fair value are reported in the consolidated statement of comprehensive income.

As at September 30, 2012, the fair values of the Company’s interest rate swaps in the amounts of 117 and 184 were recorded in other current and other non-current liabilities, respectively, in the accompanying consolidated balance sheets. The fair values of the swaps are based on a forward yield curve and represent the estimated amounts the Company would receive or pay to terminate these agreements at the reporting date, taking into account current interest rates, creditworthiness, nonperformance risk, and liquidity risks associated with current market conditions. The amount reclassified into earnings during the nine months ended September 30, 2012 was immaterial. All movements in fair values are reflected in other comprehensive income/(loss). At September 30, 2012, the amount recorded in other comprehensive income/(loss) which is expected to be reclassified to interest expense in the next twelve months is 117.

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**12. Settlement of Contingent Consideration**

In June 2012, the Company paid approximately \$44 million (1,431 at the exchange rates as of payment dates) in full and final settlement of all contingent consideration liability due in respect of the NetByNet acquisition completed in June 2011.

**13. Commitments, Contingencies and Uncertainties***Russian Environment and Current Economic Situation*

Russia continues economic reforms and development of its legal, tax and regulatory frameworks as required for a market economy. The future stability of the Russian economy is largely dependent upon these reforms and developments and the effectiveness of economic, financial and monetary measures undertaken by the Russian government.

The Russian economy is vulnerable to market downturns and economic slowdowns elsewhere in the world. In 2011 and during the nine months ended September 30, 2012, the Russian Government continued to take measures to support the economy in order to overcome the consequences of the global financial crisis.

Despite some indications of recovery there continues to be uncertainty regarding further economic growth, access to capital and cost of capital, which could negatively affect the Company's future financial position, results of operations and business prospects.

While management believes it is taking appropriate measures to support the sustainability of the Company's business in the current circumstances, unexpected further deterioration in the areas described above could negatively affect the Company's results and financial position in a manner not currently determinable.

*3G License Capital Commitments*

In May 2007, MegaFon was awarded a license that expires on May 21, 2017, for the provision of 3G wireless communications services for the entire territory of the Russian Federation. The 3G license was granted subject to certain capital and other commitments. The three major conditions were that the Company builds a specified number of base stations that support 3G standards, starts commercial exploitation of the 3G technology in each region of the Russian Federation over the period from May 2008 through May 2010, and also builds a certain number of base stations by the end of the third, fourth and fifth years from the date of granting of the license. As of November 8, 2012, the Company believes it is in full compliance with these license conditions, including constructing the number of base stations required at this time.

*4G/LTE License Capital Commitments*

In July 2012, the Federal Service for Supervision in Communications, Information Technologies and Mass Media granted the Company a license and allocated frequencies to provide services under the 4G/LTE standard in Russia.

Under the terms and conditions of this license, the Company is obligated to provide 4G/LTE services in each population center with over 50,000 inhabitants in Russia by 2019. The Company is also obligated to make capital expenditures of at least 15,000 annually toward the 4G/LTE roll-out until the network is fully deployed, to clear frequencies currently allocated to the military at its own cost and to compensate other operators for surrendering frequencies in an aggregate amount of 401. In July 2012, the Company has fully paid the compensation due to the other operators. It is currently not able to reasonably estimate the amount of the cost of clearing military frequencies.

*Taxation*

Russian tax, currency and customs legislation are subject to varying interpretations and changes, which can occur frequently. Management's interpretation of such legislation as applied to transactions and activities of the

*See report of independent accountants*

**13. Commitments, Contingencies and Uncertainties (continued)**

Company may be challenged by the relevant regional and federal authorities. Recent events within Russia suggest that the tax authorities are taking a more assertive position in their interpretation and enforcement of the legislation and assessments and as a result, it is possible that transactions and activities that have not been challenged in the past may now be challenged. Therefore, significant additional taxes, penalties and interest may be assessed. Fiscal periods remain open to review by the authorities in respect of taxes for the three calendar years preceding the current year. Under certain circumstances reviews may cover longer periods.

The Company's management believes that its interpretation of the relevant legislation is appropriate and is in accordance with the current industry practice and that the Company's tax, currency and customs positions will be sustained. However, the interpretations of the relevant authorities could differ. As of November 8, 2012, the Company's management estimated the possible effect of additional income taxes, before fines and interest, if any, on these condensed consolidated financial statements, if the authorities were successful in enforcing different interpretations, in the amount of up to approximately 950.

*Litigation*

The Company is not a party to any material litigation, although in the ordinary course of business, the Company and some of its subsidiaries may be party to various legal and tax proceedings, and subject to claims, certain of which relate to the developing markets and evolving fiscal and regulatory environments in which they operate. In the opinion of management, the Company's and its subsidiaries' liability, if any, in all pending litigation, other legal proceedings or other matters, will not have a material effect on the financial condition, results of operations or liquidity of the Company.

*Apple Commitment*

In August 2008, the Company entered into a two-year fixed commitment with Apple Sales International ("Apple"), an Irish affiliate of Apple Computer Inc., to purchase a total of one million unlocked iPhone handsets over a two-year period for further resale in Russia. The Company fulfilled this requirement with respect to the fourth quarter of 2008, but due to the significantly reduced handset demand caused by the economic crisis in Russia, the Company experienced difficulty re-selling these iPhones.

While the Company placed several orders for iPhone handsets thereafter, none of these orders fulfilled the minimum quarterly requirement for the applicable quarters.

The contract with Apple terminated in August 2010 and, since such date, Apple has not asserted any claim against the Company with respect to any alleged non-fulfillment of its obligation to purchase iPhone handsets, and the Company has no basis to believe that any such claim will be asserted.

**14. Scartel Agreement**

In February 2012, MegaFon entered into a MVNO agreement with Scartel, a related party of the Company since July 2012, which operates under the "Yota" brand, for the joint development and provision of 4G/LTE services in Russia.

The MVNO agreement enables the Company to provide 4G/LTE services to its customers using the network of Scartel and enables Scartel to use network infrastructure of MegaFon to provide voice services to its customers.

In March and April 2012, the Company prepaid Scartel an aggregate amount of \$50 million (1,546 at the exchange rate as of September 30, 2012) for the provision of future interconnection services under the MVNO agreement. 584 of the advance amount were included in prepaid expenses and 855 were included in other non-current assets in the accompanying consolidated balance sheets as at September 30, 2012.

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**15. Segment Information**

The Company conducts its business activities in three operating segments, which are wireless, wireline and retail, of which only the wireless segment meets quantitative thresholds as a reportable segment. Less than 1% of the Company's revenues and results are generated by segments outside of Russia. No single customer represents 10% or more of the consolidated revenues.

**16. Subsequent Events**

*Long-Term Incentive Program 2012*

In October 2012, the Company's Board of Directors approved a long-term motivation and retention program for certain key executive and senior level employees under which the parties selected to participate are awarded phantom share options. In the aggregate, the value ascribed to the full package of phantom share options for which options may be awarded is 1.1% of the share capital of OJSC MegaFon (equal to 7,000,000 phantom shares) at the base price of \$17.86 per share. The plan has a three-year duration and the awarded share options shall vest in April-May 2014 and 2015 and be settled in cash upon vesting. Payments shall be made on the basis of the difference between the base price and the weighted average price of the Company's shares in the period between 15 January and 15 March of the relevant year of vesting. Vesting of the options is contingent upon the recipient's continuing employment with the Company.

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## THE COMPANY

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