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

The following is a discussion of our financial condition and results of operations as of and for the years ended December 31, 2006 and 2005, and of the material factors that we believe are likely to affect our consolidated financial condition. You should read this section together with our audited consolidated financial statements for the years ended December 31, 2006 and 2005, including the notes to those financial statements. In addition, this discussion contains forward-looking statements that involve risk and uncertainties. Our actual results may differ materially from those discussed in forward-looking statements as a result of various factors. Our reporting currency is the U.S. dollar and our consolidated financial statements have been prepared in accordance with U.S. GAAP.

Overview

We are the largest private sector consumer services group of companies in Russia and the CIS with a combined customer base of over 70 million customers in Russia and the CIS. Our business is developing, managing and realizing the value of market-leading businesses in fast-growing service-based industries. We operate in a select number of service-based industries offering the potential for rapid growth of our businesses. In our consolidated financial statements, we report our results in eight segments: Telecommunications; Technology; Insurance; Banking; Retail; Real Estate; Mass Media and Other Businesses (which comprises our miscellaneous businesses together with our other operations and central corporate functions). Given the scale, scope and market position of our existing operations, we are uniquely positioned to exploit the growth in consumer and corporate purchasing power in the countries in which we operate. Our consolidated revenues reached $10,862.8 million for the year ended December 31, 2006 and $7,593.5 million for the year ended December 31, 2005. Our total assets have grown to $20,131.5 million as of December 31, 2006, as compared to $13,090.9 million as of December 31, 2005. Net income for the year ended December 31, 2006 amounted to $813.0 million as compared to $534.4 million in the year ended December 31, 2005.

Our revenues and total assets have increased through organic growth, as well as through acquisitions. Our major acquisitions during the year ended December 31, 2006 included Intracom Telecom, a provider of the complete telecommunications solutions and services in the EEMEA (Eastern Europe, Middle East and Africa) region, United Cable Networks ("UCN"), a pay TV and broadband service provider in Russia; Cosmos Hotel and Pekin Hotel; Riviera Holding, a tour operator in Saint-Petersburg; DG Tel and Technology Systems, alternative fixed-line telecommunication operators in Ukraine, which provide broadband and dial-up Internet access, trunk rental, hosting and collocation, and telematic services; Callnet and Cornet, telecommunication operators in the Republic of Armenia; Dagtelecom, a mobile services provider in the Republic of Dagestan; Astelit, an alternative wireline telecommunication operator; and UralElektro and UralElektro-K, producers of electronic equipment. During this period we also increased our ownership shares in MTS, Comstar-UTS, MGTS, MBRD, EWUB, VZPP Micron through acquisition of minority holdings. Revenue growth in existing businesses for 2006 was $2,606.9 million, or 79.7% of total revenue growth as compared to 2005. The consolidation of Intracom Telecom, UCN, Riviera Holding, DG Tel, Technology Systems, Callnet, Cornet, Cosmos Hotel, Pekin Hotel and Dagtelecom and others in 2006 contributed a total of $662.4 million to the increase. The Telecommunications segment's share of our consolidated revenues continued to decline, from 77.6% in the year ended December 31, 2005 to 68.8% in the year ended December 31, 2006.

We require substantial funds to support our operations, primarily for increasing network capacity and developing networks in our Telecommunications segment. Our cash outlays for capital expenditures in 2006 and 2005 were $3,002.1 million and $3,004.5 million, respectively. In addition, in the years ended December 31, 2006 and 2005 we paid for purchases of businesses $631.4 million and $540.4, respectively. We have financed our cash requirements through our operating cash flows and borrowings. Net cash provided by operating activities in 2006 and 2005 was $2,116.0 million and $1,792.8 million, respectively. The proceeds from long-term borrowings, net of debt issuance costs, for the years ended December 31, 2006 and 2005 amounted to $2,260.1 million and $1,346.6 million, respectively. As of December 31, 2006, we had indebtedness of $6,873.6 million, including capital lease obligations, and our interest expense for 2006 was $355.3 million, net of amounts capitalized.

We continue to capitalize on our competitive advantages to build market-leading businesses in select sectors which exploit the growth in consumer and corporate purchasing power in the Russian and CIS markets. We employ a disciplined approach to our investment decisions with the aim of maximizing returns for our shareholders. Our internal performance benchmarks require that our businesses achieve certain operational, revenue and profitability targets, which also reflect the nature of these individual businesses. Progress against these targets is monitored and used to develop annual budgets, long-term business plans and capital allocation strategies.

In some of our segments such as Telecommunications and Technology we developed international expansion. Though we still consider our natural prime markets Russia and CIS countries, but to support our positions on such highly competitive market we strive to become global players, which requires international expansion to achieve the scale and access to new client base and technologies. Additionally, following our strategy to concentrate on the businesses with high technology component we accelerated our development in the business lines requiring significant know-how. A number of strategic alliances were put in place which should provide us access to cutting edge global technologies.

In the year ended December 31, 2006, we have reiterated our positioning as a diversified business focused on the consumer sector. With ongoing growth across our portfolio, we remain committed to investing in market-leading businesses in the service sector, where growth continues to be driven by improving macro picture resulting in increasing spending power of our customers. We believe that through our geographical and sectoral diversification we are best positioned to capture this growth. Our fundamental goal remains unchanged - we plan to continue to invest in profitable growth in the areas of our expertise, and grow both organically and through mergers and acquisitions, as well as ensure the most efficient use of our available resources.

The following table illustrates our ownership interests in our principal consolidated subsidiaries and affiliates as of December 31, 2006.

Segment	**Company**	**Beneficial ownership**[(1)]	**Voting interest**[(2)]
Telecommunications	MTS	53%	53%
	Comstar UTS[(3)]	59%	59%
	Sky Link	50%	50%
	MTT	43%	50%
Technology	SITRONICS	85%	85%
Insurance	ROSNO	49%	51%
Banking	MBRD	95%	99%
	East-West United Bank	51%	51%
Real Estate	Sistema-Hals	80%	80%
Retail	Detsky Mir	75%	75%
	Detsky Mir-Center	100%	100%
Mass Media	Sistema Mass Media	100%	100%
Other Businesses			
Travel Services	Intourist	66%	66%
International Operations	Financial Fleurus	100%	100%
Radio and Space Technology	RTI Systems	100%	100%
Pharmaceuticals and Biotechnology	Binnofarm	100%	100%
Oil and Oil-Refining	Bashneft	17%	26%

(1) ''Beneficial ownership'' represents the percentage of ownership interests of the relevant entity that are beneficially owned by Sistema, directly or indirectly, based on Sistema's proportionate ownership of the relevant entity through its consolidated subsidiaries. Our ownership interests in the subsidiaries presented above are calculated based on shares owned by us as well as shares owned by certain companies affiliated but not owned by us, which we are required to consolidate under U.S. GAAP (FIN 46R). Excluding the ownership interests of these affiliated companies, our beneficial ownership interests in certain subsidiaries listed above would have been lower by the following amounts: MBRD (24.4%), Detsky Mir (4.7%).

(2) ''Voting interest'' represents the percentage of ownership interests of the relevant entity that Sistema or any of its consolidated subsidiaries has the power to vote.

(3) Comstar UTS holds our 25.0%+1 share of Svyazinvest.

Macroeconomic Factors Affecting Our Results of Operations

Most of our operations are based in Russia. As a result, Russian macroeconomic trends and country-specific risks significantly influence our performance. In recent years, Russia has been able to overcome the consequences of the 1998 financial crisis. Below is a summary of several key macroeconomic factors that may have a substantial impact on our business:

	Years ended December 31,	
	2005	2006
GDP growth	6.4%	6.7%
Consumer price index	10.9%	9.0%
Unemployment rate	7.7%	6.9%
Nominal exchange rate (rubles per U.S. dollar) (1)	28.3	27.1
Real ruble appreciation against U.S. dollar(2)	12.5%	13.9%

Sources: Central Bank of Russia, Rosstat, EIU, Russian Ministry of Economic Development.

(1) The average of the exchange rates on the last business day of each full month during the relevant period.

(2) Real ruble appreciation against U.S. dollar is a consumer price index adjusted for nominal exchange rate changes over the same period.

GDP growth rates in Russia remain relatively high compared to North America and Europe. The Russian economy growth is primarily attributable to the high proportion of oil and oil products in its export revenues and the high oil prices on the international markets. The higher disposable income of the Russian population has stimulated demand for the services provided by our main businesses, such as telecommunications, insurance, banking and retail. The continuation of growth in Russian GDP and real and disposable income in Russia is subject to the influences of various political groups whose interests may not be aligned with those of the current government and to the ability of the government to continue to progress economic and regulatory reforms currently underway.

Acquisitions and Divestitures

During the years under review, we have completed a number of acquisitions and divestitures, several of which have had a significant impact on our results of operations and financial condition. We consolidate revenues and expenses of newly acquired entities from the beginning of the year in which we obtain a controlling interest. Earnings attributable to these entities for the portion of the year prior to the date upon which we obtained a controlling interest are included in minority interests.

Due to the number of significant transactions completed during the periods under review, period-to-period comparisons of our results of operations need to be considered in the light of the impact of such transactions.

Below is a list of our major acquisitions during the years ended December 31, 2005 and December 31, 2006.

Company	Principal activity	Date of acquisition	Stake acquired	Acquiring entity	Purchase price[(1)] (in millions)
Year ended December 31, 2006					
Svyazinvest	Telecommunications operator	December 2006	25.0%+1 share	Comstar UTS	$ 1,390.0
MGTS	Telecommunications operator	February 2006 – October 2006	11.3%	Comstar UTS	181.4
Intracom Telecom	Telecom solutions provider	June 2006	51.0%	SITRONICS	150.6
United Cable Network	Pay-TV and broadband service provider	February 2006	100.0%	Sistema Mass Media	145.9
Bashneft, Ufaneftekhim, Novoil, Ufimsky NPZ, Ufaorgsintez, Bashnefteproduct	Oil producing and refining companies the Republic of Bashkortostan	September 2006 – December 2006	0.8%-8.9%	Sistema-Invest	141.7
Pekin	Hotel	June 2006	100.0%	Intourist	62.8
Cosmos	Hotel	March 2006	20.0%	Intourist	20.8
Dagtelecom	Mobile services provider	July 2006	75.0%	MTS	14.7
Astelit	Wireline telecommunication operator	June 2006	100.0%	Comstar UTS	7.8
Riviera Holding	Tour operator	December 2006	51.0%	Intourist	7.0
Medexpress	Provider of voluntary medical insurance	February 2006	51.0%	Rosno	6.6
UralElektro group	Producers of electronic equipment	March 2006	50.0%+1 share	RTI Systems	5.4
VZPP-Micron	Producer of electronic components	December 2006	45.7%	SITRONICS	4.5
Callnet	Telecommunications operator	October 2006	75.0%	Comstar UTS	4.4
East-West United Bank	Banking	December 2006	2.0%	MBRD	0.8
Dom Igrushki	Retail	March 2006	30.0%	Detsky Mir	2.4
Year ended December 31, 2005					
Bashneft, Ufaneftekhim, Novoil, Ufimsky NPZ, Ufaorgsintez, Bashnefteproduct	Oil producing and refining companies in Bashkortostan	August and October 2005	18.6%-28.2%	Sistema-Invest	$ 613.3
MTS	Mobile operator in Russia and CIS	October and December 2005	2.3%	Sistema	275.5
ReCom	Mobile operator in Orel	December 2005	46.1%	MTS	110.0
BCTI	Mobile operator in Turkmenistan	June and November 2005	100.0%	MTS	46.7
Telesot Alania	Mobile operator in the Republic of North Osetia	December 2005	47.5%	MTS	32.6
STROM telecom	Intergated solutions provider for wireless and fixed networks	July 2005	33.0%	SITRONICS	19.8
Metrocom	Alternative fixed line operator in Saint-Petersburgh	September 2005	45.0%	Comstar UTS	22.5
Gorizont-RT	Mobile operator in the Republic of Sakha (Yakutia)	June 2005	24.0%	MTS	13.5
MBRD	Banking	February 2005	13.3%	Sistema	10.0
ESTA	Cable television operator	August 2005	100.0%	Sistema Mass Media	8.6
Telmos	Fixed line operator	February 2005	20.0%	Sistema	8.5
MTT	Nationwide transit network operator	February 2005	5.0%	Hurdsfield	6.4
CTK Contrast Telecom	Alternative fixed line operator in Moscow region	December 2005	100.0%	Comstar UTS	5.5
Conversia Svyaz and Overta	Alternative fixed-line operators in Saratov region	December 2005	100.0%	Comstar UTS	10.0
Tyumenneftegassvyaz	Alternative fixed line telecommunications services provider	October 2005	89.4%	Comstar UTS	9.0
Yaroslavl radio plant	Producer of commercial payload for satellites and professional communications facilities	June 2005	51.0%	RTI Systems	6.1
Eurodawn / Digital TV	Aerial, digital, multiprogram television broadcasting	November 2005	74.0%	Mardenhead	7.0
Kvant	Personal computers and components manufacturer	April 2005	53.0%	Concern SITRONICS	6.0
Upravlenie i Leasing	Provider of cable TV broadcasting services	December 2005	75.0%	Sistema Mass Media	5.1

[(1)] Excluding acquisition-related costs.

Recent Acquisitions

In March 2007, we purchased a remaining minority share of 26% in Cifrovoe Teleradioveschanie (CTV) for a total cash consideration of $3.0 million thus increasing our ownership interest in CTV to 100%. CTV is licensed to provide digital TV broadcasting services in Moscow, Moscow Region, Nizhny Novgorod and Nizhny Novgorod Region.

In March 2007, SITRONICS acquired a 3.0% stake in VZPP-Micron for a cash consideration of $0.5 million. As a result, SITRONICS ownership interest in VZPP-Micron increased to 100%.

Divestitures

In December 2006, as a part of our business restructuring activities we sold our interest in Literaturnaya Gazeta for $4.6 million with a resulting gain of $4.5 million.

In November 2006, Sistema-Hals completed its initial public offering ("IPO") of 1,738,650 newly issued shares, and in addition, we sold 112,171 ordinary shares, in the form of global depository receipts ("GDRs"), with 20 GDR representing 1 share of common stock. The gross proceeds from Sistema-Hals IPO and subsequent sale of shares amounted to approximately to $432.1 million. The transaction resulted in an increase of our additional paid-in capital of $301.4 million and a gain from disposal of interest in subsidiaries of $19.2 million. As a result of the IPO our effective ownership in Sistema Hals decreased from 100% to 80%.

In August 2006, we sold our 8.0% stake in Moscow Telecommunication Company ("Comcor") for the cash consideration of $20.0 million. The transaction resulted in a gain on disposal of $14.5 million.

In July 2006, we sold our 35.0% stake in TV Stolitsa for a cash consideration of $2.5 million.

In July 2006, we disposed of 35.0% interest in Sistema-Invest, a subsidiary holding our stakes in energy companies in the Republic of Bashkortostan for a total cash consideration of $201.0 million. The transaction resulted in a gain from disposal of $175.1 million.

In June 2006, we sold our ownership in Gazeta Metro, a subsidiary operating in the media business for the total cash price of $1.9 million. The transaction resulted in a gain from disposal of $1.9 million.

In June 2006, Intourist issued additional stock to us and to the Moscow Government. Moscow Government contributed its 100.0% stake in Pekin Hotel with a fair value of $62.8 million. The transaction resulted in a decrease of our additional paid-in capital by $2.5 million and a decrease in our ownership in Intourist from 72.0% to 66.0%.

In May 2006, we sold our 50.0% interest in Regiony, an affiliate operating in the real estate business for the total cash consideration of $3.1 million. The transaction resulted in a gain on disposal of $3.6 million.

In March 2006, 5.0% of SITRONICS' common shares were sold to Sistema's CEO for a total cash consideration of $14.0 million with a deferral of payment for up to 4 years. The fair value of the shares amounted to approximately $105.0 million. We have recorded compensation costs of $91.0 million and gain from disposal of an interest in a subsidiary of approximately the same amount. Following the transaction, our effective ownership in SITRONICS decreased from 93.0% to 88.2%.

In February 2006, Comstar UTS completed its IPO of 139,000,000 newly issued shares, and in addition, we sold 7,500,000 ordinary shares, in the form of GDRs, with each GDR representing 1 share of common stock. The total proceeds from Comstar UTS' IPO and subsequent sale amounted to $1,060 million. The transaction resulted in an increase of our additional paid-in capital of $418.1 million and a gain from disposal of interest in subsidiaries of $25.8 million. As a result of the IPO our effective ownership in Comstar UTS decreased from 100.0% to 59.1%.

Consolidated Financial Results Overview

The following table sets forth a summary of our financial results for the years ended December 31, 2006 and 2005. This financial information should be read in conjunction with our consolidated financial statements.

	Years ended December 31,			
	2005	% of revenues	2006	% of revenues
	(Amounts in thousands, except percentages)			
Revenues	$7,593,549	100.0	$10,862,782	100.0
Costs of sales, exclusive of depreciation and amortization shown separately below	(3,219,187)	(42.4)	(5,074,104)	(46.7)
Selling, general and administrative expenses	(1,414,313)	(18.6)	(2,016,227)	(18.6)
Depreciation and amortization	(1,024,592)	(13.5)	(1,290,266)	(11.9)
Net other operating expenses	(71,392)	(0.9)	(171,544)	(1.6)
Equity in net income of investees	54,446	0.7	92,196	0.8
Gain on disposal of interests in subsidiaries and affiliates	15,326	0.2	330,412	3.0
Operating income [(1)]	$1,933,837	25.5	$2,733,249	25.2
Interest income	66,132	0.9	65,439	0.6
Change in fair value of derivative instruments	-	-	(60,000)	(0.6)
Interest expense, net of amounts capitalized	(225,684)	(3.0)	(355,326)	(3.3)
Currency exchange and translation (loss)/gain	(13,913)	(0.2)	67,300	0.6
Bitel liability and investments write-off	-	-	(320,000)	(2.9)
Income tax expense	(512,993)	(6.8)	(803,429)	(7.4)
Equity in net income of energy companies in the Republic of Bashkortostan	23,587	0.3	139,724	1.3
Income before minority interests and extraordinary gain	$1,270,966	16.7	$1,467,027	13.5
Minority interests	(740,514)	(9.8)	(654,023)	(6.0)
Extraordinary gain	3,956	0.1	-	-
Net income	$534,408	7.0	$813,004	7.5%
OIBDA [(2)]	$2,958,429	39.3	$4,023,515	37.0

(1) Operating income is calculated as revenues less operating costs, plus equity in net income of investees (excluding equity in net income of energy companies in the Republic of Bashkortostan) and gain on disposal of interests in subsidiaries and affiliates. Operating costs include costs of sales, selling, general and administrative expenses and depreciation and amortization, as well as other operating expenses (net of other operating income).

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

The following tables set forth a summary of revenues and operating income by reporting segment for the years ended December 31, 2005 and 2006. In our comparison of period-to-period results of operations, in order to analyze changes, developments and trends in revenues by reference to individual segment revenues, we present our revenues on an aggregated basis, which is revenues after elimination of intra-segment (between entities in the same segment) transactions, but before inter-segment (between entities in different segments) eliminations. Amounts attributable to individual companies, where appropriate, are shown prior to both intra-segment and inter-segment eliminations.

Revenues by segment:

	Years ended December 31,			
	2005	% of revenues	2006	% of revenues
	(Amounts in thousands, except percentages)			
Telecommunications	$ 5,892,883	77.6	$ 7,475,589	68.8
Technology	961,133	12.7	1,610,734	14.8
Insurance	408,860	5.4	638,632	5.9
Banking	106,785	1.4	228,191	2.1
Real Estate	78,448	1.0	282,866	2.6
Retail	208,008	2.7	335,309	3.1
Mass Media	52,428	0.7	106,706	1.0
Other Businesses (1)	283,594	3.7	647,566	6.0
Aggregated Revenue	$ 7,992,139	105.2	$ 11,325,593	104.3
Eliminations (2)	(398,590)	(5.2)	(462,811)	(4.3)
Total	$ 7,593,549	100.0	$ 10,862,782	100.0

(1) Other Businesses includes our travel services, radio and space technology, pharmaceuticals and biotechnology businesses together with our other operations and central corporate functions.
(2) Eliminations of inter-segment revenue.

Operating income by segment:

	Years ended December 31,			
	2005	% of operating income	2006	% of operating income
	(Amounts in thousands, except percentages)			
Telecommunications	$ 1,933,269	100.0	$ 2,377,358	87.0
Technology	143,517	7.4	129,809	4.7
Insurance	28,417	1.5	42,015	1.5
Banking	12,722	0.7	33,971	1.2
Real Estate	10,399	0.5	85,974	3.1
Retail	10,445	0.5	15,152	0.6
Mass Media	7,070	0.4	15,447	0.6
Other Businesses (1)	(63,012)	(3.3)	310,648	11.4
Aggregated Operating Income	$ 2,082,827	107.7	$ 3,010,374	110.1
Eliminations (2)	(148,990)	(7.7)	(277,125)	(10.1)
Total	$ 1,933,837	100.0	$ 2,733,249	100.0

(1) Other Businesses includes our travel services, radio and space technology, pharmaceuticals and biotechnology businesses together with our other operations and central corporate functions.
(2) Eliminations of inter-segment operating income.

Year ended December 31, 2006 compared to year ended December 31, 2005

Revenues

Our consolidated revenues increased by 43.1% to $10,862.8 million for the year ended December 31, 2006 from $7,593.5 million for the year ended December 31, 2005.

The growth in our aggregated revenues was attributable to the growth in our Telecommunications Segment of $1,582.7 million, in our Technology Segment of $649.6 million, in our Insurance Segment of $229.8 million, in our Banking Segment of $121.4 million, in our Real Estate Segment of $204.4 million, in our Retail Segment of $127.3 million, in our Mass Media Segment of $54.3 million and in our Other Businesses Segment of $364.0 million.

The consolidation of significant acquired businesses - Intracom Telecom, UCN, Riviera Holding, Cosmos Hotel, and UralElectro group - contributed $346.8 million, $40.1million, $38.9 million, $31.5 million, and $31.1 million, respectively, to the increase in aggregated revenues for the year ended December 31, 2006.

The Telecommunications Segment continued to be the largest revenue contributor for the year ended December 31, 2006, though its share of the aggregated revenues from sales to external customers decreased to 68.8% from 77.6% for the year ended December 31, 2005 owing to accelerated growth and significant acquisitions in our other segments. Revenues of MTS and Comstar UTS grew by $1,373.2 million and $212.6 million, or by 27.4% and 23.4%, respectively, compared to the year ended December 31, 2005. This increase was primarily due to the significant growth in MTS' subscriber base from 58.2 million as of December 31, 2005 to 72.9 million as of December 31, 2006. The increase in Comstar UTS' revenues is primarily explained by the rise in subscription fees for residential and corporate subscribers by MGTS that took effect in October 2005 and second half of 2006.

The increase in revenues of our Technology Segment was attributable to the organic growth of electronic equipment and IT Solutions divisions and acquisitions in telecom solutions division. Revenues of electronic equipment and IT Solutions divisions for the year ended December 31, 2006 increased by $63.2 million and $88.7 million, or by 106.0% and 18.8%, respectively, compared with the year ended December 31, 2005.

Revenues from our Insurance Segment grew by $229.8 million, or 56.2%, for the year ended December 31, 2006, compared with the year ended December 31, 2005, due to expansion of the client base following the overall growth of the insurance market in Russia.

Our Real Estate Segment revenues increased by $204.4 million as there were significant sales of completed office buildings and residential property or partial revenue recognition for several construction projects in the year ended December 31, 2006 compared to the year ended December 31, 2005.

Revenues from our Mass Media Segment grew by $54.3 million, or 103.5%, for the year ended December 31, 2006, compared with the year ended December 31, 2005 due to acquisitions of new subsidiaries in the regions.

Revenues from our Retail Segment grew by 61.2%, or $127.3 million, for the year ended December 31, 2006, compared with the year ended December 31, 2005 primarily due to increase in number of stores.

Our radio and space technology business as well as travel services business were main contributors to the growth in our Other Businesses Segment, with respective increase in revenues of $109.9 million and $171.6 million for the year ended December 31, 2006, compared to the prior year. The increase in revenues for the year ended December 31, 2006 was primarily due to acquisitions of new companies.

Operating costs

Operating costs include costs of sales, selling, general and administrative expenses and depreciation and amortization, as well as other operating expenses (net of other operating income).

For the year ended December 31, 2006, our gross margin (before deducting the depreciation and amortization expenses) decreased to 53.3% from 57.6% for the year ended December 31, 2005, primarily as a result of the growth of operations in non-telecom segments which have significantly lower margins in comparison to Telecommunications segment, while the gross margin in our Telecommunications segment decreased from 67.9% for the year ended December 31, 2005 to 66.3% for the year ended December 31, 2006.

Our selling, general and administrative expenses remained at the level of 18.6% of revenues for the year ended December 31, 2006. Depreciation and amortization decreased to 11.9% of revenues in the year ended December 31, 2006 from 13.5% in the year ended December 31, 2005.

Operating income

Operating income is revenues less operating costs, plus equity in net income of investees (excluding equity in net income of energy companies in the Republic of Bashkortostan) and gain on disposal of interests in subsidiaries and affiliates.

Our consolidated operating income margin comprised 25.2% for the year ended December 31, 2006, compared with 25.5% for the year ended December 31, 2005. MTS continued to be the main contributor to the operating margin with $1,977.6 million, or 65.7% of aggregated operating income, for the year ended December 31, 2006.

Change in fair value of derivative instruments

An expense of $60.0 million was recorded in the year ended December 31, 2006 due to an increase in fair value of the call and put option on Comstar UTS shares, that we issued in connection with our acquisition of 25.0%+1 share of Svyazinvest, between the date of acquisition and December 31, 2006.

Interest expense, net of amounts capitalized

Our consolidated interest expense, net of amounts capitalized, for the year ended December 31, 2006 increased by 57.4% to $355.3 million from $225.7 million for the year ended December 31, 2005, primarily owing to the increase in our indebtedness by $2,503.0 million or 57.3% as of December 31, 2006 compared to December 31, 2005.

Currency exchange and translation gain/(loss)

Currency exchange and translation gain for the year ended December 31, 2006 amounted to $67.3 million compared to currency exchange and translation loss of $13.9 million for the year ended December 31, 2005, resulting primarily from appreciation of the Russian Rouble against the U.S. Dollar in 2006.

Bitel liability and investments write-off

In 2006, we made a decision to write off the costs of $150.0 million associated with the purchase by MTS of 51.0% stake in Bitel, a Kyrgyz company holding a GSM 900/1800 license for the entire territory of Kyrgyzstan. An additional liability of $170.0 million was recorded in respect of the put and call option entered by MTS to acquire the remaining 49.0% stake in Bitel.

Equity in net income of energy companies in the Republic of Bashkortostan

Our share in net income of affiliated energy companies in the Republic of Bashkortostan (including Bashneft, Novoil, Ufimsky NPZ, Ufaneftekhim, Ufaorgsintez, Bashnefteproduct) amounted to $139.8 million in the year ended December 31, 2006 compared to $23.6 million in the year ended December 31, 2005. Our share in net income of these entities for the year ended December 31, 2006 increased compared to the prior year as we acquired interests in them in August 2005 and have subsequently increased our holdings through additional purchases in October 2005 and September 2006. At the same time net income of these companies for 2006 increased year-on-year due to growing prices for oil and oil products.

Income before minority interests and extraordinary gain

Consolidated income before minority interests and extraordinary gain increased by 15.4% to $1,467.0 million for the year ended December 31, 2006 from $1,271.0 million for the year ended December 31, 2005. Income before minority interests and extraordinary gain as a percentage of revenues was 13.5% for the year ended December 31, 2006, compared with 16.7% for the year ended December 31, 2005.

Minority interests

Minority interests in net income of our subsidiaries decreased from $740.5 million for the year ended December 31, 2005 to $654.0 million for the year ended December 31, 2006 due to the increase of our ownership in significant subsidiaries, including MTS, MGTS and SITRONICS, partially offset by the initial public offerings of Comstar UTS and Sistema-Hals.

Segment Financial Results Overview

The following analysis concentrates on our eight reporting segments: Telecommunications, Technology, Insurance, Banking, Mass Media, Real Estate, Retail and Other Businesses. We include the discussion of our travel services, radio and space technology, pharmaceuticals and biotechnology businesses together with our other operations and central corporate functions, under the Other Businesses Segment.

Segment results are presented after elimination of intra-segment transactions, but prior to elimination of transactions between segments.

Telecommunications

We divide our Telecommunications Segment into two divisions: wireless services (MTS) and fixed line communications (Comstar UTS).

The following table presents the results of operations of our Telecommunications Segment for the periods under review:

	Years ended December 31,			
	2005	% of revenues	2006	% of revenues
	(Amounts in thousands, except percentages)			
Revenues	$ 5,892,883	100.0%	$ 7,475,589	100.0%
Costs of sales, exclusive of depreciation and amortization shown separately below	(1,892,102)	(32.1)	(2,517,911)	(33.7)
Selling, general and administrative expenses	(1,078,508)	(18.3)	(1,275,423)	(17.1)
Depreciation and amortization	(989,210)	(16.8)	(1,246,280)	(16.7)
Net other operating expenses	(66,176)	(1.1)	(150,322)	(2.0)
Equity in net income of investees	66,382	1.1	91,717	1.2
Operating income	$ 1,933,269	32.8%	$ 2,377,358	31.8%
OIBDA [1]	$ 2,922,479	49.6%	$ 3,625,638	48.5%

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

Year ended December 31, 2006 compared to year ended December 31, 2005

Revenues

Telecommunications Segment revenues increased by 26.9% to $7,475.6 million for the year ended December 31, 2006 compared to $5,892.9 million for the year ended December 31, 2005. MTS and Comstar UTS contributed $1,373.2 million and $212.6 million, respectively, to the growth in segment revenues.

Wireless services

Revenues of MTS for the year ended December 31, 2006 were $6,390.4 million, an increase of 27.5% compared to $5,011.0 million for the year ended December 31, 2005. This increase was primarily attributable to the growth in MTS' subscriber base from 58.2 million as of December 31, 2005 to 72.9 million as of December 31, 2006, including 51.2 million in Russia, 20.0 million in Ukraine, 1.5 million in Uzbekistan and 0.2 million in Turkmenistan. The growth was attributable to MTS' sales and marketing efforts and the expansion of its network, as well as improving general economic conditions and income levels in Russia and Ukraine. The increase in revenues from subscriber growth was partially offset by a decrease in tariffs in the Moscow license area and other highly competitive license areas, an increase of mass-market subscribers in MTS' subscriber mix and its continuing expansion into the regions of Russia outside the Moscow license area where tariffs are lower. As a result, average monthly service revenue per subscriber in Russia decreased by 11.1% from $9 per subscriber for the year ended December 31, 2005 to $8 per subscriber for the year ended December 31, 2006.

For the year ended December 31, 2006, MTS' service revenues and connection fees increased by $1,344.8 million, or by 27.2%, to $6,287.1 million from $4,942.3 million for the year ended December 31, 2005 due to growth in the number of its subscribers, as explained above. Revenues from sales of handsets and accessories increased by $28.4 million, or 41.4%, for the year ended December 31, 2006, compared to the year ended December 31, 2005, due to an increase of number of sold handsets.

Fixed line communications

Comstar UTS's revenues increased by $212.6 million, or by 23.4%, to $1,120.2 million for the year ended December 31, 2006 from $907.6 for the year ended December 31, 2005 mostly as a result of growth in MGTS' tariffs and in the number of active lines.

MGTS' revenues grew by 25.4% in the year ended December 31, 2006 to $802.2 million, compared to $639.6 million for the year ended December 31, 2005. Revenues from residential subscribers increased by 37.6% in the year ended December 31, 2006, compared to the year ended December 31, 2005, and reached $334.7 million This increase in revenues was primarily due to an increase in the regulated tariffs set by the Federal Tariff Service. Specifically, fixed monthly charges for voice transmission approved by the Federal Tariff Service for residential subscribers increased by $1.1 per month, or 17.6%, from $6.3 per month for the nine months ended September 30, 2005 to $7.4 per month for the fourth quarter of 2006 and the year ended December 31, 2006. Introduction of the CPP added approximately $23.9 million in revenues from residential subscribers for the year ended December 31, 2006. Revenues from corporate subscribers increased by 19.0% compared to the year ended December 31, 2005, to $223.1 million. Revenues from operators increased by 16.9% compared to the year ended December 31, 2005, to $244.5 million.

Operating income

The operating income margin of the Telecommunications Segment was 31.8% in the year ended December 31, 2006, compared to 32.8% in the year ended December 31, 2005. This decline was primarily attributable to the decrease in the operating income margin of MTS.

MTS' operating income margin was 30.8% for the year ended December 31, 2006, compared to 33.2% for the year ended December 31, 2005. The decrease in MTS' operating income margin is due to increased cost of sales, advertising and marketing expenses and depreciation and amortization expenses as a percentage of revenues.

Comstar UTS' operating income margin for the year ended December 31, 2006 was 21.0%, compared to 29.6% for the year ended December 31, 2005, primarily due to non-cash stock bonus awards accrued in 2006.

Equity in net income of investees

Equity in net income of investees accounted for $91.7 million and $58.3 million for the years ended December 31, 2006 and December 31, 2005, respectively. The increase in equity in net income of investees is primarily caused by the growth in the net income of MTS Belarus and MTT, contributing $58.1 million and $39.8 million, respectively, for the year ended December 31, 2006.

Technology

As of December 31, 2006, our subsidiaries in the Technology Segment operated along five main divisions: telecommunication solutions (SITRONICS Telecom Solutions and Intracom Telecom), IT Solutions (Kvazar-Micro), Microelectronic Solutions (Mikron, VZPP-Mikron, NIITM), Consumer Electronics (Sitronics) and Electronics Manufacturing Services (Kvant, Elion, Elaks, Koncel).

The following table presents the operating results of our Technology Segment for the periods under review:

	Years ended December 31,			
	2005	% of revenues	2006	% of revenues
	(Amounts in thousands, except percentages)			
Revenues	$ 961,133	100.0%	$ 1,610,734	100.0%
Costs of sales, exclusive of depreciation and amortization shown separately below	(750,985)	(78.1)	(1,225,419)	(76.1)
Selling, general and administrative expenses	(48,348)	(5.0)	(199,720)	(12.4)
Depreciation and amortization	(12,044)	(1.3)	(42,706)	(2.7)
Net other operating expenses	(6,255)	(0.7)	(10,004)	(0.6)
Equity in net income of investees	16	0.0	245	0.0
Operating income	143,517	14.9%	129,809	8.1%
OIBDA [(1)]	155,561	16.2%	172,515	10.7%

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

Year ended December 31, 2006 compared to year ended December 31, 2005

Revenues

The revenues of our Technology Segment increased by $649.6 million, or by 67.6%, to $1,610.7 million for the year ended December 31, 2006. Revenues of Telecommunication Solutions division, which includes SITRONICS Telecom Solutions and Intracom Telecom, grew by 187.0% to $707.9 million, or 43.9% of the total segment revenues in the year ended December 31, 2006, compared to $246.6 million, or 25.7% of the segment revenues in the year ended December 31, 2005. The increase of revenues in the Telecommunication solutions division was primarily attributable to the acquisition of Intracom Telecom. Revenues of IT solutions division increased by 18.8% to $560.7 million, or 34.7% of the total segment revenues in the year ended December 31, 2006, compared to $472.0 million, or 49.1% of the segment revenues for the year ended December 31, 2005. The increase of revenues in the IT Solutions division was attributable both to growth in the system integration business, primarily as a result of the division’s entry into the Russian market, and to volume growth in the IT components distribution business, primarily in the Russian and Ukrainian markets. Revenues of the Microelectronic Solutions division increased by 106.0% to $122.8 million, or 7.6% of segment revenues in the year ended December 31, 2006 compared to $59.6 million, or 6.2% of the segment revenues in the year ended December 31, 2005.

Operating income

Operating income decreased to $129.8 million, or 8.1% of segment revenues, for the year ended December 31, 2006 from $143.5 million in the year ended December 31, 2005. The decrease in operating income was primarily attributable to an increase in selling, general and administrative expenses as a percentage of revenues due to expansion of the segment operations and an increase in the depreciation and amortization expense. Telecom solutions division continued to be the main contributor to the operating margin with $114.5 million, or 88.3% of the segment’s operating income, for the year ended December 31, 2006. For the year ended December 31, 2005, operating income of telecom solutions division was $128.3 million or 89.4% of the segment’s operating income. IT Solutions division contributed $15.6 million to the segment’s operating income for the year ended December 31, 2006, compared to $11.6 million for the year ended December 31, 2005. Microelectronic Solutions division contributed $23.8 million and $6.1 million to the segment’s operating income for the years ended December 31, 2006 and 2005, respectively.

Insurance

Our Insurance Segment is represented by ROSNO. ROSNO's principal activities are non-life and life insurance, as well as insurance-related services, such as obligatory insurance. ROSNO's corporate clients are primarily in the telecommunications, oil and gas, banking, retail and manufacturing sectors.

The following table presents the results of operations of our Insurance Segment for the periods under review:

	Years ended December 31,			
	2005	% of revenues	2006	% of revenues
	(Amounts in thousands, except percentages)			
Revenues from insurance services	$ 408,860	100%	$ 638,632	100%
Insurance services related costs, exclusive of depreciation and amortization shown separately below	(290,901)	(71.1)	(467,162)	(73.2)
Selling, general and administrative expenses	(90,070)	(22.0)	(136,892)	(21.4)
Depreciation and amortization	(4,373)	(1.1)	(4,393)	(0.7)
Other operating income	4,883	1.2	11,439	1.8
Net loss on disposal of subsidiary	(221)	(0.1)	-	-
Equity in net income of investees	239	0.1	391	0.1
Operating income	$ 28,417	7.0%	$ 42,015	6.6%

Voluntary medical insurance, auto-transport insurance and property insurance historically have been the largest contributors to our gross premiums written, or GPW. The share of voluntary medical insurance in GPW changed slightly to 26.2% in the year ended December 31, 2006 compared to 26.0% in the year ended December 31, 2005. Auto-transport insurance increased its share in the total GPW to 42.0% in the year ended December 31, 2006 compared to 35.7% in the year ended December 31, 2005 as we expanded auto-transport insurance operations opening specialized outlets for sale of insurance products at automobile dealers. Revenues from property insurance decreased from 27.7% of the total GPW for the year ended December 31, 2005 to 21.2% for the year ended December 31, 2005.

The adjustments necessary to reconcile GPW to segment revenues are set forth in the table below.

	Year ended December 31,	
	2005	2006
	(Amounts in thousands)	
Voluntary medical insurance	120,621	208,188
Auto-transport insurance	165,187	333,738
Property	128,568	168,861
Other non-life liability	42,849	72,947
Life insurance	6,130	11,178
Total gross premiums written	463,355	794,912
Reinsurance outwards	(57,525)	(95,566)
Change in provision in unearned premiums, net of reinsurance	(41,054)	(127,878)
Net premiums earned	364,776	571,468
Commission income	1,981	6,040
Medical services income	10,945	17,509
Net (loss)/gain on operations with securities	17,864	23,661
Interest income	13,294	17,332
Other income	-	2,622
Total revenue	$408,860	$638,632

Year ended December 31, 2006 compared to the year ended December 31, 2005

Revenues

In the year ended December 31, 2006, our Insurance Segment revenues grew by $229.8 million, or 56.2%, compared to the year ended December 31, 2005. Voluntary medical insurance, auto-transport and property insurance together accounted for $710.8 million, or 89.4% of GPW for the year ended December 31, 2006.

Overall, GPW increased by 71.6%, to $794.9 million in the year ended December 31, 2006, in comparison with $463.4 million in the year ended December 31, 2005 owing primarily to vast expansion of insurance market in Russia.

Non-insurance revenues increased to $67.2 million in the year ended December 31, 2006 from $44.1 million in the year ended December 31, 2005, or by 52.4%, primarily due to growth of revenues from investment activities and revenues from medical services.

Operating income

The operating income of our Insurance Segment increased to $42.0 million in the year ended December 31, 2006 from $28.4 million in the year ended December 31, 2005, though the operating margin decreased from 7.0% in the year ended December 31, 2005 to 6.6% in the year ended December 31, 2006.

Total assets

The total assets of our Insurance Segment increased to $946.8 million as of December 31, 2006 from $564.8 million as of December 31, 2005, or by 62.8%. This growth is attributable to increases of $163.3 million in trading securities portfolio, $101.7 million in receivables from insurance operations, $38.1 million in bank deposits, $45.3 million in deferred policy acquisition costs and $12.7 million in fixed assets.

Banking

Our Banking Segment is represented primarily by MBRD. MBRD provides a broad range of services. Historically, MBRD mainly performed treasury functions for companies in or related to our consolidated group. Accordingly, MBRD's revenues were previously primarily derived from our subsidiaries and related parties. We are currently focusing on developing and expanding MBRD's retail banking business in Moscow and major cities throughout Russia. As of December 31, 2006, the bank operated in Moscow and 21 regions, whereas 6 regional offices were launched in the year ended December 31, 2006. The volume of revenues from our subsidiaries and related parties as a percentage of total MBRD revenues was declining throughout the year ended December 31, 2006 as a consequence of the expansion of third-party operations.

In December 2006, MBRD purchased 2.0% share in East-West United Bank ("EWUB") increasing our ownership in EWUB to 51.0%. Accordingly, the operating results of Banking Segment for the year ended December 31, 2006 include the operating results of EWUB.

The following table summarizes Banking Segment's financial performance for the periods indicated:

	Years ended December 31,			
	2005	**% of revenues**	**2006**	**% of revenues**
	(Amounts in thousands, except percentages)			
Revenues from financial services	$ 106,785	100%	$ 228,191	100%
Including:				
Revenues from consolidated companies	28,557	26.7	24,181	10.6
Revenues from related parties	4,506	4.2	3,534	1.5
Financial services related costs, exclusive of depreciation and amortization shown separately below(1)	(65,469)	(61.3)	(140,054)	(61.4)
Selling, general and administrative expenses	(28,270)	(26.5)	(50,930)	(22.3)
Depreciation and amortization	(1,975)	(1.8)	(3,236)	(1.4)
Equity in net income of investees	1,231	1.2	-	-
Operating income	$ 12,722	11.9%	$ 33,971	14.9%

(1) Includes interest expense on deposits.

Year ended December 31, 2006 compared to the year ended December 31, 2005

Revenues

In the year ended December 31, 2006, the segment revenues increased year-on-year by 113.7%, to $228.2 million, including $24.7 million, or 10.8% of the segment revenues, related to the consolidation of EWUB. Interest income grew by $101.1 million in the year ended December 31, 2006 and amounted to $193.7 million, including EWUB interest income of $21.4 million, or 11.0% of the segment interest income. This growth was attributable to interest on loans to corporate and retail customers.

As of December 31, 2006, loans to customers increased by 63.3% compared with December 31, 2005 to $1,250.9 million, including $100.1 million, or 8.0%, of loans to our subsidiaries and $52.8 million, or 4.2%, of loans to our related parties. As of December 31, 2006, the weighted average interest on MBRD's loans to our subsidiaries was 12.6% for ruble-denominated loans and 18.3% on foreign currency denominated loans. The weighted average interest rate on loans to related parties was 11.4% for ruble-denominated loans and 12.7% for foreign currency denominated loans. Loans to third-party customers increased by $600.4 million to $1,098.0 million as of December 31, 2006 from $497.6 million as of December 31, 2005. The weighted average interest rate on loans to third-party customers was 15.4% for ruble-denominated loans and 12.5% for foreign currency denominated loans as of December 31, 2006.

Non-interest income increased to $32.1 million in the year ended December 31, 2006 from $13.4 million in the year ended December 31, 2005 primarily due to the growth in commissions received and gain on foreign exchange operations.

Operating income

Segment's operating income increased by 167.0% and amounted to $34.0 million in the year ended December 31, 2006, compared to $12.7 million in the year ended December 31, 2005. An increase in operating income is mostly explained by growth of the segment loan portfolio.

Equity in net income of investees

Equity in net income of investees of $1.2 million recorded in the operating income of the segment in the year ended December 31, 2005 represents our share of the net income of EWUB, that was our affiliate during this period.

Total assets

Total assets of the Banking Segment increased to $2,513.5 million as of December 31, 2006 from $1.135.0 million as of December 31, 2005 primarily owing to an increase in loans to customers and loans and advances to other banks and consolidation of EWUB in 2006. During 2006, MBRD completed an issue of subordinated loan participation notes for the total amount of $60.0 million (maturing in March 2016) and an issue of loan participation notes for the total amount of $100.0 million (maturing in 2009). The notes were admitted to trade on the Luxembourg Stock Exchange. Additional funds secured from the open market, as well as from Sistema, allowed the bank to expand its loan portfolio.

Real Estate

In our Real Estate Segment, represented by Sistema-Hals, we are a leading real estate owner, developer and manager predominantly focused on the Moscow market in the segments of Class A and B offices, elite housing, cottages and land development. We have been in the real estate business since the early 1990s, making real estate one of our first businesses. Since 1994, we have successfully completed more than 30 projects totaling over 250,000 sq.m. of space.

	Years ended December 31,			
	2005	**% of revenues**	**2006**	**% of revenues**
	(Amounts in thousands, except percentages)			
Revenues	$ 78,448	100.0%	$ 282,866	100.0%
Cost of sales, exclusive of depreciation and amortization shown separately below	(36,685)	(46.8)	(153,852)	(54.4)
Selling, general and administrative expenses	(31,295)	(39.9)	(38,574)	(13.6)
Depreciation and amortization	(2,104)	(2.7)	(7,153)	(2.5)
Net other operating income/(expenses)	2,035	2.6	(449)	0.2
Operating income	$ 10,399	13.3%	$ 85,974	30.4%

Year ended December 31, 2006 compared to year ended December 31, 2005

Revenues

The Real Estate segment, represented by Sistema Hals, reported almost four-fold revenue growth year on year to $282.9 million in 2006. The real estate development division remained one of the primary growth drivers of the segment and accounted for 72% of total segment's revenues compared to 52% in 2005. This growth in revenues in 2006 resulted primarily from the sale of "Pokrovka 40" project, which is a mixed-use Class A office and hotel complex in the center of Moscow, for $83.7 million, "Yartsevskaya 27" project, a residential development in Moscow, for $26.3 million. Additionally, Sistema Hals recognized $62.4 million in revenues from the partial completion of the Siemens Tower project. Sistema Hals's project construction management division contributed $22.2 million to the increase in revenues compared to 2005. The asset management division increased revenues by 80% year on year to $ 27.0 million in 2006 primarily as a result of an increase in the number of sold houses within the asset restructuring program and the growth in rental revenue.

Operating income

Operating income of the Real Estate Segment for the year ended December 31, 2006 increased to $86.0 million from $10.4 million in the year ended December 31, 2005. The operating income increased as several significant real estate projects were completed or sufficiently progressed to completion to allow us to recognize revenues from these projects during the year ended December 31, 2006.

Total assets

Total assets of the Real Estate Segment increased from $331.8 million as of December 31, 2005 to $943.3 million as of December 31, 2006, or by 184.3%. This growth is primarily due to an increase of a number of construction projects in the segment's portfolio.

Retail

We operate our retail business through Detsky Mir, the largest retailer of children's goods in Russia and the CIS. Detsky Mir, through its subsidiary, S-Toys, is also the leading Russian toys importer and exclusive distributor of the world-class toys brands.

Detsky Mir had its new strategy approved in December 2006. The strategy is to continue opening new retail outlets in Moscow and other large cities of Russia and the CIS taking advantage of limited competition in the sector of large format nationwide children's goods retail chains. Detsky Mir plans to continue offering broad selection of children's toys, goods for babies, clothes and footwear, stationery and sporting goods targeted at middle-income consumers. Detsky Mir also plans to increase share of larger store formats (hypermarkets) in its stores portfolio.

As of December 31, 2006 Detsky Mir operated 65 stores in 27 regions of the Russian Federation adding 29 stores during the year. The company almost doubled its retail space from 54.6 thousand sq.m. to 108.6 thousand sq.m. increasing the share of its retail area located outside Moscow and Moscow region from 48% to 63%.

	Years ended December 31,			
	2005	% of revenues	2006	% of revenues
	(Amounts in thousands, except percentages)			
Revenues	$ 208,008	100.0%	$ 335,309	100.0%
Cost of sales, exclusive of depreciation and amortization shown separately below	(142,752)	(68.6)	(216,096)	(64.4)
Selling, general and administrative expenses	(53,245)	(25.6)	(98,691)	(29.4)
Depreciation and amortization	(1,618)	(0.8)	(5,706)	(1.7)
Net other operating income/(expenses)	52	0.0	(40)	(0.0)
Operating income	$ 10,445	5.0%	$ 15,152	4.5%

Revenues

Our Retail segment increased its revenues by 61% year on year to $335.3 million in 2006. 29 retail stores added during the year contributed $42.9 million, or 12.8%, to the segment revenues in 2006. Wholesale operations accounted for $62.5 million, or 19% of the annual revenues.

Operating income

Operating income of the Retail Segment for the year ended December 31, 2006 increased to $15.2 million, from $10.4 million in the year ended December 31, 2005. The increase resulted from a significant increase of retail space during the year ended December 31, 2006.

Mass Media

We operate our Mass Media Segment through Sistema Mass Media, a holding company that is active in three main areas: pay-TV, advertising and other media sectors, such as publishing, film production and news services. Following a strategic review of our media assets, we primarily focus on developing distribution platforms and content for pay-TV and multi-media services initially in Moscow and subsequently in other parts of Russia. Starting from the year ended December 31, 2005, our Mass Media Segment is actively developing cable television network throughout Russia.

	Years ended December 31,					
	2005		% of revenues	2006		% of revenues
	(Amounts in thousands, except percentages)					
Revenues	$	52,428	100.0%	$	106,706	100.0%
Cost of sales, exclusive of depreciation and amortization shown separately below		(33,045)	(63.0)		(66,193)	(62.0)
Selling, general and administrative expenses		(11,405)	(21.8)		(24,286)	(22.8)
Depreciation and amortization		(4,540)	(8.7)		(11,155)	(10.5)
Net other operating (expenses)/income		(2,226)	(4.2)		357	0.3
Gain on disposal of interests in subsidiaries and affiliates		5,858	11.2		4,489	4.2
Operating income	$	7,070	13.5%	$	15,447	14.5%

Revenues

The Mass Media segment, which operates in pay-TV, advertising and other media sectors, doubled its revenues year on year to $106.7 million in 2006. UCN, the largest provider of pay TV services in Russia, which was acquired in February 2006, contributed $61.0 million in revenues in 2006, including $15.5 million from regional providers acquired by UCN in 2006.

Operating income

Operating income of the Mass Media Segment for the year ended December 31, 2006 increased to 14.5% of total revenues, or $15.4 million, from $7.1 million in the year ended December 31, 2005 as a result of acquisitions of new businesses in 2006.

Other Businesses

In this segment we include our travel services, radio and space technology, pharmaceuticals and biotechnology businesses together with our other operations and central corporate functions. Thus, costs of our corporate function are included in the operating costs of this segment. These costs amounted to $176.6 million for the year ended December 31, 2006, compared to $35.4 million in the year ended December 31, 2005 being mostly attributable to personnel costs (including share awards and bonuses granted in 2006) pursuant considerable improvement in our performance for the reporting period.

	Years ended December 31,					
	2005		% of revenues	2006		% of revenues
	(Amounts in thousands, except percentages)					
Revenues	$	283,594	100.0%	$	647,568	100.0%
Cost of sales, exclusive of depreciation and amortization shown separately below		(220,084)	(77.6)		(499,039)	(77.1)
Selling, general and administrative expenses		(141,296)	(49.8)		(229,881)	(35.5)
Depreciation and amortization		(9,148)	(3.2)		(16,937)	(2.6)
Net other operating income		27,654	9.8		63,225	9.8
Equity in net loss of investees		(13,422)	(4.7)		(849)	(0.1)
Gain on disposal of interests in subsidiaries and affiliates		9,690	3.4		345,869	53.4
Operating (loss)/income	$	(63,012)	(22.2)%	$	310,648	48.0%
Equity in net income of energy companies in the Republic of Bashkortostan		23,587	8.3		139,794	21.6

Our radio and space technology division represented by RTI Systems is primarily involved in the design and production of radars and radar systems, space control systems and telecommunications equipment for both governmental agencies and corporate clients.

Our travel services business consists of Intourist, a Moscow-based tour operator. Intourist is one of the leading Russian providers of travel and leisure services and operates its business through more than 40 Russian and several foreign subsidiaries.

Our miscellaneous businesses consist of pharmaceuticals and biotechnology, international operations and sport.

Year ended December 31, 2006 compared to year ended December 31, 2005

Revenues

Total operating revenues of the Other Businesses Segment increased to $647.6 million for the year ended December 31, 2006, compared to $283.6 million for the year ended December 31, 2005.

The total operating revenues of our radio and space technology division for the year ended December 31, 2006 were $248.9 million compared to $139.0 million for the year ended December 31, 2005, (including DMZ Kamov transferred in the reporting period from another business division) representing growth of 79.0%. The growth in revenues is explained by acquisition of new companies (Uralelectro, Uralelectro-K) and increase in the volume of contracts with governmental agencies.

The total operating revenues of our travel services business for the year ended December 31, 2006 were $269.9 million compared to $98.0 million for the year ended December 31, 2005, representing growth of 175.1%. The growth in revenues is explained by acquisition of new subsidiaries (primarily, Cosmos, Riviera Holding, Mir Otdykha and Pekin).

Operating (loss)/income

In the Other Businesses Segment operating losses for the year ended December 31, 2005 amounting to $63.0 million were replaced in the reporting period by operating income of $310.6 million, due to a gain from disposal of interests in subsidiaries in affiliates (energy companies in Bashkortostan, SITRONICS, Comstar UTS and Sistema Hals).

In our radio and space technology division, operating margin increased to 8.3% during the year ended December 31, 2006 from 7.8% in the year ended December 31, 2005.

In our travel services business operating margin also increased to 5.6% for the year ended December 31, 2006 from 1.3% in the year ended December 31, 2005.

Telecommunications Operating Data

Our revenues and operating income for the years ended December 31, 2006 and 2005 were influenced by trends in the principal businesses included in our Telecommunications Segment: MTS and Comstar UTS. The following discussion contains certain operating data relating to each of the principal businesses in our Telecommunications Segment.

MTS

The following tables show the number of MTS' subscribers and average monthly service revenue per subscriber as of the dates indicated.

	At December 31,		
	2004	2005	2006
	(in thousands)		
Subscribers[1]			
Russia	26,540	44,219	51,222
Ukraine	7,373	13,327	20,003
Uzbekistan	311	580	1,450
Turkmenistan	—	68	184
Total consolidated	34,224	58,194	72,859
MTS Belarus (unconsolidated)	1,214	2,134	3,208

(1) MTS defines a ''subscriber'' as an individual or organization whose account shows chargeable activity within 61 days (or 183 days in the case of the "Jeans" and "SIM-SIM" brand tariffs) and whose account does not have a negative balance for more than this period. Prior to October 1, 2004, UMC used a 90-day period for such purposes with respect to its "Jeans" and "SIM-SIM" subscribers.

We had approximately 51.2 million subscribers in Russia at December 31, 2006, of which 11.2 million were in the Moscow license area that encompasses the City of Moscow and the Moscow region. According to AC&M-Consulting, approximately 18.0% of all mobile cellular subscribers in Russia reside in the Moscow license area, where penetration stood at approximately 156.4% as of December 31, 2006. Penetration in all of Russia was lower, at approximately 104.6%, according to AC&M-Consulting. Our subscribers in Russia outside of the Moscow license area totaled approximately 40.0 million as of December 31, 2006. According to AC&M-Consulting, as of December 31, 2006, we had a leading 33.7% market share of total mobile cellular subscribers in Russia. Our market share in the Moscow license area was higher at 42.2% as of December 31, 2006, according to AC&M-Consulting. We had approximately 20.0 million subscribers in Ukraine as of December 31, 2006, and, according to AC&M-Consulting, a 40.6% market share of total mobile cellular subscribers in Ukraine. In addition, we had approximately 1.5 million subscribers in Uzbekistan, representing a 57.9% market share, according to our estimates.

UMC has experienced subscriber growth from 13.3 million subscribers as of December 31, 2005 to 20.0 million subscribers as of December 31, 2006, and we expect this trend to continue, assuming the Ukrainian economy continues to grow. Average monthly service revenue per subscriber decreased in the year ended December 31, 2006 as a result of an extensive marketing campaign focused on penetration to the mass-market.

Subscriber Churn

We define our churn as the total number of subscribers who cease to be a subscriber during the period (whether involuntarily due to non-payment or voluntarily, at such subscriber's request), expressed as a percentage of the average number of our subscribers during that period. We view the subscriber churn as a measure of market competition and customer dynamics. The following table shows our Russian and Ukrainian subscriber churn for the periods indicated.

	Year Ended December 31,		
	2004	2005	2006
Subscriber Churn			
Russia	27.5%	20.7%	23.3%
Ukraine	15.8%[1]	21.8%	29.9%

(1) The significant decrease in the 2004 churn rate in Ukraine is largely attributable to the change in our churn policy for "Jeans" and "SIM-SIM" subscribers in Ukraine. Under the previous churn policy, the 2004 churn rate would have been 23%.

The churn rate is highly dependent on competition in our license areas and those subscribers who migrate as a result of such competition. The increase in our churn rate in Russia during 2006 occurred mainly due to aggressive pricing policies and promo actions of competitive cellular operators, not oriented on keeping the high profit margin. The churn rate in Ukraine has increased significantly due to increased competition with Beeline (VimpelCom) and Life (Astelit) in 2006.

While our subscribers and revenues have been growing, our average monthly service revenue per subscriber has been decreasing. We calculate our average monthly service revenue per subscriber by dividing our service revenues for a given period, including guest roaming fees and interconnect fees, by the average number of our subscribers during that period and dividing by the number of months in that period. The following table shows our average monthly service revenue per subscriber and average monthly minutes of use per Russian and Ukrainian subscriber for the periods indicated.

	Year Ended December 31,		
	2004	2005	2006
Average monthly service revenue per subscriber			
Russia	$12	$9[1]	$8
Ukraine	$13	$10	$7
Uzbekistan	—	$16	$11
Average monthly minutes of use per subscriber			
Russia	157	128	129
Ukraine	114	117	142
Uzbekistan	—	433	437

(1) As of June 30, 2006, we changed the methodology for reporting average revenue per user for its Russian subscribers, a common calculation used throughout the telecommunications industry as a measure of company effectiveness and performance. Whereas previously we had excluded interconnect fees, we are now including all network revenue in our calculation.

Average monthly service revenue per subscriber for Russia decreased from $12 for the year ended December 31, 2004, to $9 for the year ended December 31, 2005, and to $8 for the year ended December 31, 2006.

Comstar UTS

Comstar UTS had near 560,000 residential subscribers in its alternative fixed-line communications segment as at December 31, 2006, of which the number of broadband and pay-TV (StreamTV) subscribers increased by 14% and 1,145%, respectively, year on year. The pay-TV subscriber base grew strongly during the year and had reached more than 83,300 by the end of the year. The number of dial-up subscribers declined by 38% in 2006, which was in line with the general market trend of subscribers switching to broadband services.

The corporate client base in the alternative fixed-line telecommunications segment grew to nearly 43,500 subscribers as at December 31, 2006. The numbering capacity in the alternative fixed-line telecommunications segment was near 631,000 numbers by the year end, whilst the number of ADSL and data transmission channels increased by 11% during the year. Local connections still account for the majority of the traffic.

The total numbering capacity in the traditional fixed-line telecommunications segment was 4,706,883 numbers, of which over 3.6 million numbers were provided to residential subscribers and more than 760,000 numbers were provided to corporate subscribers. Comstar UTS provided traditional fixed-line telecommunications services to 3,571,639 residential customers and more than 72,000 corporate customers as at December 31, 2006.

Alternative Fixed-Line Business

	Years ended December 31,	
	2005	2006
Number of subscribers	**556,966**	**603,735**
Residential subscribers	518,529	559,847
Broadband subscribers	242,893	277,345
Dial-up subscribers	186,986	115,612
Voice subscribers	81,959	83,562
Pay-TV subscribers	6,691	83,328
Corporate subscribers	38,012	43,485
Operators	425	403

	Years ended December 31,	
	2005	2006
Active telephone lines		
Corporate subscribers	135,528	141,799
Operators	112,038	123,966
Mobile operators	325,572	325,572
Residential subscribers	8,260	10,261
Total	**581,398**	**601,598**
Installed capacity / telephone lines	**629,183**	**630,966**
ADSL and data transmission channels	**26,912**	**29,890**

Traditional Fixed-Line Business

	Years ended December 31,	
	2005	2006
Number of current subscribers		
Residential subscribers	3,537,128	3,571,639
Corporate subscribers	77,324	72,639
Operators	232	254
Total	**3,614,684**	**3,644,532**
Active telephone lines		
Residential subscribers	3,537,128	3,571,639
Corporate subscribers	761,061	762,928
Total	**4,298,189**	**4,334,567**
Installed capacity / telephone lines	**4,637,383**	**4,706,883**
Access nodes / lines rented		
Corporate subscribers	32,042	30,299
Operators	213,512	221,290
Total	**245,554**	**251,589**

Liquidity and Capital Resources

We use a variety of sources to finance our operations, both external and internal. In addition to net cash provided by operations, our companies use short- and long-term borrowings to fund capital expenditures and strategic investments. Short- and long-term funding sources may change with time, but currently include notes issued in the international and Russian capital markets and credit facilities with international and Russian banks, denominated in both rubles and foreign currencies.

In February, March and June 2006 we raised $200.0 million, $60.0 million and $100.0 million, respectively, through U.S. dollar-denominated bond offerings in the international capital markets. In April 2006, MTS entered into a syndicated loan facility provided by international financial institutions. The amount drawn under the facility in 2006 was $860 million. MTS fully repaid its indebtedness under the previous syndicated loan facility entered into in July 2004 in the amount of $460 million. In 2006 our subsidiary Sistema-Invest entered into a loan facility of approximately $600 million with VTB. In December 2006, Comstar UTS raised approximately $675.0 million to finance acquisition of a 25% plus one share stake in Svyazinvest. Our other borrowings in 2006 amounted to approximately $600 million, including $105.4 million received to finance construction of Siemens' building by Sistema-Hals and $121.2 million syndicated loan assumed by us as a result of acquisition of Intracom Telecom in 2006.

Our parent company, JSFC Sistema, is a holding company with direct operations mostly limited to certain functions for our group, including budgeting, corporate finance, strategic development and public relations. The ability of JSFC Sistema to repay its debts depends primarily upon the receipt of dividends, distributions and other payments from our subsidiaries, proceeds from the sale of subsidiaries and from additional borrowings. In February 2005, JSFC Sistema completed its initial public offering on the London Stock Exchange. The amount of proceeds, net of related expenses, equaled to $1,284.6 million. We invested a significant portion of the proceeds from the offering in the purchase of minority shareholdings in six energy companies in the Republic of Bashkortostan, while the rest amount was invested in corporate and municipal bonds and in other short-term securities.

In February 2006, Comstar UTS completed its initial public offering on the London Stock Exchange. The total proceeds from Comstar UTS' initial public offering and subsequent sale of shares amounted to $1,060 million.

In November 2006, Sistema Hals completed its initial public offering on the London Stock Exchange. The total proceeds from Sistema Hals initial public offering and subsequent sale of shares amounted to $432.1 million.

In December 2006, we established a $3,000 million Guaranteed Debt Issuance Programme which has been approved for listing and regulated market trading purposes by the London Stock Exchange. The Programme provides for the issuance of notes with maturities of up to 30 years, subject to compliance with all relevant laws, regulations and directives.

We expect to repay all long-term debts as they become due from our operating cash flows or through re-financings. See Notes 21 and 22 to our audited consolidated financial statements for a description of our indebtedness.

Working capital

Working capital is defined as current assets less current liabilities. As of the date hereof, we believe our working capital is sufficient for our present requirements. As of December 31, 2006, we had a positive working capital of $402.8 million, compared to $18.0 million as of December 31, 2005.

Our working capital increased primarily as we received cash proceeds from the initial public offerings of our subsidiaries.

Credit Ratings

Our credit ratings impact our ability to obtain short- and long-term financing, and the cost of such financing. In determining our credit ratings, the rating agencies consider a number of factors, including our operating cash flows, total debt outstanding, commitments, interest requirements, liquidity needs and availability of liquidity. Other factors considered may include our business strategy, the condition of our industry and our position within the industry. Although we understand that these and other factors are among those considered by the rating agencies, each agency might calculate and weigh each factor differently.

The credit ratings of our parent company and our subsidiaries as of the date of this document were as follows:

Name of issuer	Rating Agency	Date of Rating	Long-term Debt Rating	Outlook / Watch
	Standard & Poor's	February 01, 2007	BB-	Positive
Sistema	Fitch	April 28, 2006	B+	Positive
	Moody's	November 19, 2003	B1	Stable
	Moody's	May 10, 2007	Ba3	Positive
MTS	Standard & Poor's	February 01, 2007	BB-	Positive
	Fitch	February 14, 2006	B-	Stable
Sitronics	Moody's	February 16, 2006	B3	Stable
	Standard & Poor's	February 01, 2007	BB-	Positive
Comstar	Moody's	May 10, 2006	Ba3	Stable
	Standard & Poor's	February 01, 2007	BB-	Positive
MGTS	Moody's	January 19, 2006	Ba3	Stable
	Fitch	February 19, 2007	B	Positive
MBRD	Moody's	December 14, 2004	B1	Stable

None of our existing indebtedness has any triggers related to our credit ratings.

Capital Requirements

We need funding to finance the following:

- capital expenditures, consisting of purchases of property, plant and equipment and intangible assets;
- acquisitions;
- repayment of debt;
- changes in working capital; and
- general corporate activities, including dividends.

We anticipate that capital expenditures, acquisitions and repayment of long-term debt will represent the most significant uses of funds for several years to come.

Our capital expenditures in the years ended December 31, 2005 and December 31, 2006 were $2,474.4 million, including $10.3 million non-cash equipment acquisitions, and $2,386.4 million, including $15.5 million non-cash equipment acquisitions, respectively. We expect to continue to finance most of our capital expenditure needs through our operating cash flows, and to the extent required, to incur additional indebtedness through borrowings or additional capital raising activities. Historically, a significant portion of our capital expenditures have been related to the installation and build out of our telecommunication networks and expansion into new license areas. Our future expenditures may be higher, in particular as licenses relating to new telecommunication technologies became available and our investment program for expansion and full digitalization of the Moscow public switch telephone network is being implemented. We expect that capital expenditures will remain a large portion of our cash outflows in connection with the continued installation and build out of our networks.

In addition to our capital expenditures, we spent $540.4 million and $631.4 million in the years ended December 31, 2005 and December 31, 2006, respectively, to acquire businesses. We may continue to expand our business through acquisitions. Our cash requirements relating to potential acquisitions can vary significantly based on market opportunities.

Capital Resources

We plan to finance our capital requirements through operating cash flows and financing activities, as described above. We do not depend on off-balance sheet financing arrangements.

At December 31, 2006, our debt was comprised of the following:

	Currency	Annual interest rate (Actual at December 31, 2006)	December 31, 2006 (In thousands)
Sistema Capital Notes due 2011	USD	8.9%	$ 350,000
Sistema Finance Notes due 2008	USD	10.3%	312,471
MTS Finance Notes due 2012	USD	8.0%	400,000
MTS Finance Notes due 2010	USD	8.4%	400,000
MTS Finance Notes due 2008	USD	9.8%	400,000
Sitronics Finance Bonds due 2009	USD	7.8%	200,000
MBRD Loan Participation Notes due 2016	USD	8.9%	60,000
MBRD Loan Participation Notes due 2008	USD	8.6%	150,000
MB Capital Notes due 2009	USD	8.8%	100,000
MGTS Bonds due 2010	RUB	8.3%	55,842
MGTS Bonds due 2009	RUB	7.1%	27,533
DMC Bonds due 2015	RUB	8.5%	43,654
			2,499,500
Less unamortized discount			(1,662)
Total notes and corporate bonds			**$ 2,497,838**

USD-denominated loans from banks and financial institutions:	**Annual interest rate (Actual at December 31, 2006)**	**December 31, 2006 (In thousands)**
MTS Syndicated Loan Facility	LIBOR+0.8% (6.4%)	$ 860,000
Vneshtorgbank	8.5%	600,000
EBRD	LIBOR+3.1% (7.8%)	250,000
Citibank International plc and ING Bank N.V.	LIBOR+0.3% (5.7%)	150,208
HSBC Bank plc and ING BHF Bank AG	LIBOR+0.4% (5.8%)	149,984
Commerzbank AG, ING Bank AG and HSBC Bank plc	LIBOR+0.3% (5.7%)	118,324
HSBC Bank plc, ING Bank AG and Bayerische Landesbank	LIBOR+0.3% (5.7%)	117,109
Barclays Bank plc	LIBOR+0.2% (5.5%)	98,672
Vnesheconombank	LIBOR+3.0% (8.4%)	71,213
Dresdner Bank	LIBOR+1.3% (6.7%)	50,000
ABN AMRO Bank	LIBOR+0.4% (5.7%)	44,009
Commerzbank (Eurasia)	LIBOR+3.5% (8.9%)	42,516
Other	Various	76,249
		$ 2,628,284
EUR-denominated loans from banks and financial institutions:	**Annual interest rate (Actual at December 31, 2006)**	**December 31, 2006 (In thousands)**
Intracom Telecom Syndicated Loan	EURIBOR+1.6% (5.1%)	121,200
Deutsche Bank AG	EURIBOR+4.0% (7.9%)	105,360
ING BHF Bank and Commerzbank AG	EURIBOR+0.7% (4.5%)	34,360
ABN AMRO Bank	EURIBOR+0.4% (4.2%)	31,921
Vneshtorgbank	EURIBOR+5.4% (9.2%)	21,428
Other	Various	35,417
		$ 349,686
Loans from banks and financial institutions: other currencies	Various	$ 27,539
Total long-term loans from banks and financial institutions		**$ 3,005,509**
Other borrowings	Various	$ 73,097
Total long-term loans and borrowings		**3,078,606**

USD-denominated:	**Annual interest rate** (Actual at December 31, 2006)	**December 31, 2006** (In thousands)
ABN Amro Bank	LIBOR+1.2% (6.6%)	$ 675,000
Deutsche Bank	8.7%	140,000
Nomura International	8.5%	100,000
UBS AG	8.7%	100,000
Nomos Bank	11.0-12.0%	19,533
Vneshtorgbank	12.8%	18,332
Donau Bank	9%	6,494
		1,059,359

EUR-denominated:	**Annual interest rate** (Actual at December 31, 2006)	**December 31, 2006** (In thousands)
Societe Generale – Geniki Bank	EURIBOR+1.2% (5.4%)	25,662
Eurobank	EURIBOR+1.2% (5.4%)	10,937
Other	Various	34,279
		70,878
Borrowings in other currencies	Various	162,816
Loans from related parties	Various	4,115
Total short-term loans		**$ 1,297,168**

The following table presents the aggregate scheduled maturities of debt principal outstanding as of December 31, 2006:

Year ended December 31,	
2007	$ 1,577,595
2008	1,553,385
2009	1,164,091
2010	1,231,579
2011	493,148
Thereafter	853,814
Total	**$ 6,873,612**

Our ability to incur further indebtedness is limited by the covenants in our outstanding notes, including (i) consolidated indebtedness to consolidated EBITDA test (as defined in the indenture relating to the notes), (ii) MTS' debt/cash flow incurrence test. The covenants in our outstanding notes also limit our ability to grant liens on our properties and to enter into mergers, acquisitions, sales and sale-leaseback transactions.

The following table presents a summary of our cash flows and cash outlays for capital expenditures and acquisitions of subsidiaries:

	Year ended December 31,	
	2005	**2006**
	(Amounts in thousands)	
Cash flows		
Net cash provided by operating activities	$ 1,792,830	$ 2,115,960
Net cash used in investing activities	(4,276,199)	(5,316,833)
Net cash provided by financing activities	2,468,125	3,289,383
Net (decrease)/increase in cash	(21,100)	115,734
Cash outlays for		
Capital expenditures(1)	(2.464.121)	(2,370,735)
Acquisition of subsidiaries, net of cash acquired	(540,404)	(631,401)

(1) Includes acquisitions of property, plant and equipment, intangible assets and principal payments on capital lease obligations.

During the periods under review, our operating activities generated positive cash flows due to growth through organic growth and acquisitions. During the same periods, our investing activities generated negative cash flows due primarily to capital expenditures in connection with the development of our telecommunications network and the acquisitions of new businesses. We expect for the foreseeable future to continue to use cash in investing activities as we continue to expand our telecommunications network in the Moscow region, into the regions outside of Moscow and into other CIS countries. We also intend to continue to expand our business through acquisitions. We intend to finance our future investments primarily through net cash flows from operations and the incurrence of additional indebtedness. The availability of financing is influenced by many factors, including our profitability, operating cash flows, debt levels, contractual restrictions and market conditions. For the year ended December 31, 2006, our financing activities generated positive cash flows following the receipt of proceeds from initial public offerings of Comstar UTS and Sistema-Hals and increase of borrowings needed to finance our investing activities.

Liquidity

As of December 31, 2006 and December 31, 2005, we had total cash and cash equivalents of $598.4 million and $482.6 million, respectively. In addition, as of December 31, 2006 and December 31, 2005, we had short-term investments of $944.0 million and $594.2 million, respectively, mostly in corporate and municipal bonds and bank deposits.

For details of external financing refer to Notes 21 and 22 to our audited consolidated financial statements.

Because most of our operating subsidiaries are incorporated in Russia, their ability to pay dividends to us is limited by provisions of Russian law. For example, Russian law requires that, among other things, dividends can only be paid in an amount not exceeding net profits as determined under Russian accounting standards. In addition, dividends may only be paid if the value of the company's net assets is not less than the sum of the company's charter capital, the company's reserve fund and the difference between the liquidation value and the par value of the issued and outstanding preferred stock of the company, if any, as determined under Russian accounting standards.

In August 2005, the Board of Directors of JSFC Sistema approved dividend policy, which describes recommendations on the size of dividends as well as JSFC Sistema's obligations on dividend payments and relevant disclosures. The policy determines the recommended dividend rate at 2% of our consolidated net income.

In May 2007, MTS's Board of directors recommended to the shareholders to approve cash dividends of RUR 9.67 (equivalent of $0.38 as of the announcement date) per share for the year ended December 31, 2006, for the total of approximately $747.4 million, which is to be approved by the Shareholders' meeting of MTS. This is an increase by 33.0% from $562.0 million announced and paid for the year ended December 31, 2006.

Competition

We operate in some of the most competitive industries in Russia, including telecommunications, technology, insurance and banking. Our businesses confront aggressive pricing practices, evolving customer demand patterns and changing technologies.

For example, in the Telecommunications Segment, our wireless business is subject to increasing competition from a number of existing and emerging companies, resulting in pricing pressures and lower margins. We compete with at least one other mobile cellular operator in each of our markets. The competition has evolved in recent years to exist primarily between MTS, Vimpelcom and MegaFon, each of which has effective national coverage in Russia. Competition is based largely on local tariff prices and secondarily on network coverage and quality, the level of customer service provided, roaming and international tariffs and the range of services offered.

We compete with a number of alternative fixed line operators servicing Moscow, Saint-Petersburg and other commercial centers. Intensifying competition in Moscow's alternative carrier market has resulted in increasing pressure on prices and profitability for all operators. Smaller companies with insufficient scale and limited resources are focusing on niche segments of the market while large players act as market consolidators. As a result, the alternative carrier market is presently dominated by two large operators: the companies comprising Comstar UTS and the companies forming the Golden Telecom group.

Market risks

Foreign Currency Risk

The following tables show, for the periods indicated, certain information regarding the exchange rate between the ruble and the U.S. dollar, based on data published by the Central Bank of Russia. These rates may differ from the actual rates used in preparation of our financial statements and other financial information provided herein.

	Rubles per U.S. dollar			
	High	Low	Average[(1)]	Period End
Year ended December 31,				
2002	31.86	30.14	31.39	31.78
2003	31.88	29.25	30.61	29.45
2004	29.45	27.75	28.73	27.75
2005	29.00	27.46	28.32	28.78
2006	28.78	26.18	27.09	26.33

(1) The average of the exchange rates on the last business day of each full month during the relevant period.

The following tables show, for the periods indicated, certain information regarding the exchange rate between the hryvnia and the U.S. dollar, based on data published by the National Bank of Ukraine. These rates may differ from the actual rates used in preparation of our financial statements and other financial information provided herein.

	Hryvnias per U.S. dollar			
	High	Low	Average[(1)]	Period End
Year ended December 31,				
2002	5.33	5.30	5.33	5.33
2003	5.33	5.33	5.33	5.33
2004	5.33	5.31	5.32	5.31
2005	5.31	5.05	5.11	5.05
2006	5.05	5.05	5.05	5.05

(1) The average of the exchange rates on the last business day of each full month during the relevant period.

Our principal exchange rate risk involves changes in the value of the ruble, hryvnia and the euro relative to the U.S. dollar.

If the ruble or the hryvnia decline against the U.S. dollar and tariffs for our telecommunication services cannot be maintained for competitive or other reasons, our operating margins could be adversely affected and we could have difficulty repaying or refinancing our U.S. dollar-denominated indebtedness. Our investment in monetary assets denominated in rubles and hryvnias is also subject to risk of loss in U.S. dollar terms. In particular, we are unable economically to hedge the risks associated with our ruble and hryvnia bank or deposit accounts. Generally, as the value of the ruble or the hryvnia declines, our net ruble and hryvnia monetary asset position results in currency remeasurement losses.

In January 2006, MTS entered into a variable-to-fixed interest rate swap agreements to manage its exposure to changes in fair value of future cash flows of its variable-rate long term debt, caused by interest rate fluctuations. We also entered into several short-term USD forward agreements to hedge the fair value of our investments in RUB-denominated financial instruments and accounts receivable. Interest rate swap is designated as a cash flow hedge, while currency exchange forward agreements are classified as a fair value hedge.

Inflation and Exchange Rates

The Russian economy has been characterized by high rates of inflation:

Year	Inflation rate
2002	15.1%
2003	12.0%
2004	11.7%
2005	10.9%
2006	9.0%

The Ukrainian economy has been characterized by varying rates of inflation:

Year	Inflation rate
2002	(0.6)%
2003	8.2%
2004	12.3%
2005	10.3%
2006	11.6%

Over the past several years, the rate of increase in the consumer price index in Russia has steadily declined, due to conservative fiscal and monetary policies and the resulting federal budget surpluses. However, inflation remains high in comparison to developed countries.

Certain of our costs, including salaries and utility costs, are sensitive to rises in the general price level in Russia. During the years ended December 31, 2005 and 2006, the ruble appreciated against the U.S. dollar, both in terms of the nominal exchange rate and real appreciation. We would expect increases in ruble-denominated costs, driven by real appreciation of the ruble to put pressure on our margins. Starting from January 1, 2007, MTS' subsidiaries in Russian Federation introduced ruble tariffs for settlements with the majority of its customers to compensate for such increases in costs, though competitive pressures may not permit increases in our tariffs that are sufficient to preserve our operating margins. Accordingly, ruble appreciation could materially adversely affect our results of operations.

Interest Rate Risk

We are exposed to variability in cash flow risk related to our variable interest rate debt and exposed to fair value risk related to our fixed-rate notes. As of December 31, 2006, approximately $3,035.1 million, or 44.2% of our total indebtedness was variable interest rate debt, while $3,838.5 million, or 55.8% of our total indebtedness was fixed interest rate debt.

In January 2006, MTS entered into a variable-to-fixed interest rate swap agreement with HSBC Bank Plc to hedge MTS' exposure to variability of future cash flows caused by the change in EURIBOR related to the ABN AMRO Bank. MTS agreed with HSBC Bank plc to pay a fixed rate of 3.3% and receive a variable interest of EURIBOR on EUR 26.0 million for the period from April 2006 up to October 2013. As of December 31, 2006, we recorded an asset of $1.0 million in relation to hedge contract in the accompanying consolidated balance sheet and an income of $0.8 million, net of tax of $0.2 million, as other comprehensive income in the consolidated statement of changes in shareholders equity in relation to the change in fair value of these agreements.

We continue to consider other financial instruments available to us on the market to mitigate exposure to variability in the interest rates.

For indebtedness with variable interest rates, the table below presents principal cash flows and related weighted average interest rates by contractual maturity dates as of December 31, 2006.

Contractual Maturity Dates as of December 31, 2006:

	Currency	December 31, 2007	2008	2009	2010	2011	Thereafter	Total	Average rate at December 31, 2006
Syndicated Loan to MTS	USD	-	53,077	700,769	70,769	35,385	-	860,000	LIBOR+0.8% (6.4%)
EBRD	USD	33,334	33,334	33,334	33,334	33,334	83,332	250,000	LIBOR+3.1% (8.5%)
Citibank International plc and ING Bank N.V.	USD	19,741	19,741	19,741	19,741	19,741	51,504	150,208	LIBOR+0.3% (5.7%)
HSBC Bank plc and ING BHF Bank AG	USD	21,800	21,800	21,800	21,800	21,800	40,966	149,967	LIBOR+0.4% (5.8%)
HSBC Bank plc	USD	14,790	14,790	14,790	14,790	14,790	44,371	118,324	LIBOR+0.3% (5.7%)
Bayerische Landesbank	USD	14,622	14,622	14,622	14,622	14,622	44,000	117,108	LIBOR+0.3% (5.7%)
Barclays Bank plc	USD	13,156	13,156	13,156	13,156	13,156	32,891	98,672	LIBOR+0.2% (5.5%)
Vnesheconombank	USD	-	63,436	-	-	-	-	63,436	LIBOR+3.0% (8.4%)
Dresdner Bank	USD	-	50,000	-	-	-	-	50,000	LIBOR+1.3% (6.7%)
ABN AMRO Bank	USD	6,287	6,287	6,287	6,287	6,287	12,576	44,009	LIBOR+0.4% (5.7%)
Commerzbank (Eurasia)	USD	-	42,516	-	-	-	-	42,516	LIBOR+3.5% (8.9%)
Citibank	USD	6,555	6,555	4,007	-	-	-	17,117	LIBOR+1.6% (7,1%)
CREDIT SUISSE (ZURICH)	USD	-	-	-	-	-	11,989	11,989	LIBOR+2.8% (7.5%)
ABN Amro Bank	USD	675,000	-	-	-	-	-	675,000	LIBOR+1.2% (6.6%)
Total USD variable debt		805,285	339,314	828,506	194,499	159,114	321,628	2,648,346	
Weighted average USD interest rate		6,6%	6,5%	6,4%	6,4%	6,4%	6,4%	6,5%	
Syndicated Loan to Intracom Telecom	EUR	-	121,200	-	-	-	-	121,200	EURIBOR+1.6% (5.1%)
Deutsche Bank AG	EUR	-	105,360	-	-	-	-	105,360	EURIBOR+4.0% (7.9%)
ING BHF Bank and Commerzbank AG	EUR	13,744	13,744	6,872	-	-	-	34,360	EURIBOR+0.7% (4.5%)
ABN AMRO Bank	EUR	4,560	4,560	4,560	4,560	4,560	9,121	31,921	EURIBOR+0.4% (4.2%)
Vneshtorgbank	EUR	4,309	5,327	5,327	3,411	2,036	1,018	21,428	EURIBOR+3.8%-5.4% (7.7%-9.6%)
Commerzbank	EUR	-	-	-	13,718	-	-	13,718	EURIBOR+0.6% (4.4%)
Geniki Bank	EUR	25,662	-	-	-	-	-	25,662	EURIBOR+1.2% (5.4%)
Eurobank	EUR	10,937	-	-	-	-	-	10,937	EURIBOR+1.2% (5.4%)
National bank of Greece	EUR	5,930	-	-	-	-	-	5,930	EURIBOR (3m)+1,0% (5,13%)
PIRAEUS BANK	EUR	5,271	-	-	-	-	-	5,271	EURIBOR (2m)+1,1% (5,4%)
EMPORIKI BANK	EUR	4,348	-	-	-	-	-	4,348	EURIBOR (2m)+1,3% (5,5%)
Hellenic Bank (Greece)	EUR	3,761	-	-	-	-	-	3,761	EURIBOR (3m)+1,3% (4,9%)
ING BANK	EUR	2,892	-	-	-	-	-	2,892	EURIBOR (1m)+1,3% (4,9%)
Total EUR variable debt		81,415	250,191	16,759	21,689	6,595	10,139	386,788	
Weighted average EUR interest rate		6,0%	6,0%	5,1%	5,0%	4,9%	0,0%	5,8%	

We would experience an additional interest expense of approximately $25.9 million in the year ended December 31, 2007, $18.5 million in the year ended December 31, 2008, $11.4 million in the year ended December 31, 2009, $6.1 million in the year ended December 31, 2010, $4.1 million in the year ended December 31, 2011 and $3,3 million thereafter as a result of a hypothetical increase in the LIBOR/EURIBOR by 1% over the current rate as of December 31, 2006.

The fair value of our publicly traded long-term notes as of December 31, 2006 ranged from 101.3% to 106.6% of the principal amount. At December 31, 2006, the fair value of our other debt approximated its book value. We have not experienced significant changes in the market risks associated with our debt obligations in the table above subsequent to December 31, 2006.

Critical accounting policies

Critical accounting policies are those policies that require the application of management's most challenging, subjective or complex judgments, often as a result of the need to make estimates about the effect of matters that are inherently uncertain and may change in subsequent periods. Critical accounting policies involve judgments and uncertainties that are sufficiently sensitive to result in materially different results under different assumptions and conditions. We believe that our most critical accounting policies are those described below.

Revenue recognition

Telecommunications

Telecommunications Segment earns revenues from the provision of wireless telecommunication services, local telephone and data transmission services and usage of its local exchange networks and facilities. Revenues are recognized on an accrual basis, when services are actually provided or title to equipment passes to the customer, regardless of when the resulting monetary or financial flow occurs. Segment revenue sources consist of the following: (a) monthly subscription fees, (b) usage fees, (c) value-added telecommunication service fees, (d) roaming fees charged to other operators for guest roamers utilizing our network, (e) connection fees, (f) revenues from use of prepaid phone cards and (g) sales of handsets and accessories.

We defer initial connection fees paid by subscribers for the first time activation of network service, as well as one time activation fees received for connection to various value-added services. These fees are recognized as revenue over the estimated average subscriber life. We periodically review our estimates of the expected subscriber relationship period.

Technology

The Technology Segment earns revenues from (a) sale of consumer electronic, semiconductor products and other electronic devices; (b) manufacturing and distribution of software products; and (c) computer hardware sale and systems integration services. Revenues are recognized on an accrual basis, when services are actually provided or title to equipment passes to the customer, regardless of when the resulting monetary or financial flow occurs:

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

In those cases where we buy components from and subsequently sell the assembled devices to the same counterparty or where our responsibility to the customer is limited solely to assembly services, we record only the net amount retained as our revenues.

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

If the services element of the arrangement is deemed essential to the functionality of the software arrangement, the accounting for performance of construction-type contracts is applied. Revenue on such arrangements is recognized applying the percentage-of-completion method. The measurement of progress towards completion is based on the ratio of hours or costs to date to estimated total hours or costs at completion.

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

In cases where extended payment terms exist, license and related customization fees are recognized when payments are due, unless a history of collection, without providing concessions, has been established under comparable arrangements.

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

The arrangements regarding systems integration services typically include multiple elements, such as equipment and software, installation services and post-contract support.

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

Revenue and cost of sales from contracts involving solutions achieved through modification of telecommunications equipment and software are recognized by reference to the stage of completion of the contract at the balance sheet date when the outcome of a contract can be estimated reliably. Where the outcome of a contract cannot be estimated reliably, equal amounts of revenue and costs are recognized until results can be estimated more precisely. When it is probable that total contract costs will exceed total contract revenue, the expected loss is recognized immediately.

Insurance

Premiums on written non-life insurance of the Insurance Segment are recognized on a pro-rata basis over the term of the related policy coverage, normally not exceeding 1 year. The unearned premium provision represents that portion of premiums written relating to the unexpired term of the policy. Premiums from traditional life and annuity policies with life contingencies are recognized as revenue when due from the policyholder.

Banking

Interest income of the Banking Segment is recognized on accrual basis. Loans are placed on non-accrual status when interest or principal is delinquent for a period in excess of 90 days, except when all amounts due are fully secured by cash or marketable securities and collection proceedings are in process. Interest income is not recognized where recovery is doubtful. Loans are written off against allowance for loan losses in case of uncollectibility of loans and advances, including through repossession of collateral.

Real Estate

The Real Estate Segment earns revenues from (i) real estate development, (ii) project and construction management, (iii) asset management and investments, (iv) facilities management. We record revenues as follows:

(i) Revenues from real estate development activities are recognized in accordance with the provisions of FAS No. 66, “Accounting for Sales of Real Estate” and AICPA Statement of Position No. 81-1, “Accounting for Performance of Construction-Type and Certain Production-Type Contracts” (“SOP 81-1”).

When we undertake real estate development projects at its own risk, we recognise revenues from sales of real estate when a) a sale is consummated; b) the buyer’s initial and continuing investments are adequate to demonstrate a commitment to pay; c) our receivable is not subject to future subordination; d) we have transferred to the buyer the usual risks and rewards of ownership and does not have a substantial continuing involvement with the project. A sale is not considered consummated until (a) the parties are bound by the terms of a contract; (b) all consideration has been exchanged; (c) any permanent financing for which we are responsible has been arranged; and (d) all conditions precedent to closing have been performed. Revenues from development of office and residential buildings are recognized prior to consummation of sale by the percentage-of-completion method if (a) construction is beyond a preliminary stage; (b) the buyer is committed to the extent of being unable to require a refund except for non-delivery of the property; (c) sales prices are collectible; (d) aggregate sales proceeds and costs can be reasonably estimated.

In those instances, when we act as a contractor under construction contracts with third parties, we apply the percentage-of-completion method to the respective contracts where and as soon as we are able to reliably estimate the stage of progress to completion of the project, costs to complete the project and contractual revenues. Progress towards completion is measured by the percentage of costs incurred to date to the estimated total costs at completion for each contract (the “cost-to-cost” method). On most of its contracts, the we are not able to reliably estimate costs to complete the project and contractual revenues until the project is at least 30% complete. Until the 30% completion point, we carry the projects at cost. We do not recognize revenue on contracts until reasonably dependable estimates of costs to complete the project and contractual revenues can be made.

(ii) We provide project and construction management services to municipal governments on certain socially important infrastructure projects. Our remuneration for such services was determined as a percentage of project costs incurred by third parties and approved by the municipal government. Based upon the guidance in Emerging Issues Task Force Consensus No. 99-19, “Reporting Revenue Gross as a Principal versus Net as an Agent” (“EITF 99-19”), we have concluded that our services under such contracts do not transfer to us full risks and rewards associated with the projects. Therefore, we recognise as revenues only our fees from project management services. Fees are recognized as the project costs are incurred and approved by the municipal government.

(iii) Revenues from asset management and investments include rental revenues, revenues from sale or assignment of rights to land plots and residential units. Rental revenues are recognized over the lease term on a straight-line basis. Revenues from sale or assignment of rights over real estate are recognized when substantially all the risks and rewards of ownership have been passed to the buyer.

(iv) Revenues from service contracts for facilities management are recognized on the accrual basis over the periods when services are provided.

Other businesses

Our other segments recognize revenues when products are shipped or when services are rendered to customers.

In arrangements where we act as an agent, including travel agency arrangements and arrangements to administer construction projects, only the agency fee is recognized as revenue.

Management Estimates

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

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

License Costs and Other Intangible Assets

We capitalize the cost of licenses acquired in business combinations and directly from the government. As the telecommunications industries in Russia, Ukraine and Uzbekistan do not have sufficient experience with renewal of licenses or extensions of license terms, we amortize each license on a straight-line basis over the term of the license commencing from the date such license becomes commercially operational. We review these licenses and their remaining useful life and, if necessary, revise the useful lives based on our actual utilization. The estimated useful lives of licenses may vary depending on market or regulatory conditions, and any revision to the estimated useful lives may result in a write off or an increase in amortization costs.Other intangible assets represent acquired customer base, trademarks, roaming contracts with other telecommunications operators, telephone numbering capacity, rights to use premises and various purchased software costs. Trademarks and telephone numbering capacity with unlimited contractual life are not amortized, but are reviewed, at least annually, for impairment in accordance with the provisions of FAS No. 142, ‘‘Goodwill and Other Intangible Assets.’’

Acquired customer base is amortized over the estimated average subscriber life. Deferred telephone numbering capacity costs with limited contractual life and the rights to use premises are being amortized over their contractual lives, which vary from five to twenty years. Software costs and other intangible assets are amortized over three to ten years. All finite-life intangible assets are amortized using the straight-line method.

Useful Lives of Property, Plant and Equipment

We calculate depreciation expense for property, plant and equipment on a straight-line basis over their estimated useful lives. We establish useful lives for each category of property, plant and equipment based on our assessment of the use of the assets and anticipated technology evolution. We review and revise if appropriate the assumptions used in the determination of useful lives of property, plant and equipment at least on an annual basis.

Impairment of Long-Lived Assets

We periodically evaluate the recoverability of the carrying amount of our long-lived assets in accordance with FAS No. 144, “Accounting for the Impairment or Disposal of Long-Lived Assets”. Whenever events or changes in circumstances indicate that the carrying amounts of those assets may not be recoverable, we compare undiscounted net cash flows estimated to be generated by those assets to the carrying amount of those assets. When these undiscounted cash flows are less than the carrying amounts of the assets, we records impairment losses to write the asset down to fair value, measured by the estimated discounted net future cash flows expected to be generated from the use of the assets.

Translation Methodology

We follow a translation policy in accordance with FAS No. 52, "Foreign Currency Translation."

Management has determined that the functional currency of MGTS, ROSNO, MTS' macro-region South, SITRONICS' Russian subsidiaries, Detsky Mir, DM-Center, MBRD, Sistema Mass Media and RTI Systems is the Russian Ruble. The functional currency of UMC is the Ukrainian Hryvnia, the functional currency of SITRONICS Telecom Solutions, Czech Republic is the Czech Krona and the functional currency of Intracom Telecom is the Euro. Management believes that the U.S. dollar is the appropriate functional currency for our other significant subsidiaries due to the pervasive use of the U.S. dollar in their operations.

Taxation

We are subject to a variety of taxes levied in the Russian Federation, including income taxes, payroll taxes, VAT, property taxes and other, and our foreign subsidiaries are subject to taxation in their respective jurisdictions.

The taxation system in Russia is subject to frequent changes, varying interpretations and inconsistent enforcement at the federal, regional and local levels. In some instances, new tax regulations have been given retroactive effect, while under the Tax Code only laws benefiting the taxpayer may have retroactive effect. In addition to our substantial tax burden, these conditions complicate our tax planning and related business decisions. For example, tax laws are unclear with respect to the deductibility of certain expenses and at times we have taken a position that may be considered aggressive by tax authorities, but that we consider to be in compliance with current law. Tax declarations, together with other legal compliance areas (for example, customs and currency control matters), are subject to review and investigation by a number of authorities, which are enabled by law to impose extremely severe fines, penalties and interest charges. These facts create tax risks in Russia that are more significant than those typically found in countries with more developed tax systems.

Russia currently has a number of laws related to various taxes imposed by both federal and regional governmental authorities. Applicable taxes include value added tax ("VAT"), corporate income tax (profits tax), a number of turnover-based taxes, and payroll (social) taxes, together with others. Laws related to these taxes have not been in force for significant periods, in contrast to more developed market economies; therefore, the government's implementation of these regulations is often inconsistent or nonexistent. Accordingly, few precedents with regard to tax rulings have been established. Generally, tax declarations remain open and subject to inspection for a period of three years following the tax year. As of December 31, 2006, our tax declarations for the preceding two fiscal years were open to further review.

In the ordinary course of business, we 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 we operate. We consider that our liability, if any, in all pending litigation, other legal proceeding or other matters will not have a material effect upon our financial condition, results of operations or liquidity. We have adequately provided for tax liabilities in our financial statements; however, the risk remains that the authorities could take a different position with regard to interpretive issues.

Income Taxes

Income taxes of our Russian entities have been computed in accordance with RF laws. Income tax rate in the RF equals 24%. The income tax rate on dividends paid within Russia is 9%. Our foreign subsidiaries are paying income taxes in their jurisdictions. As of December 31, 2006, the income tax rate in Ukraine is 25%.

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

Value-added Taxes

Value-added taxes ("VAT") related to sales are payable to the tax authorities on an accrual basis based upon invoices issued to the customer. VAT incurred for purchases may be reclaimed, subject to certain restrictions, against VAT related to sales. VAT related to purchase transactions that are not reclaimable as of the balance sheet dates are recorded as VAT receivable in the accompanying financial statements.

New Accounting Pronouncements

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

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

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

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

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

In February 2007, the FASB issued SFAS No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities" – including an amendment of FASB Statement No. 115, which permits an entity to measure certain financial assets and financial liabilities at fair value. SFAS No. 159 offers an irrevocable option to carry the vast majority of financial assets and liabilities at fair value, with changes in fair value recorded in earnings (the fair value option, or FVO). The Statement's objective is to improve financial reporting by allowing entities to mitigate volatility in reported earnings caused by the measurement of related assets and liabilities using different attributes, without having to apply complex hedge accounting provisions. SFAS No. 159 is effective as of the beginning of an entity's first fiscal year beginning after November 15, 2007. Early adoption is permitted as of the beginning of the previous fiscal year provided that the entity (1) makes that choice in the first 120 days of that fiscal year, (2) has not yet issued financial statements, and (3) elects to apply the provisions of FASB Statement No. 157, Fair Value Measurements. We are currently evaluating the provisions of SFAS No. 159 to determine the potential impact, if any, its adoption will have on our financial statements.

Off-balance sheet arrangements

Obligations under guarantee contracts

As of December 31, 2006, MTS has issued guarantees to third party banks for the loans taken by MTS-Belarus, MTS' equity investee, for the total amount of $3.0 million. The guarantees expired by April 2007.

MBRD guaranteed loans for several companies, including related parties, which totaled $54.3 million as of December 31, 2006.

The issued guarantees are recorded at fair value in the accompanying consolidated balance sheet.

These guarantees would require payment by us only in the event of default on payment by the respective debtor. As of December 31, 2006 no event of default has occurred under any of the guarantees issued by us.

Obligations under derivative contracts

In connection with MTS' acquisition of 74% of the shares in Uzdunrobita in August 2004, it entered into call and put option agreements with the existing shareholders of Uzdunrobita to acquire the remaining 26% of the shares. The exercise period for the option is 48 months from the acquisition date. The call and put option agreements stipulate a minimum purchase price of $37.7 million plus 5% per annum commencing from the acquisition date. The fair value of the put option was $0 as of December 31, 2006 (compared to $5.9 million as of December 31, 2005).

In December 2006, Comstar UTS acquired 25%+1 share of Svyazinvest. Simultaneously with acquisition MGTS Finance S.A., Comstar UTS' subsidiary, and "2711 Centerville Cooperatief U.A." ("2711 UA"), an affiliate of the seller, signed a call and put option agreement, which gives 2711 UA a right to purchase and sell 46,232,000 shares of Comstar UTS, representing 11.06% of its total issued shares, from MGTS Finance S.A. The call option acquired by 2711 UA may be exercised at a strike price of $6.97 per share at any time following the signing of the agreement with respect to 10.5% of Comstar UTS' shares. The call option for the remaining 0.56% stake may be exercised at any time beginning from April 1, 2007. The call option will expire one year from the date of signing of the agreement. 2711 UA may exercise its put option at any time within two years from the date of exercising the call option at a strike price, which will be calculated based on a weighted average price of Comstar UTS' GDRs during the period.

In 2002, Intracom Holdings S.A. had entered into a swap agreement with Alfa-Bank to eliminate the foreign currency exposure risk and to effectively convert a syndicated loan of $121.2 million at a rate of three months LIBOR+1.50% to EUR 118.0 million ($155.5 million as of December 31, 2006) bearing three months EURIBOR+1.59% interest rate. The terms of the swap matched the terms of the underlying debt. The arrangement did not qualify for hedge accounting. In 2005, the loan and the swap were transferred to Intracom Telecom. As of December 31, 2006, we recorded a liability of $34.3 million in relation to this instrument in the consolidated balance sheet and a loss of $15.5 million for the year ended December 31, 2006, which was offset by the foreign exchange gain resulted from underlying debt.

Other obligations

In August 2005, we entered into a binding agreement with the other shareholder of Skylink, our affiliate, to protect the other shareholder from losses in case the joint venture does not reach certain targets in terms of customer base, cash flows and earnings. If Skylink does not reach certain quantitative targets by the first half of 2007, we will have at the discretion of the other shareholder to purchase the 50% share in Skylink for a total cash consideration of $200.0 million, or reimburse the other shareholder in the amount determined as $200.0 million multiplied by the percentage of deviation from the agreed quantitative targets. As of December 31, 2006, we do not expect any payments to be made under this agreement.

Tabular Disclosure of Contractual Obligations

We have various contractual obligations and commercial commitments to make future payments, including debt agreements, lease obligations and certain committed obligations. The following table summarizes our future obligations (including interest) under these contracts due by the periods indicated as of December 31, 2006:

	January 1, 2007 - December 31, 2007	January 1, 2008 - December 31, 2008	January 1, 2009 - December 31, 2009	January 1, 20010 - December 31, 2010	January 1, 2011 - December 31, 2011	January 1, 2012 - thereafter	Total
				(Amounts in thousands)			
Contractual obligations:							
Notes payable	301,530	1,072,813	418,510	490,002	369,264	544,727	3,196,846
Bank loans	1,723,045	845,025	991,640	898,984	209,524	372,402	5,040,619
Capital lease	8,206	6,093	1,026	112	89	348	15,874
Operating leases and services agreements	126,345	95,213	84,100	83,741	92,026	170,527	651,952
Committed investments:							
Purchases of property, plant and equipment	347,100	–	–	–	–	–	347,100
Construction contracts	243,700	–	–	–	–	–	243,700
Total	2,749,925	2,019,144	1,495,275	1,472,839	670,904	1,088,005	9,496,092

As of December 31, 2006, MTS had executed non-binding purchase agreements in the amount of approximately $347.1 million to subsequently acquire property, plant and equipment.

In December 2003, MGTS announced its long-term investment program for the period from 2004 to 2012 providing for extensive capital expenditures including expansion and full digitalization of the Moscow telephone network. The program was approved by the resolution of Moscow City Government of December 16, 2003. At the inception of the investment program, capital expenditures were estimated to be approximately $1,600 million and include reconstruction of 350 local telephone stations and installation of 4.3 million of new phone numbers.

During the year ended December 31, 2006, Sistema-Hals has contracted for construction works for a building in Moscow, Leningradsky 39, including foundations, shell and core, utilities and other general construction expenditures. Commitments under these contracts amounted to $ 82.6 million as of December 31, 2006. In addition, in connection with this project, we undertook obligations to provide the Central Army Sports Club (“CSCA”) with 17,437 sq.m of residential housing. Also Sistema-Hals has hired a contractor to perform general construction works for Western Kuntsevo properties. Commitments under these contracts amounted to $127.6 million as of December 31, 2006.

Sistema-Hals has obligations to manage a number of construction projects for Moscow City Government which were not yet completed as of December 31, 2006. Additionally, Sistema-Hals entered into construction agreements with various third party subcontractors for a total amount of $33.5 million.

Recent activities

Sitronics Initial Public Offering

In February 2007, SITRONICS completed its initial public offering (“IPO”) of 1,675,000,000 newly issued shares in the form of global depository receipts (“GDRs”), with 50 shares of common stock representing 1 GDR. Proceeds from the offering, net of the underwriters’ discount and other direct costs, comprised $356.4 million. As a result of the IPO, our effective ownership in SITRONICS decreased from 84.7% to 71.4%

Disposals

In February 2007, we sold our stake in Rosno for $750.0 million to Allianz AG. Transaction resulted in a gain from disposal of $591.8 million. After the transaction we retained a minority interest in ROSNO of 2.8%.

MTS Functional Currency

Starting from January 1, 2007, MTS’ Russian subsidiaries introduced ruble tariffs for settlements with the majority of its customers. As a result of the changes, MTS reevaluated the functional currency criteria under SFAS No. 52, “Foreign Currency Translation”, and determined that, beginning January 1, 2007, the functional currency of the MTS’ Russian subsidiaries is the ruble. The change is adopted prospectively beginning January 1, 2007. No restatement of comparative amounts will be made for the change in functional currency.