JSC SISTEMA-HALS AND SUBSIDIARIES

Independent Auditors' Report

Consolidated Financial Statements
Years Ended December 31, 2006 and 2005

JSC SISTEMA-HALS AND SUBSIDIARIES

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INDEPENDENT AUDITORS' REPORT

To the Shareholders of JSC Sistema-Hals:

We have audited the accompanying consolidated balance sheets of JSC Sistema-Hals ("Sistema-Hals") and its subsidiaries (collectively – the "Group") as of December 31, 2006 and 2005, and the related statements of operations, cash flows and changes in shareholders' equity for the years then ended. These financial statements are the responsibility of the Group's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Group's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such consolidated financial statements present fairly, in all material respects, the financial position of the Group as of December 31, 2006 and 2005, and the results of its operations and its cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

Deloitte & Touche

April 12, 2007
Moscow, Russia

JSC SISTEMA-HALS AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS
AS OF DECEMBER 31, 2006 AND DECEMBER 31, 2005
(Amounts in thousands of U.S. Dollars)

	Notes	2006	2005
ASSETS			
Cash and cash equivalents	5	261,952	10,362
Trade receivables, net	6	34,741	20,929
Taxes receivable	7	38,855	25,058
Other receivables, net	8	9,771	3,917
Deposits, loans receivable and investments in debt securities	9	164,855	7,708
Costs and estimated earnings in excess of billings on uncompleted contracts	10	13,081	38,348
REAL ESTATE INVESTMENTS, NET			
Real estate developed for sale	11	270,892	124,312
Income producing properties, net	11	59,541	47,580
Total		330,433	171,892
Buildings used for administrative purposes, plant and equipment, net	12	5,477	3,356
Development rights and other intangible assets, net	13	40,035	43,178
Investments in associates	14	2,799	287
TOTAL ASSETS		**901,999**	**325,035**
LIABILITIES AND SHAREHOLDERS' EQUITY			
LIABILITIES			
Payables to suppliers and subcontractors	15	33,477	12,148
Billings in excess of costs and estimated earnings on uncompleted contracts	16	25,363	13,996
Accrued expenses and other liabilities	17	25,130	5,198
Taxes payable		3,899	856
Construction obligations	18	2,232	21,898
Loans and notes payable	19	377,967	216,500
Deferred tax liabilities	23	21,504	10,883
TOTAL LIABILITIES		489,572	281,479
COMMITMENTS AND CONTINGENCIES	26	-	-
MINORITY INTERESTS		18,681	14,125
SHAREHOLDERS' EQUITY			
Share capital	20	20,492	24
Treasury stock	20	(2,322)	-
Additional paid-in capital	20	430,126	41,909
Accumulated deficit		(54,550)	(12,502)
TOTAL SHAREHOLDERS' EQUITY		393,746	29,431
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY		**901,999**	**325,035**

See notes to consolidated financial statements.

JSC SISTEMA-HALS AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS
FOR THE YEARS ENDED DECEMBER 31, 2006 AND 2005
(Amounts in thousands of U.S. dollars, except for share and per share amounts)

	Notes	2006	2005
REVENUES		282,899	93,124
OPERATING EXPENSES	22	(199,903)	(81,425)
OPERATING INCOME		82,996	11,699
OTHER INCOME/(EXPENSES):			
Other expenses, net		(372)	(1,201)
Interest income		4,255	682
Interest expense, net of amounts capitalized		(7,554)	(3,988)
Losses on foreign currency transactions		(1,930)	(193)
Gain on sale of shares in associates		2,808	-
Gain on sale of a controlling interest in a subsidiary		-	2,781
INCOME BEFORE INCOME TAX AND MINORITY INTERESTS		80,203	9,780
Income tax expense	23	(16,299)	(4,517)
INCOME BEFORE MINORITY INTERESTS		63,904	5,263
Minority interests		(8,330)	(4,556)
NET INCOME		**55,574**	**707**
Weighted average number of common shares outstanding		6,316,318	1,118
Earnings per common share, U.S. Dollars, basic and diluted		8.80	632.29

See notes to consolidated financial statements.

JSC SISTEMA-HALS AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED DECEMBER 31, 2006 AND 2005
(Amounts in thousands of U.S. Dollars)

	2006	2005
OPERATING ACTIVITIES:		
Net income	55,574	707
Adjustments to reconcile net income to net cash provided by/ (used in) operations:		
Depreciation and amortization	7,144	2,783
Gain on disposal of plant and equipment	(507)	(293)
Minority interests	8,330	4,556
Gain on sale of a controlling interest in a subsidiary	-	(2,781)
Gain on sale of shares in associates	(2,808)	-
Profit recognized by the percentage-of-completion method on real estate developed for sale	(96,919)	(2,195)
Deferred tax expense	10,621	539
Change in estimate of construction obligations	-	(5,288)
Bad debt expense	115	2,041
Foreign currency transactions (gain)/loss on non-operating activities	(448)	2,126
Changes in operating assets and liabilities:		
Billings in excess of costs/(costs in excess of billings) on uncompleted contracts	66,602	(19,804)
Trade receivables	(13,927)	(19,078)
Taxes receivable	(13,797)	(9,105)
Other receivables	(6,197)	(102)
Payables to suppliers and subcontractors	20,267	(8,589)
Accrued expenses and other current liabilities	10,416	1,302
Taxes payable	(3,229)	(1,089)
Net cash provided by/(used in) operating activities	**41,237**	**(54,270)**
INVESTING ACTIVITIES:		
Payments for real estate investments	(145,407)	(22,095)
Proceeds from sale of real estate investments	52,537	-
Purchases of plant and equipment and intangible assets	(4,094)	(1,701)
Proceeds from sale of plant and equipment	1,207	340
(Increase)/decrease in deposits, loans receivable and investments in debt securities, net	(157,544)	3,142
Purchases of shares in associates	(2,697)	(247)
Proceeds from sale of shares in associates	3,290	185
Proceeds from sale of controlling interest in a subsidiary	-	3,000
Net cash used in investing activities	**(252,708)**	**(17,376)**

JSC SISTEMA-HALS AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED DECEMBER 31, 2006 AND 2005 (CONTINUED)
(Amounts in thousands of U.S. Dollars)

	2006	2005
FINANCING ACTIVITIES:		
Proceeds from issuance of common stock, net	391,756	15,113
Principal payments on long-term borrowings	(85,264)	(60,744)
Proceeds from long-term borrowings	28,609	33,424
Proceeds from short-term borrowings, net	183,728	86,440
Transfers to Sistema	(57,451)	(2,503)
Proceeds from capital transaction of a subsidiary	-	4,052
Dividends paid to minority shareholders of subsidiaries	(3,551)	-
Net cash provided by financing activities	**457,827**	**75,782**
Effects of foreign currency translation on cash and cash equivalents	5,234	(314)
INCREASE IN CASH AND CASH EQUIVALENTS	251,590	3,822
CASH AND CASH EQUIVALENTS, beginning of the year	10,362	6,540
CASH AND CASH EQUIVALENTS, end of the year	261,952	10,362
CASH PAID DURING THE YEAR FOR:		
Income taxes	6,174	4,807
Interest, net of amounts capitalized	10,245	3,750

NON-CASH INVESTING AND FINANCING ACTIVITIES:

Non-cash investing and financing activities for the year ended December 31, 2006 included transfer to Sistema of a share of profit on Pokrovka 40 development project, as described in Note 3, and acquisitions of subsidiaries, as described in Note 4.

See notes to consolidated financial statements.

JSC SISTEMA-HALS AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY
FOR THE YEARS ENDED DECEMBER 31, 2006 AND 2005
(Amounts in thousands of U.S. Dollars)

	Share capital	Treasury stock	Additional paid-in capital	Accumulated deficit	Total
Balances at January 1, 2005	**$ 24**	**$ -**	**$ 26,480**	**$ (10,706)**	**$ 15,798**
Issuance of common stock (Note 20)	-	-	15,113	-	15,113
Capital transaction of a subsidiary (Note 20)	-	-	316	-	316
Transfers to Sistema (Note 21)	-	-	-	(2,503)	(2,503)
Net income	-	-	-	707	707
Balances at December 31, 2005	**$ 24**	**$ -**	**$ 41,909**	**$ (12,502)**	**$ 29,431**
Issuance of common stock (Note 20)	20,468	(2,322)	388,217	(14,607)	391,756
Transfers to Sistema (Notes 3, 21)	-	-	-	(83,015)	(83,015)
Net income	-	-	-	55,574	55,574
Balances at December 31, 2006	**$ 20,492**	**$ (2,322)**	**$ 430,126**	**$ (54,550)**	**$ 393,746**

See notes to consolidated financial statements.

1. DESCRIPTION OF THE BUSINESS

JSC Sistema-Hals ("Sistema-Hals") and subsidiaries (together – "the Group") are engaged in real estate development, project and construction management, real estate asset management and facility management, primarily focused on the "Class A" and "Class B" segments of the Moscow office market, shopping centers, high-end housing, single family houses, apartment buildings and land development. The Group's revenues are derived principally from the following activities: (i) sale of completed development projects, both commercial and residential, as well as the sale of rights for land; (ii) project and construction management activities for infrastructure and other construction and development projects; (iii) rental income from completed development projects held as investments; and (iv) facility management services.

Business operations of the Group are conducted in the Russian Federation (hereinafter referred to as the "RF") and the CIS, primarily in Moscow, the Moscow Region and Saint-Petersburg. All entities of the Group are incorporated in the CIS.

Initial public offering – In November 2006, Sistema-Hals has completed an initial public offering of 1,850,821 common shares, including 1,738,650 newly issued shares (in the form of global depositary receipts ("GDRs"), with twenty GDRs representing one share) and 112,171 shares sold by the shareholders (Note 20). The GDRs were admitted to trade on the London Stock Exchange.

The Group's reorganization – In the fourth quarter of 2006, JSFC Sistema ("Sistema"), the controlling shareholder of the Group, has completed the corporate reorganization of its Real Estate business segment by consolidating ownership of the segment's entities under Sistema-Hals. The reorganization has been accounted for at the historical book value of the assets and liabilities of the Group's entities. The Group's equity has been retroactively restated to reflect the reorganization as if it had occurred at the beginning of the earliest period presented.

Prior to reorganization, Sistema did not charge the Group for any management services, including corporate oversight, financial management, legal, corporate communications or human resources. Costs incurred by Sistema to provide such services to the Group have not been significant during these periods. However, the financial statements for the periods prior to reorganization may not necessarily be indicative of the conditions that would have existed or the results of operations and cash flows if the Group had been operated as a stand-alone company during these periods.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of presentation – The accompanying financial statements have been prepared in conformity with the accounting principles generally accepted in the United States of America ("U.S. GAAP"). The Group's entities maintain accounting records and prepare their statutory financial statements in Russian rubles ("RUB") in accordance with the requirements of accounting and tax legislation in Russia. The accompanying financial statements differ from the financial statements prepared for statutory purposes in Russia in that they reflect certain adjustments, not recorded in the Russian statutory accounting books of the Group's entities, which are appropriate to present the financial position, results of operations and cash flows in accordance with U.S. GAAP.

Principles of consolidation – All significant transactions within the Group, balances and unrealized gains/(losses) on such transactions have been eliminated in these financial statements.

The ownership interest of Sistema-Hals and proportion of its voting power in its major subsidiaries as of December 31, 2006 and 2005 (including interests held by Sistema as of December 31, 2005) were as follows:

Operating entities	**December 31, 2006**		**December 31, 2005**	
	Ownership interest	**Proportion of voting power**	**Ownership interest**	**Proportion of voting power**
Kuntsevo-Invest	100%	100%	81%	81%
Sistema-Hals Nord-West	76%	76%	76%	76%
DM Krasnoyarsk	100%	100%	-	-
TRK Kazan	100%	100%	50%	50%
Investments to the Technologies Development (IRT)	100%	100%	100%	100%
Beijing-Invest	90%	90%	90%	90%
Big City				
Mosdachtrest	57%	60%	56%	60%
Landshaft	100%	100%	100%	100%
Landshaft-2	100%	100%	100%	100%
Sistema-Temp	100%	100%	100%	100%
Nostro	100%	100%	-	-
Organizator	51%	51%	51%	51%
PSO Sistema-Hals	51%	51%	51%	51%
Upravlenie Metrostroya	26%(1)	51%	26%(1)	51%
Hals-Stroy	100%	100%	100%	100%
City-Hals	100%	100%	100%	100%

(1) – including indirect ownership.

Use of estimates – The preparation of the 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 amounts of revenues and expenses of the reporting period. Actual results could differ from those estimates.

Concentration of business risk – The Group's principal business activities are within the RF. Laws and regulations affecting businesses operating in the RF are subject to rapid changes. Russian land and property legislation is complicated, often ambiguous and contradictory at the federal and regional levels. In particular, it is not always clear which state bodies are authorized to enter into land leases with respect to particular land plots, construction approval procedures are complicated and prone to challenge or reversal, and construction and environmental rules often contain requirements that are impossible to comply with in practice. As a result, the risk exists that the Group's ownership of and/or lease rights for land and buildings might be challenged by government authorities or third parties.

The construction industry in general is subject to unique risks in respect to the means of financing, the legal and political risks and the financial risks associated with construction projects which transpire over a prolonged period of time. The Group is also reliant on a limited number of general contractors and subcontractors to undertake its commitments for construction in the timeframe required to avoid penalties and other associated costs.

Foreign currency translation – The Group follows a translation policy in accordance with Statement on Financial Accounting Standards ("SFAS") 52, "Foreign Currency Translation".

Management believes that the U.S. Dollar ("USD") is the functional currency of the Group, as the majority of its revenues, costs and capital expenditures are either priced, incurred, payable or otherwise measured in USD. In addition, the Group maintains significant portion of its debt instruments in USD. To the extent settlements are required to be in RUB, the Group sets prices and values in USD and performs the settlements in RUB using the then prevailing exchange rate of the Central Bank of Russia.

As such, during the years ended December 31, 2006 and 2005, the Group remeasured its assets, liabilities, income and expense items in USD. Monetary assets and liabilities were translated into USD at the rate in effect as of the balance sheet date; non-monetary assets and liabilities and income and expense items were translated at the rate prevailing on the date of the transaction. Exchange gains and losses arising from the remeasurement of monetary assets and liabilities not denominated in USD were included in gains/(losses) on foreign currency transactions in the statements of operations. The official exchange rates quoted by the Central Bank of Russia as of December 31, 2006 and 2005 were 26.33 and 28.78 rubles per 1 USD, respectively.

Revenue recognition – The Group's revenues are principally derived from i) real estate development, ii) project and construction management, iii) real estate asset management, iv) facility management. The Group records revenues as follows:

(i) Revenues from real estate development activities are recognized in accordance with the provisions of SFAS 66 "Accounting for Sales of Real Estate" or AICPA Statement of Position 81-1, "Accounting for Performance of Construction-Type and Certain Production-Type Contracts" ("SOP 81-1").

When the Group undertakes real estate development projects at its own risk, it recognizes 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) the Group's receivable is not subject to future subordination; d) the Group has 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 the Group is responsible has been arranged; and (d) all conditions precedent to closing have been performed. Revenues from development of office buildings, apartments, condominiums, shopping centers and similar structures 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 nondelivery of the property; (c) sales prices are collectible; (d) aggregate sales proceeds and costs can be reasonably estimated.

Investments in real estate developed for sale where the sale is not consummated are accounted for under the deposit method in accordance with SFAS 66, except for those investments in development of office buildings, apartments, condominiums, shopping centers and similar structures, where criteria for revenue recognition have been met as of the balance sheet date. Such investments are accounted for by the percentage-of-completion method.

In those instances, when the Group acts as a contractor under construction contracts with third parties, it applies the percentage of completion method to the respective contracts where and as soon as it is 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 Group is 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, the Group carries the projects at cost. The Group does not recognize revenue on contracts until reasonably dependable estimates of costs to complete the project and contractual revenues can be made.

(ii) The Group provides project and construction management services to municipal governments on certain socially important infrastructure projects. The Group's 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 99-19, Reporting Revenue Gross as a Principal versus Net as an Agent ("EITF 99-19"), management has concluded that the Group's services under such contracts do not transfer to the Group full risks and rewards associated with the projects. Therefore, the Group recognizes as revenues only its fees from project management services. Fees are recognized as the project costs are incurred and approved by the municipal government.

(iii) Revenues from real estate asset management 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 facility management are recognized on the accrual basis over the periods when services are provided.

Change orders and claims – Once contract performance is underway, the Group may experience changes in the conditions, client requirements, specifications, designs, materials and/or work schedule ("change orders"). Generally a change order will be negotiated with the customer to modify the original contract to approve both the scope and the pricing of the change. When a change order becomes a point of dispute between the Group and its customer, the Group then considers it as a claim. Costs related to change orders and claims are recognized when they are incurred. Change orders are included in total estimated contract revenues when it is probable that the change order will result in a bona fide addition to the relevant contract value and can be reliably estimated. Claims are included in total estimated contract revenue only to the extent that contract costs related to the claim have been incurred and when it is probable that the claim will result in a bona fide addition to contract value and can be reliably estimated.

Estimated losses on uncompleted contracts and changes in contract estimates – The Group provides for estimated losses on uncompleted contracts in the periods in which such losses are identified. The cumulative effects of revisions to contract revenue and estimated completion costs are recorded in the accounting period in which the amounts become evident and can be reasonably estimated. These revisions may include such items as the effects of change orders and claims, warranty claims, other contractual penalties and contract closeout settlements.

Costs and billings on uncompleted contracts – Costs related to the Group's performance under construction contracts (including estimated earnings from uncompleted contracts) is recorded net of billings on those contracts. Billings when in excess of costs and estimated earnings on uncompleted contracts are recorded as liabilities.

Income producing properties – The Group has a number of developments where it generates or expects to generate economic benefits through retaining title to or lease rights for the property and receiving rental revenues. Such properties primarily consist of residential and commercial buildings and land which is, or will be, leased on either a short-term or long-term basis.

Income producing properties are depreciated on a straight-line basis over estimated useful lives of the assets (buildings and land improvements – 20 to 40 years; leasehold improvements – the lesser of the remaining life of the asset or term of the lease).

Financial instruments – The Group's financial instruments primarily comprise cash and cash equivalents, deposits, loans receivable, investments in debt and equity securities, receivables, payables and debt. The estimated fair value of short-term financial instruments as of December 31, 2006 approximated their carrying value as reflected in the balance sheet. The fair value of long-term loans and notes payable which have variable interest rates based on market rates approximate the carrying amount of those financial instruments. The fair value of the Group's long-term loans and notes payable to Sistema and its subsidiaries is not practicable to estimate based on the related party nature of the underlying transactions. The fair value of investments in shares of associates was not determined due to quoted market prices not being readily available and valuations not being obtained due to the excessive costs involved.

Cash and cash equivalents – Cash and cash equivalents include cash on hand, amounts on deposit in banks and cash invested temporarily in various instruments with maturities of three months or less at the time of purchase.

Deposits, loans receivable and investments in debt securities – Deposits and loans receivable with original maturities in excess of three months are being accounted for at amortized cost. Management annually assesses the realizability of the carrying values of deposits and loans receivable and, if necessary, records impairment losses to write these assets down to fair value.

Investments in marketable debt securities are classified as available-for-sale and stated at fair value based on market quotes. Unrealized gains/(losses), net of deferred taxes, are recorded as a component of other comprehensive income. For the years ended December 31, 2006 and 2005 unrealized gains/(losses) on marketable debt securities have not been significant.

Investments in associates – The Group's share in net assets and net income/(loss) of Sibmost, Amiral B.V., Telecom Development, and Kamenny Ostrov in all of which the Group holds 20-50% of voting shares and has the ability to exercise significant influence over their operating and financial policies ("affiliates") is accounted for using the equity method of accounting. During the years ended December 31, 2006 and 2005, the Group's share in the net income/(loss) of these entities was insignificant.

Investments in corporate shares where the Group owns less than 20% voting interest are accounted for at cost of acquisition.

Accounts receivable – Accounts receivable are stated at their net realizable value after deducting an allowance for doubtful accounts. Such provisions reflect either specific cases or estimates based on evidence of collectibility.

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 reclaimable after the balance sheet dates is recorded in taxes receivable. Non-reclaimable VAT is included into the cost of construction as it is a cost necessarily incurred in the completion of the relevant object.

Buildings used for administrative purposes, plant and equipment – Plant and equipment with a useful life of more than one year is capitalized at historical cost. Cost includes major expenditures for improvements and replacements which extend useful lives of the assets or increase their revenue generating capacity. Repairs and maintenance are charged to the statements of operations as incurred.

Items of plant and equipment that are retired or otherwise disposed of are eliminated from the balance sheet along with the corresponding accumulated depreciation. Any gain or loss resulting from such retirement or disposal is included in the determination of net income.

Plant and equipment is depreciated on the straight-line basis over 3 to 5 years. Buildings used for administrative purposes is depreciated on the straight-line basis over 40 years.

Development rights and other intangible assets – Development rights acquired by the Group are stated at acquisition cost. The costs of development rights will be amortized on a straight-line basis from the date when the project starts generating revenues until the development period expires. Development rights as of December 31, 2006 and 2005, comprise rights to develop residential property in the Western Kuntsevo district of Moscow. The development period for this project expires in 2012. Amortization of other finite-life intangible assets is computed on a straight-line basis.

Impairment of long-lived assets – The Group periodically evaluates the recoverability of the carrying amount of its long-lived assets in accordance with SFAS 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, the Group compares undiscounted net cash flows estimated to be generated by those assets to the carrying amount of those assets. When these undiscounted cash flows are less than the carrying amounts of the assets, the Group records impairment losses to write the asset down to fair value, measured by the estimated discounted net future cash flows expected to be generated from the use of the assets. Management does not believe there should be any impairment charge recorded relating to the Group's investments in long-lived assets as of December 31, 2006 and 2005.

Construction obligations – Construction obligations represent obligations to construct apartments assumed as a result of the acquisition of rights to develop residential property in the Western Kuntsevo district of Moscow.

Income taxes – Income taxes have been computed in accordance with the laws of the RF. The standard income tax rate in the RF for the years ended December 31, 2006 and 2005 was 24%.

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 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 the Group will be able to realize the benefit, or the future deductibility is uncertain.

Retirement benefit and social security costs – The Group contributes to the RF state pension fund, social insurance fund, medical insurance fund on behalf of all of its current employees in the RF. In accordance with the current RF legislation, all social contributions are calculated by the application of a regressive rate from 26% to 2% to the annual gross remuneration of each employee.

Borrowing costs – The Group capitalizes interest on borrowings during the active construction period of its capital projects. Capitalized interest is added to the cost of the underlying assets and is amortized over the useful lives of the assets. For the years ended December 31, 2006 and 2005, capitalized borrowing costs were USD 10,234 thousand and USD 10,960 thousand, respectively. Other borrowing costs were recognized as an expense in the period in which they were incurred.

Advertising costs – The Group expenses the cost of advertising in the period in which they are incurred.

Minority interests – Minority interests represent share in book value of net assets of the Group's entities proportional to equity interests in those entities owned, directly or indirectly, by shareholders outside of the Group.

Dividends and distributions – Dividends and distributions to shareholders are recognized at the date they are declared. Distributable retained earnings of the Group are based on amounts extracted from statutory accounts of Sistema-Hals and differs from amounts calculated on the basis of U.S. GAAP.

Earnings per share – Basic earnings per share of common stock are computed by dividing net income by the weighted average number of common shares outstanding for the period. Diluted earnings per share of common stock reflects the maximum potential dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock and would then share in the net income of the Group.

Comprehensive income – Comprehensive income consists of net income and other comprehensive income. Other comprehensive income refers to revenues, expenses, gains and losses that are not included in net income, but rather are recorded directly in shareholders' equity. For the years ended December 31, 2006 and 2005, the Group had no items of other comprehensive income, and, accordingly, comprehensive income is the same as net income.

Recent accounting pronouncements – In February 2006, the Financial Accounting Standards Board ("FASB") issued SFAS No. 155, Accounting for Certain Hybrid Financial Instruments, an amendment to SFAS No. 133, Accounting for Derivative Instruments and Hedging activities and SFAS No. 140, Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities. SFAS 155 addresses application of SFAS 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, and clarifies certain other derivatives classification issues. SFAS 155 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. Its adoption did not have a material impact on the Group's financial position and results of operations.

In July 2006, the FASB issued Interpretation No. 48, Accounting for Uncertainty in Income Taxes, ("FIN 48") of SFAS No. 109, Accounting for Income Taxes. FIN 48 applies to all tax positions that are within the scope of SFAS 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. FIN 48 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. FIN 48 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. The Group is currently assessing the impact of the adoption of FIN 48.

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. The Group is 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. The adoption of SFAS 158 did not have a material impact on the Group’s 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, which permits an entity to measure certain financial assets and financial liabilities at fair value. SFAS 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 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 159 is effective as of the beginning of an entity's first fiscal year beginning after November 15, 2007. The Group is currently evaluating the provisions of SFAS 159 to determine whether it will elect the fair value option for eligible items.

3. DISPOSAL OF THE OFFICE PART OF POKROVKA 40 DEVELOPMENT PROJECT

During the year ended December 31, 2006, the Group has entered into a series of related transactions in order to dispose of the office part of a real estate complex, developed by the Group at 40, Pokrovka St. In April 2006, the Group has established a special-purpose entity, Pokrovka 40, where Sistema-Hals and subsidiaries owned 36.4%, Sistema and subsidiaries owned 60.6% and the ultimate buyer of the office building owned 3%. The shareholders, in proportion to their ownership interests, contributed USD 30,000 thousand to the share capital of Pokrovka 40 that were used to acquire rights for the office building from the Group. Upon satisfactory transfer of the title for the completed office building to Pokrovka 40 the buyer has acquired ownership interests of Sistema and Sistema-Hals in that entity. The transaction has been completed in the fourth quarter of 2006. In the year ended December 31, 2006, revenues related to the office part of the complex amounted to USD 70,900 thousand. The profit share retained by Sistema and its subsidiaries amounted to USD 25,563 thousand.

4. ACQUISITIONS OF SUBSIDIARIES

During the year ended December 31, 2006, the Group acquired additional 50% interest in TRK Kazan, 19% interest in Kuntsevo Invest and 0.3% interest in Mosdachtrest for consideration of USD 11 thousand, USD 102 thousand, and USD 163 thousand, respectively. As a result, the Group’s ownership interest in TRK Kazan and Kuntsevo-Invest increased to 100%, and the Group’s ownership interest in Mosdachtrest increased to 57%.

In 2006, the Group also acquired 51% interest in NPTC Transtekhproekt, 100% interest in Yurlack (from a related party) and 100% interest in Detsky Mir Krasnoyarsk for consideration of USD 36 thousand, USD 9 thousand and USD 474 thousand, respectively.

The aggregate effect of these transactions on the Group’s financial position and results of operations was not significant.

5. CASH AND CASH EQUIVALENTS

Cash and cash equivalents as of December 31, 2006 and 2005 consisted of the following:

	December 31, 2006	December 31, 2005
Cash and cash equivalents on deposit with:		
Third parties	7,542	3,732
Moscow Bank of Reconstruction and Development (“MBRD”), a subsidiary of Sistema	254,410	6,630
Total	**261,952**	**10,362**

The Group had USD 240,771 thousand and USD 500 thousand of demand deposits classified as cash equivalents as of December 31, 2006 and December 31, 2005, respectively. The weighted average interest rate on demand deposits as of December 31, 2006 was 5.4%.

6. TRADE RECEIVABLES, NET

Trade receivables, net of provision for doubtful debts, as of December 31, 2006 and 2005 consisted of the following:

	December 31, 2006	December 31, 2005
Trade receivables from third parties	27,616	6,267
Trade receivables from Sistema subsidiaries	7,319	14,958
Less: provision for doubtful debts	(194)	(296)
Total	**34,741**	**20,929**

As of December 31, 2006 and 2005, trade receivables from Sistema subsidiaries included amounts due for reimbursement of the Group’s construction costs of USD 6,246 thousand related to 13, Mokhovaya St. project and of USD 14,442 thousand related to 7, Nastasyinskiy lane project, respectively.

7. TAXES RECEIVABLE

Taxes receivable as of December 31, 2006 and 2005 consisted of the following:

	December 31, 2006	December 31, 2005
VAT receivable	34,133	22,608
Other taxes receivable	4,722	2,450
Total	**38,855**	**25,058**

8. OTHER RECEIVABLES, NET

Other receivables, net of provision for doubtful debts as of December 31, 2006 and 2005 consisted of the following:

	December 31, 2006	December 31, 2005
Advances to and other receivables from third parties	7,358	4,830
Prepaid expenses	4,328	1,111
Other receivables from Sistema subsidiaries	663	276
Less: provision for doubtful debts	(2,578)	(2,300)
Total	**9,771**	**3,917**

Management assesses the realizability of other receivables on an annual basis. This assessment identified advances paid in prior reporting periods for construction of residential property for which the receipt of services is unlikely. Accordingly, the Group has fully provided for those advances as of December 31, 2006 and 2005.

9. DEPOSITS, LOANS RECEIVABLE AND INVESTMENTS IN DEBT SECURITIES

Deposits, loans receivable and investments in debt securities as of December 31, 2006 and 2005 consisted of the following:

	December 31, 2006	December 31, 2005
Investments in marketable debt securities	64,974	-
Loans and notes receivable from:		
- subsidiaries of Sistema	64,211	7,258
- associates	3,464	-
- third parties	25,210	450
Time deposits in MBRD	6,996	-
Total	**164,855**	**7,708**

The Group’s investments in marketable debt securities comprise debt securities of Russian issuers, unrelated to the Group. The Group determines the appropriate classification of its investments in marketable debt securities at the time of purchase and reevaluates such designation at each balance sheet date. As of December 31, 2006, the Group’s marketable debt securities have been classified as available for sale. In response to changes in the yield on alternative investments as well as liquidity requirements, the Group may or may not sell these securities prior to their stated maturities.

The weighted average interest rates for loans and notes receivable from Sistema subsidiaries, the Group’s associates and third parties as of December 31, 2006 were 9.5%, 12.0% and 7.8%, respectively. Substantially all loans and notes receivable held by the Group as of December 31, 2006 mature prior to the end of 2007.

The Group’s time deposits in MBRD mature in 2007. The weighted average interest rate for time deposits as of December 31, 2006 was 5.2%.

In December 2006, the Group has transferred a portfolio of its investments in debt securities into a trust managed by MBRD. The portfolio includes promissory notes of Sistema subsidiaries in the amount of USD 32,148 thousand and debt securities of third parties in the amount of USD 64,974 thousand. The trust management agreement expires in 2007 but is automatically prolonged, unless any of the parties issues a cancellation notice.

10. COSTS AND ESTIMATED EARNINGS IN EXCESS OF BILLINGS ON UNCOMPLETED CONTRACTS

Costs and estimated earnings in excess of billings on uncompleted contracts as of December 31, 2006 and 2005 consisted of the following:

	December 31, 2006	December 31, 2005
Accumulated costs and earnings	25,578	102,345
Less: amounts billed	(12,497)	(63,997)
Total	**13,081**	**38,348**

11. REAL ESTATE INVESTMENTS, NET

Real estate investments, net of accumulated depreciation as of December 31, 2006 and 2005 consisted of the following:

	December 31, 2006	December 31, 2005
Real estate developed for sale	**270,892**	**124,312**
Income producing properties		
Buildings and constructions	66,140	51,290
Construction in progress	-	130
	66,140	51,420
Less: accumulated depreciation	(6,599)	(3,840)
	59,541	**47,580**
Total	**330,433**	**171,892**

Depreciation charge for the years ended December 31, 2006 and 2005 amounted to USD 2,759 thousand and USD 1,925 thousand, respectively.

12. BUILDINGS USED FOR ADMINISTRATIVE PURPOSES, PLANT AND EQUIPMENT, NET

Buildings used for administrative purposes, plant and equipment, net of accumulated depreciation, as of December 31, 2006 and 2005 consisted of the following:

	December 31, 2006	December 31, 2005
Plant and equipment	4,714	3,114
Other assets	3,446	2,136
	8,160	5,250
Less: accumulated depreciation	(2,683)	(1,894)
Total	**5,477**	**3,356**

Depreciation charge for the years ended December 31, 2006 and 2005 amounted to USD 988 thousand and USD 799 thousand, respectively.

13. DEVELOPMENT RIGHTS AND OTHER INTANGIBLE ASSETS, NET

Development rights and other intangible assets, net of accumulated amortization as of December 31, 2006 and 2005 consisted of the following:

	December 31, 2006	December 31, 2005
Development rights – Kuntsevo properties	43,156	43,156
Other intangible assets	391	137
	43,547	43,293
Less: accumulated amortization	(3,512)	(115)
Total	**40,035**	**43,178**

Amortization charged for the years ended December 31, 2006 and 2005 amounted to USD 3,397 thousand and USD 59 thousand, respectively.

Development rights granted to Kuntsevo-Invest in accordance with the Decree of the Moscow City Government relate to the program for reconstruction of residential property in the Kuntsevo district of Moscow. Under the program, as subsequently amended, the Group is committed to complete construction of 381.4 thousand square meters of residential living space to be sold in the market ("commercial buildings") and of additional 173.3 thousand square meters of residential living space to be transferred to the Moscow City Government ("municipal buildings"). Kuntsevo-Invest entered into an investment agreement with CJSC Inteko, pursuant to which Inteko undertook to (i) develop, fund and construct approximately 50% of the commercial buildings and (ii) fund the development and construction of approximately 50% of the municipal buildings under the program. As of December 31, 2006, the Group's remaining commitment under the program was to complete 167.9 thousand square meters of commercial buildings and 77.8 thousand square meters of municipal buildings.

Management estimates that on the basis of the amortization policy referred to in Note 2, the estimated amortization expense is as follows:

Year ended December 31,	
2007	6,642
2008	6,642
2009	6,642
2010	6,642
2011	6,642
Thereafter	6,825
Total	**40,035**

Actual amortization expense to be reported in future periods could differ from these estimates as a result of new intangible assets acquisitions, changes in useful lives and other relevant factors.

14. INVESTMENTS IN ASSOCIATES

Investments in associates as of December 31, 2006 and 2005 consisted of the following:

	December 31, 2006	December 31, 2005
Sibmost	2,400	-
Other	399	287
Total	**2,799**	**287**

In January 2006, PSO Sistema-Hals acquired 25% plus one share of Sibmost, an infrastructure project manager and developer in the Siberian Federal Region for USD 2,400 thousand. The Group's share in the net income of Sibmost was not significant for the year ended December 31, 2006.

In May 2006, Sistema-Hals sold its stake in Regiony, an associate, for USD 3,094 thousand. The gain from disposal amounted to USD 3,078 thousand.

15. PAYABLES TO SUPPLIERS AND SUBCONTRACTORS

Payables to suppliers and subcontractors as of December 31, 2006 and 2005 consisted of the following:

	December 31, 2006	December 31, 2005
Payables to third parties	30,729	10,568
Payables to Sistema subsidiaries	2,748	1,580
Total	**33,477**	**12,148**

16. BILLINGS IN EXCESS OF COSTS AND ESTIMATED EARNINGS ON UNCOMPLETED CONTRACTS

Billings in excess of costs and estimated earnings on uncompleted contracts as of December 31, 2006 and 2005 consisted of the following:

	December 31, 2006	December 31, 2005
Amounts billed	97,274	44,820
Less: accumulated costs and earnings	(71,911)	(30,824)
Total	**25,363**	**13,996**

17. ACCRUED EXPENSES AND OTHER LIABILITIES

Accrued expenses and other liabilities as of December 31, 2006 and 2005 consisted of the following:

	December 31, 2006	December 31, 2005
Accrued expenses and other liabilities to third parties	23,484	3,725
Other liabilities to Sistema subsidiaries	1,646	1,473
Total	**25,130**	**5,198**

18. CONSTRUCTION OBLIGATIONS

Upon acquisition of Kuntsevo-Invest, the Group assumed obligations to construct two residential buildings (15, Elninskaya St. and 9, Aviatorov St.). During the year ended December 31, 2006, the Group incurred related construction costs in the amount of USD 19,666 thousand. As of December 31, 2006, construction of those buildings was substantially completed. The construction costs were offset against the respective obligations when the completed buildings were accepted by the customers and the Moscow City Government. The remaining balance in construction obligations as of December 31, 2006 represents a provision for settlement of legal claims in connection with these properties (Note 26).

19. LOANS AND NOTES PAYABLE

The Group's loans and notes payable as of December 31, 2006 and 2005 consisted of the following:

	December 31, 2006	December 31, 2005
Loans and notes payable to third parties		
Deutsche Bank AG	140,000	-
NOMURA International plc	100,000	-
UBS AG	100,000	-
Commerzbank	-	20,000
West LB Vostok	-	10,400
Other	27,867	3,660
	367,867	34,060
Loans and notes payable to Sistema and its subsidiaries	10,100	182,440
Total loans and notes payable	**377,967**	**216,500**
Current portion of loans and notes payable	362,560	152,857
Non-current portion of loans and notes payable	15,407	63,643

In August, September and October 2006, Sistema-Hals entered into one-year loan facilities with Deutsche Bank AG, NOMURA International plc and UBS AG in the amounts of USD 140,000 thousand, USD 100,000 thousand and USD 100,000 thousand, respectively. The facilities were extended for the Group's general operational needs and refinancing of its existing debt facilities and bear interest rate of 8.65%, 8.45% and 8.65%, respectively. The debt is guaranteed by Sistema. The guarantee fee payable by the Group is 3% per annum. The facilities require that the Group not incur indebtedness unless the aggregate of all indebtedness does not exceed 60% of the aggregate market value of the Group's properties as valued by an internationally recognized valuation expert and the ratio of EBITDA to interest expense is no less than 2:1. The loan facilities also include certain negative covenants restricting or limiting the Group's ability to dispose of any assets unless such disposal is made for consideration at least equal to the fair market value of the assets disposed of, and at least 75% of the consideration received is in the form of cash, cash equivalents or certain capital stock; to change substantially the general nature of the Group's business; to merge or otherwise reorganize, save where Sistema-Hals is the surviving entity and such reorganizations might not reasonably be expected to have a material adverse effect; to repay or prepay any indebtedness of Sistema which is subordinated in right of payment to the facilities; and to make investments in certain Sistema subsidiaries.

The interest rates on loans and notes obtained by the Group from Sistema and its subsidiaries are fixed and range from 0% to 12.5%.

The weighted average interest rate on loans outstanding as of December 31, 2006 and 2005 was 8.7% and 9.0%, respectively.

The schedule of repayments of long-term debt is as follows:

Year ended December 31,	
2007	362,560
2008	5,626
2009	3,024
2010	6,757
Total	**377,967**

In December 2006, the Group entered into an agreement with Eurohypo AG to open a credit facility to finance the development of the Hals Mart ('Leto') retail and entertainment complex in Saint-Petersburg. The amount of the facility is the lower of USD 106,400 thousand and 70% of budgeted costs for financing of the development. The facility may be prolonged up to 12 years and the facility amount can be extended up to USD 187,500 thousand. To obtain the facility the Group must comply with certain conditions precedent. As of the date of these financial statements, the conditions precedent have not been fulfilled.

20. CAPITAL TRANSACTIONS

In June 2005, Sistema-Hals issued 125 common shares to Sistema with par value of RUB 50 at RUB 3,480 thousand per share. The proceeds from the issuance amounted to USD 15,113 thousand.

In April 2006, Sistema-Hals increased its share capital by issuing 8,086,350 common shares at par value of RUB 50. The issuance was effected through capitalization of accumulated statutory earnings of Sistema-Hals. In the Group's consolidated financial statements this issuance was recorded as a concurrent increase in share capital and accumulated deficit for USD 14,607 thousand.

In November 2006, Sistema-Hals issued 1,738,650 common shares in the course of its initial public offering and 168,256 additional common shares as the underwriters exercised their over-allotment option at USD 0.214 thousand per share. The Group's proceeds from the offerings amounted to USD 408,078 thousand, net of the underwriting commissions and other offering costs of USD 17,719 thousand. Concurrently, Sistema-Hals issued to Sistema and repurchased for the same amount 1,222,663 common shares. As of December 31, 2006, these shares are held by the Group's 100% subsidiary, classified as treasury stock and accounted for at par value.

The authorized share capital of Sistema-Hals as of December 31, 2006 comprised 13,087,525 common shares, of which 11,217,094 shares were issued and 9,994,431 shares were outstanding. The share capital of Sistema-Hals as of December 31, 2005 comprised 1,175 authorized, issued and outstanding common shares.

During the year ended December 31, 2005, Mosdachtrest issued 19,894 common shares with a par value of RUB 16,361. The Moscow Government acquired 7,162 common shares for USD 4,046 thousand. Other shareholders acquired 10 common shares for USD 6 thousand. The remaining shares were acquired by Sistema-Hals. These transactions increased Sistema-Hals' ownership interest in Mosdachtrest to 56%. The excess of the Moscow Government contribution over the book value of the respective share of Mosdachtrest's net assets of USD 316 thousand has been recorded as a capital transaction.

21. TRANSFERS TO SISTEMA

During the year ended December 31, 2005, Sistema-Hals acquired from Sistema 50% of the ordinary shares in Sistema-Temp for USD 2,091 thousand, 81% of the ordinary shares in Kuntsevo-Invest for USD 2 thousand and 30% of the ordinary shares in City-Hals for USD 10 thousand.

In August 2006, Sistema-Hals acquired from Sistema a 99% stake in Terra, a 98% stake in Yalta Fish Processing Plant, 100% stake in Kaskad and a 100% stake in Hotel Korona- Intourist for an aggregate consideration of USD 30,300 thousand.

In August 2006, the Group acquired from parties under common control a 100% stake in Nostro for consideration of USD 26,600 thousand and committed to additionally invest USD 7,200 thousand to settle the debts of that entity. Nostro owns a building located at 75, Sadovnicheskaya St. The difference between the purchase price for the Group and the price paid for the building by Nostro was recorded by the Group as a transfer to Sistema.

22. OPERATING EXPENSES

Operating expenses for the years ended December 31, 2006 and 2005 comprised the following:

	2006	**2005**
Cost of sales of development projects	151,476	51,969
Payroll and employee related costs	24,720	15,318
Depreciation and amortization	7,144	2,783
Repairs and maintenance	2,247	1,021
Rent of premises and land	2,009	2,512
Consulting services	1,617	4,584
Taxes other than income taxes	1,555	1,451
Security expenses	1,479	1,884
Advertising and marketing	739	489
Utilities and energy costs	452	1,021
Insurance	134	608
Bad debt expense	115	2,041
Change in the estimate of construction obligations	-	(5,288)
Other	6,216	1,032
Total	**199,903**	**81,425**

23. INCOME TAXES

The Group's provision for income taxes for the years ended December 31, 2006 and 2005 was as follows:

	2006	**2005**
Current tax expense	5,678	3,978
Deferred tax expense	10,621	539
Total	**16,299**	**4,517**

The provision for income taxes is different from that which would be obtained by applying the statutory income tax rate of 24% to income before income tax and minority interests. The items causing this difference are as follows:

	2006	2005
Income tax provision computed on income before taxes at statutory rate	19,248	2,347
Adjustments due to:		
Non-deductible items	1,189	745
Non-taxable items	-	(137)
Share of profit on Pokrovka 40 development project, retained by the controlling shareholder	(6,135)	-
Change in valuation allowance	369	-
Taxable losses not carried forward	1,135	1,103
Currency exchange and translation differences	493	459
Total	**16,299**	**4,517**

Temporary differences between the Russian statutory tax accounts and these financial statements give rise to the following deferred tax assets and liabilities as of December 31, 2006 and 2005.

	December 31, 2006	December 31, 2005
Deferred tax assets		
Construction obligations	5,256	5,062
Other	1,089	914
Less: valuation allowance	(6,345)	(5,976)
Total deferred tax assets	**-**	**-**
Deferred tax liabilities		
Development rights	(9,561)	(10,330)
Revenue recognition	(11,100)	(553)
Other	(843)	-
Total deferred tax liabilities	**(21,504)**	**(10,883)**

The valuation allowance has been recorded, as it is more likely than not that taxable income generated by the respective entity of the Group during the periods when the deductible temporary differences are expected to reverse, will not be sufficient for this asset to realize.

24. RELATED PARTY TRANSACTIONS

During the years ended December 31, 2006 and 2005, the Group entered into the following transactions with Sistema and its subsidiaries:

	2006	2005
Revenues from development projects	2,148	17,333
Interest costs	(3,963)	(12,399)
Services provided	10,058	1,269
Services purchased	(578)	(374)
Interest income	1,522	96
Other expenses	(403)	-

Development projects:

MGTS

In the year ended December 31, 2005, the Group derived revenues of USD 14,442 thousand from the reconstruction of MGTS' building at 7, Nastasyinsky lane.

Manezh 13/1

In the year ended December 31, 2005, the Group entered into an investment agreement with Manezh 13/1, a wholly owned subsidiary of Sistema, for redevelopment of 13, Mokhovaya St. office building, owned by Manezh 13/1. The Group is recognizing a fee related to the supervisory, management and administrative services provided in respect of the Mokhovaya 13 redevelopment project, determined as 5% of the total construction costs. For the years ended December 31, 2006 and 2005, the fee recognized by the Group amounted to USD 1,033 thousand and USD 513 thousand, respectively.

Agreements to act as a developer:

In the years ended December 31, 2006 and 2005, the Group had agreements with Detsky Mir, NIIDAR and MGTS, subsidiaries of Sistema, to act as a developer for projects to redevelop properties owned by these entities.

Interest costs:

In the years ended December 31, 2006 and 2005, borrowing costs on the Group's borrowings from MBRD amounted to USD 3,742 thousand and USD 12,399 thousand, respectively.

Interest income:

Interest income on MBRD's promissory notes and deposits in MBRD for the years ended December 31, 2006 and 2005 amounted to USD 1,438 thousand and USD 96 thousand, respectively.

Site management services provided:

Services provided in the years ended December 31, 2006 and 2005, included site management revenues of USD 8,004 thousand and USD 1,269 thousand, respectively. These services are being performed primarily for Sistema and its subsidiary MTS.

Rental revenues:

During the years ended December 31, 2006 and 2005, the Group received rental revenues from Radio Centre, then a subsidiary of Sistema, of USD 418 thousand and USD 519 thousand, respectively.

Certain single-family houses owned by Mosdachtrest are leased to Sistema's related parties. The amount of rental revenues from these leases has been insignificant for the years ended December 31, 2006 and 2005.

Related party balances for the years ended December 31, 2006 and 2005 are disclosed in the corresponding notes to the financial statements.

25. GUARANTEES AND PLEDGES

Warranties and guarantees of work performed – The Group is contractually responsible for the quality of construction works performed subsequent to the date at which the relevant object was handed over, generally for an exploitation period up to 2 years subsequent to handover. Based upon prior experience with warranty claims, which have not been significant, no contingent liabilities have been recorded in the Group's financial statements in relation to warranties and guarantees for work performed.

Pledges – As of December 31, 2006, common shares of the Group's entities have been pledged under borrowings from MBRD as follows:

	Number of shares	**Ownership interest**
Mosdachtrest	10,946	57%
Landshaft	30	30%
Rosturstroy	360	90%

As of December 31, 2006, the Group has also pledged title to apartments with the fair value of USD 5,718 thousand and USD 385 thousand under obligations to Ordynka and Remstroytrest-701, respectively.

As of December 31, 2006, Alfa Bank's guarantee covering Hotel Korona Intourist' obligations to MMR Russia S.A to provide services in relation to Pokrovka 40 development project was still outstanding. The guarantee was secured by notes of Alfa Bank held by the Group in the amount of USD 17,788 thousand. The guarantee expired in 2007.

As of December 31, 2006, Sistema has guaranteed MBRD's borrowings to the Group in the amount of USD 5,204 thousand.

As of December 31, 2006, MBRD guaranteed PSO Sistema-Hals' obligations to FGUP Dorogi Rossii to provide services in relation to a highway construction project. The guarantee is secured by funds of PSO Sistema-Hals deposited in MBRD in the amount of USD 1,899 thousand.

26. COMMITMENTS AND CONTINGENCIES

a) Taxation environment

Russia currently has a number of laws related to various taxes imposed by both federal and regional governmental authorities. Applicable taxes include VAT, income tax, unified social tax, together with others. The government's policy on implementation of these regulations is often inconsistent or nonexistent. Accordingly, few precedents with regard to tax rulings have been established. Tax declarations, together with other legal compliance areas (for example, customs and currency control matters), are subject to review and investigation by a number of authorities, which are enabled by law to impose extremely severe fines, penalties and interest charges. These facts create tax risks in Russia those are more significant than typically found in countries with more developed tax systems. Generally, tax declarations remain open and subject to inspection for a period of three years following the tax year. Management believes that it has adequately provided for tax liabilities; however, the risk remains that relevant authorities could take a different position with regard to interpretive issues.

b) Russian environment and current economic situation

Over the past decade Russia has undergone substantial political and social changes. As an emerging market, Russia does not possess a fully developed business and regulatory infrastructure that would generally exist in a more mature market economy. The Russian government is attempting to address these issues; however it has not yet fully implemented the reforms necessary to create banking and judicial systems that usually exist in more developed markets. As a result, operations in Russia involve risks that typically do not exist in more developed markets.

c) Industry regulation

Construction and development of real estate in Russia is primarily governed by the Civil Code, the Federal Land Code, the City Construction Code, the Federal Law on the State Registration of Rights to Immovable Property and Transactions Therewith, construction norms and regulations approved by the Ministry of Industry and Energy, and others. Construction and development involves compliance with burdensome regulatory requirements, and authorizations from a large number of authorities at the federal, regional and local levels. In particular, the Federal Agency on Construction, Housing and the Communal Sector, or Rosstroi, the Federal Service for Supervision in the Sphere of Use of Natural Resources, the Federal Service on Ecological, Technologic and Nuclear Supervision and regional bodies of the state architectural and construction supervision are involved in the process of authorizing and supervising real estate development.

In addition, construction is subject to all applicable environmental, fire safety and sanitary norms and regulations.

The Group is constructing a number of cottages without obtaining necessary construction permits. However, management is in the process of addressing this issue and does not foresee that this will adversely affect the Group’s financial position or results of operations.

d) Legal proceedings

In the ordinary course of business, the Group may be a party to various legal and tax proceedings, and be subject to claims. In the opinion of management, the Group’s liability, if any, in all current and pending litigations or other legal proceedings will not have a material effect upon the financial condition, results of operations or liquidity of the Group, other than as is already reflected in these financial statements.

Since January 1, 2005, individual purchasers of residential buildings developed by Kuntsevo-Invest have initiated 17 separate court actions against Kuntsevo-Invest in the total amount of approximately USD 2,700 thousand. These individuals have sued to have construction defects remedied, fit-out works finalized and be compensated for the delayed delivery of their apartments, among other claims.
In all but one action, the Russian courts have ruled in favor of Kuntsevo-Invest. One plaintiff, however, was awarded approximately USD 24 thousand for damages and court fees, and three settlements were approved involving the transfer of apartments by the Group to the plaintiffs.
As of the date of these financial statements, certain lawsuits still are being considered by various courts in connection with the Kuntsevo-Invest properties, none of which is for a substantial amount.

In 2004, Amiral B.V., the Group’s associate, entered into a contract with the three companies that own Hotel Sport to redevelop the hotel. Under the contract, Amiral agreed to destroy the existing hotel and construct a new mixed-use hotel, retail and business center on the site. The project was initially approved by a decree of the Moscow City Government and the Hotel Sport building was subsequently demolished. However, in 2006 the Moscow City Government abolished its previous decree based on the failure of the co-owners to develop the land plot in a timely manner after the original building had been destroyed. As a result, the development of the project has been suspended. In August 2006, two of the co-owners filed claims in the Moscow Arbitration Court against the Moscow City Government seeking to invalidate the cancellation of the decree. As of the date of these financial statements, a final ruling on this lawsuit has not been issued.

e) Commitments under construction contracts

The Group has entered into agreements with third parties for construction of objects which will require capital outlays subsequent to December 31, 2006. A summary of significant commitments under construction contracts as of December 31, 2006 is provided below:

Leningradsky 39 – The Group has contracted for construction works, including foundations, shell and core, utilities and other general construction expenditures. Commitments under these contracts amounted to USD 82,644 thousand as of December 31, 2006. In addition, in connection with this project, the Group undertook obligations to provide the Central Army Sports Club ("CSCA") with 17,437 sq.m of residential housing.

MGTS properties – The Group entered contractual agreements for reconstruction of the abovementioned buildings. Commitments under these contracts amounted to USD 9,190 thousand as of December 31, 2006.

Mosdachtrest properties – The Group has contracted for construction works related to Mosdachtrest properties. Commitments under these contracts amounted to USD 17,776 thousand as of December 31, 2006.

Aurora project – The Group has contracted for construction works, including construction of the roads, gas and electricity networks. Commitments under these contracts amounted to USD 6,391 thousand as of December 31, 2006.

Western Kuntsevo properties – The Group has hired a contractor to perform general construction works. Commitments under these contracts amounted to USD 25,313 thousand as of December 31, 2006.

Moscow City Government – The Group has obligations to manage a number of construction projects which will be completed subsequent to the balance sheet date. The Moscow City Government has the obligation to finance these construction projects, the Group generating commissions based on the agreed upon budget cost of the project.

f) Operating leases

With a few exceptions, the land in Moscow is owned by the Moscow Government. The lease of land in Moscow is subject to a separate regulatory regime administered by the Government. As a general rule, such land lease rights are granted by the Government on the basis of an auction or tender, typically in exchange for either an upfront payment or ongoing consideration in the form of periodic lease payments. Periodic lease payments under land lease agreements in effect during the years ended December 31, 2006 and 2005 have not been significant.

Mosdachtrest leases numerous cottages to individuals at a discount to market rates as a result of the Moscow Government requirement to make available certain properties to pensioners and others entitled to social benefits. Furthermore, certain residents of Mosdachtrest settlements hold life or long-term leases, which could prevent or delay the Group from developing or redeveloping such settlements. Even if granted the right to develop or redevelop these properties, the Group would be required to transfer these residents to housing of a similar quality.

g) Commitment to maintain production at Yalta Fish Processing Plant

In acquisition of Yalta Fish Processing Plant, the Group assumed obligations to maintain activities and workforce of the plant up to 2008. Management does not expect this commitment to result in significant cash outflows for the Group.

h) Environmental regulations

Environmental laws and regulations impose certain restrictions and encumbrances on the properties that we hold or develop. Some of our land plots under development are located in areas that have special environmental protection. In addition, the development of a project may be subject to certain obligations, including planting of greenery and clean-up measures. These requirements may result in delays of development of our projects or additional costs.

27. SEGMENT INFORMATION

SFAS No. 131, "Disclosures about Segments of an Enterprise and Related Information", established standards for reporting information about operating segments in financial statements. Operating segments are defined as components of an enterprise engaging in business activities about which separate financial information is available that is evaluated regularly by the chief operating decision maker or group in deciding how to allocate resources and in assessing performance.

The Group's operating segments are: Real estate development, Project and construction management, Real estate asset management and Facility management. Activities of the Group's Real estate development segment include identification of investment opportunities, performance of feasibility studies, obtaining necessary construction permits, project financing and marketing activities.
The Project and construction management segment is currently primarily acting as a construction manager to oversee compliance by contractors with design specifications and the terms of a particular contract. The Real estate asset management segment is involved in renting of residential and commercial properties that we have developed or acquired. The Facility management segment provides site management services, including security, cleaning, staffing, technical support, repair and renovation, as well as general building maintenance. The Group's management evaluates performance of the segments based on both operating income and income before income taxes and minority interests.

Intersegment eliminations presented below consist primarily of intersegment sales transactions, elimination of interest on intersegment borrowings and other intersegment transactions conducted under the normal course of operations.

As of and for the year ended December 31, 2006	**Real estate development**	**Project and construction management**	**Real estate asset management**	**Facility management**	**Total**
Net sales to external customers	206,155	39,930	26,805	10,009	282,899
Intersegment sales	250	4,741	529	1,751	7,271
Interest income	4,048	590	2	-	4,640
Interest expense, net of amounts capitalized	(6,485)	(542)	(912)	-	(7,939)
Depreciation and amortization	(3,920)	(366)	(2,846)	(12)	(7,144)
Operating income/(loss)	64,488	9,517	11,040	(953)	84,092
Income tax expense	(9,690)	(3,485)	(2,971)	(153)	(16,299)
Income/(loss) before income tax and minority interests	66,555	9,253	6,561	(1,070)	81,299
Segment assets	850,973	40,546	96,539	3,599	991,657
Capital expenditures	148,303	826	25	347	149,501

As of and for the year ended December 31, 2005	Real estate development	Project and construction management	Real estate asset management	Facility management	Total
Net sales to external customers	48,497	22,729	14,878	7,020	93,124
Intersegment sales	463	14	421	247	1,145
Interest income	638	136	-	-	774
Interest expense, net of amounts capitalized	(1,956)	(1,948)	(541)	-	(4,445)
Depreciation and amortization	(261)	(274)	(2,223)	(25)	(2,783)
Operating income/(loss)	(6,642)	11,553	6,740	370	12,021
Income tax expense	(644)	(2,836)	(987)	(50)	(4,517)
Income/(loss) before income tax and minority interests	(1,948)	9,119	2,533	76	9,780
Segment assets	253,560	28,643	85,862	4,113	372,178
Capital expenditures	15,282	439	8,043	32	23,796

The reconciliation of segment operating income to the income before income tax and minority interests and reconciliation of segment assets to the total assets of the Group are as follows:

	2006	2005
Total segment operating income	84,092	12,021
Intersegment eliminations	(1,096)	(322)
Other expenses, net	(372)	(1,201)
Interest income	4,255	682
Interest expense, net of amounts capitalized	(7,554)	(3,988)
Loss on foreign currency transactions	(1,930)	(193)
Gain on sale of shares in associate	2,808	-
Gain on sale of a controlling interest in a subsidiary	-	2,781
Income before income tax and minority interests	**80,203**	**9,780**
Total segment assets	991,657	372,178
Intersegment eliminations	(89,658)	(47,143)
Total assets	**901,999**	**325,035**

28. SUBSEQUENT EVENTS

In March 2007, the Group acquired from Sistema a 67.58% stake in Kamelia Health Spa, a company holding a 49-year lease for a 6.3 hectare plot of land in Sochi, for USD 6,899 thousand. The site is occupied by hotel buildings owned by Sistema.

In April 2007, Rosprirodnadzor and the Federal Agency for Federal Property Management of the RF filed a lawsuit against Sistema-Hals in respect of the legality of construction of a waterfront structure at “Aurora” cottage village. The Group believes that the construction was carried out in compliance with the applicable legislation and intends to defend its interests in court.