



JOINT-STOCK FINANCIAL CORPORATION
SISTEMA

SISTEMA JSFC
ANNUAL REPORT
2011



To whom it may concern

April 26, 2012

Responsibility Statement

To the best of my knowledge (a) the financial statements, prepared in accordance with US GAAP, give a true and fair view of the assets, liabilities, financial position and profit or loss of Sistema JSFC and the undertakings included in the consolidation taken as a whole; and (b) the management report includes a fair review of the development and performance of the business and the financial position of Sistema JSFC and the undertakings included in the consolidation taken as a whole, together with a description of the principal risks and uncertainties that they face.

A handwritten signature in black ink, consisting of a series of loops and a long horizontal stroke.

Yours sincerely,

Mikhail Shamolin

President and Chief Executive Officer

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1. Key 2011 events and events after the end of reporting period

Key events of 2011

February 2011

- Sistema establishes OJSC RTI with investment from the Bank of Moscow. Sistema contributes its 97% stake in OJSC Concern RTI Systems, as well as RUB 2.88 billion in cash, to the new entity's charter capital, while the Bank of Moscow makes a RUB 3 billion cash contribution. As a result, the Bank of Moscow receives a 15.4% stake in RTI, while Sistema controls 84.6% of the new entity.

March 2011

- The Board of Directors appoints Mikhail Shamolin as President of Sistema.
- The Russian Government made an equity investment into Sistema Shyam TeleServices Ltd. This transaction involved a share issuance in which SSTL increased its share capital by INR 28,894.5 million, with the Russian Government, represented by Rosimushchestvo (the Federal Agency for State Property Management), acquiring a 17.14% stake in SSTL for INR 26,988 million. Following the completion of the secondary share issue, Sistema's stake in SSTL is 56.68%, while Indian investors own 26.05%.
- Sistema's Board of Directors approves the sale of its stake in SITRONICS to RTI. Sergey Boyev, previously Vice President of Sistema and Head of the High Technologies and Industry business unit, was appointed as General Director of OJSC RTI. The transaction is completed in July.

April 2011

- Sistema's Board of Directors approves a new organisational structure. The approved changes are in line with the new development strategy, approved by the Board in October 2010. The new strategy provides for the transition of the Group from an operational holding company to an investment company.

May 2011

- OJSC Sistema-Invest is reorganised by merging into it CJSC Bashkir Integrated Energy Systems, CJSC UNKH-EnergoInvest, CJSC UNPZ-EnergoInvest and CJSC Novoil-EnergoInvest. As a result, Sistema's energy assets are separated from its oil business.
- The Board recommends the AGM of Sistema's shareholders approve payment of a 2010 dividend of RUB 0.26 (approximately US\$ 0.009) per ordinary share, which amounts to RUB 2,509 million (approximately US\$ 89.8 million) in total. Shareholders approve the 2010 dividend payment.

July 2011

- Fortune names Sistema the fastest-growing Russian company, based on consolidated revenues. Sistema is ranked 342 in the 2010 edition of the Fortune Global 500 list, with consolidated full year 2010 revenues of US\$ 28.099 billion, which represents a 118-place increase from the previous ranking.
- OJSC Intourist and Thomas Cook Group plc complete a transaction to establish a joint venture (JV) involving Intourist's tourism and retail businesses. Thomas Cook acquires a 50.1% stake in the JV.

August 2011

- Sistema Finance acquires 17,813,600 Sistema ordinary shares, equal to 0.18% of the total share capital.

September 2011

- Sistema appoints Rafael Nagapetians as Senior Vice-President, Head of Developing Assets Business Unit.
- Sistema receives an indicative offer from MTS to purchase a 100% stake in CJSC Sistema-Inventure, a wholly-owned subsidiary of Sistema, for RUB 10.56 billion. CJSC Sistema-Inventure held a 29.05% stake in OJSC Moscow City Telephone Network (MGTS), representing 24.4% of MGTS's charter capital. The transaction is completed in December 2011.

November 2011

- Sistema's Board of Directors approves a new dividend policy. The size of Sistema's dividend payments will be determined by the Board of Directors based on annual financial results, with dividend payments to be equal to a minimum of 10% of the company's consolidated net income under US GAAP (net of any special dividends paid). Furthermore, in the event of cash deals such as a large asset sale, special dividends can be recommended by the Board of Directors in an amount of at least 10% of the net gain from such transactions, determined by the Board of Directors.

- Sistema completes the buyback of its ordinary shares and GDRs and MTS's ADRs. During the buyback, a Sistema's subsidiary purchases 375,972 of its own GDRs at an average price of US\$ 16.61. Also 8,745,100 of its own local shares at an average price of RUB 20.97, and 4,311,019 of MTS's ADRs at an average price of US\$ 13.92.
- Sistema wins an open auction to have the right to acquire a 100% stake in OJSC Donskoe from the State for RUB 476.5 million. Donskoe is located in the Rostov region of the Russian Federation and occupies 25.4 thousand hectares of land. The transaction is completed in December 2011.

December 2011

- Sistema wins an open auction to have the right to acquire a 100% stake in OJSC First Cavalry Army Stud Farm from the State for RUB 303 million. First Cavalry Army Stud Farm is located in the Rostov region of the Russian Federation and occupies 21.5 thousand hectares of agricultural land, including 17.5 thousand hectares of arable land.

Events after the reporting period

January 2012

- Sistema signed a framework agreement with OJSC RTI and NVision Group Managing Company LLC. Within the framework of the agreement, RTI will acquire a 50% stake in CJSC NVision Group from the company's shareholders. Furthermore, NVision Group's shareholders will swap the remaining 50% of the company through an additional share issue by RTI. As a result of the transaction, NVision Group's shareholders will receive a total cash consideration of up to US\$ 200 million and a significant stake in RTI's charter capital, as well as representation on RTI's Board of Directors, which will enable them to participate in key Board decisions.

February 2012

- MBRD changed its name to OJSC MTS Bank and chose the MTS brand name as the basis for its further development.
- The Supreme Court of India issued a judgment revoking 122 telecom licences of 8 telecom operators, including 21 of the 22 licences held by SSTL. The order was issued on the grounds that these licences were not granted in accordance with required procedures by the Department of Telecommunications. The court has further directed the Telecom Regulatory Authority of India (TRAI), India's top telecom regulatory body, to make fresh recommendations on the granting of 2G licences and the re-allocation of spectrum via auction within four months by the Department of Telecommunications (DOT). In April 2012, SSTL filed a review petition before the Indian Supreme Court declined to hear review petition filed by SSTL and other operators seeking to overturn this judgment. SSTL also in response to clarification petition filed a petition seeking to stay by SSTL and other operators, in April 2012 the Supreme Court extended the date for the cancellation of the licences while the review petition is pending until September 7, 2012 and ordered TRAI to conduct the new auctions by August 31, 2012. To the extent that any defaults under SSTL debt facilities arise out of the decision of the Supreme Court in India regarding telecom licences, SSTL may obtain waivers from lenders under certain of its loan agreements to eliminate such defaults. Even in the absence of any such waivers, to the extent defaults are determined to have arisen and the loans are accelerated, Sistema believes it has sufficient liquidity to repay the amounts that would then come due, including SSTL debt.
- Sistema sent a formal notice to the Republic of India notifying it of a dispute under the Bilateral Investment Treaty (BIT) between the Government of the Russian Federation and the Government of the Republic of India arising from the decision of the Supreme Court of India issued on February 2, 2012, regarding the cancellation of 122 telecom licences, including 21 licences belonging to SSTL.
- Sistema increased its stake in OJSC Navigation Information Systems from 51% to 70% through an acquisition of an additional issue of NIS' shares. Sistema paid for the shares by contributing its 51% stake in M2M telematics LLC to the charter capital of NIS.

March 2012

- Bashneft announced its plans to consolidate downstream subsidiaries: Ufa Refinery, Novoil (Novo-Ufa Refinery), Ufaneftekhim, Bashkirnefteproduct and Orenburgnefteproduct.
- SITRONICS announced its intention to sell a 3% stake in INTRACOM TELECOM. Following the completion of the sale, SITRONICS' ownership in INTRACOM TELECOM will decrease from 51% to 48%.
- RTI announced its intentions to make a Voluntary Tender Offer to acquire up to 36.926% of JSC SITRONICS' common shares, representing all the shares that RTI does not already own, at a cash price of RUB 0.55 per common share of JSC SITRONICS. The price of the Offer represents a 37.5% premium to

the closing price of SITRONICS' common shares on MICEX-RTS as of February 22, 2012 (the last trading day on MICEX-RTS before the day of filing the Offer with the FSFM) and a 66.7% premium to the three-month volume weighted average price as of February 22, 2012. GDR holders are entitled to participate in the Offer.

April 2012

- Medsi commenced a merger of assets with the State Unitary Enterprise Medical Centre under the Administration of the Mayor of Moscow and the Moscow Government ("SUE"), a large group of healthcare institutions in Moscow. SUE will have 25% in the combined entity. Further 25% will be sold to a strategic investor.
- Sistema announced a joint venture with RZ Agro Ltd, in the agricultural sector. RZ Agro Ltd. was created in 2009 and is affiliated with the Sierentz Group, both controlled by certain members of the Louis-Dreyfus family.
- The Board of Directors of MTS set the date for the company's Annual General Meeting of shareholders for June 27, 2012. The Board also recommended that the AGM approve annual dividends of RUB 14.71 per ordinary MTS share (approximately US\$ 1.01 per ADR) for the 2011 fiscal year, amounting to a total of RUB 30.4 billion (approximately US\$ 1.04 billion or 72% of US GAAP net income).
- The Board of Directors of Bashneft set the date for the Annual General Meeting of shareholders for June 29, 2012. The Board of Directors recommended that the AGM approve the dividend payment of RUB 99 per one ordinary registered and per one preferred registered share for 2011.
- The Board of Directors of Sistema set the date for the Annual General Meeting of shareholders for June 30, 2012. Sistema's Board recommended to the AGM to set the total amount of dividend payment on Sistema's shares for 2011 at RUB 2.7 billion, representing a payment of RUB 0.28 per ordinary share. The total proposed dividend payment has been determined on the basis of Sistema's full year 2011 US GAAP net income and the corporate centre's net gain from the sale of CJSC Sistema-Inventure to OJSC MTS in December 2011. The Board of Directors also convened an Extraordinary General Meeting of shareholders to approve a related party transaction involving the swap of the assets of OJSC Bashkirenergo between Sistema JSFC and OJSC INTER RAO UES.

2. Management Report

The following is a discussion of our financial condition and results of operations as of and for the years ended 31 December 2011 and 2010 and of the material factors that we believe are likely to affect our consolidated financial condition. You should read this section together with our audited consolidated financial statements as of 31 December 2011 and 2010 and for the years then ended (further – the “Financial Statements”). References to “the Group”, “we” or “us” are references to Sistema JSFC and its subsidiaries. Our reporting currency is the U.S. dollar, and our consolidated financial statements have been prepared in accordance with U.S. GAAP.

In addition, this discussion contains forward-looking statements that involve risks and uncertainties. Our actual results may differ materially from those discussed in forward-looking statements as a result of various factors.

2.1. Overview

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

We were founded in 1993 by Vladimir Evtushenkov and his close associates and developed through the 1990s and early 2000s through participation in privatisations and the creation of several successful strategic partnerships. We completed an initial public offering in February 2005, when we listed our GDRs on the London Stock Exchange. Our ordinary shares are listed under on the MICEX-RTS Stock Exchange and on the Moscow Stock Exchange.

Since our founding, we primarily operated in the wireless and fixed line communications, technology, insurance, real estate, media, banking, retail and travel sectors. In March 2009, we added the oil and gas sector to our operations by acquiring a controlling interest in OJSC Bashneft and related companies.

In October 2010, we adopted a new strategy providing for our transition from an operating holding company to an investment company. In April 2011, in line with this strategy and to better allow us to identify and evaluate new investment opportunities and to manage our existing investments, we announced a new organisational and management structure which combines our investments into two business units based on the level of maturity of the various assets under management: Core Assets and Developing Assets.

Our consolidated revenues, OIBDA and net income attributable to Sistema JSFC for the year ended 31 December 2011 were US\$ 32,981.2 million, US\$ 7,223.1 million and US\$ 218.0 million, respectively. For the year ended 31 December 2011, our Core Assets and Developing Assets accounted for 88.6% and 11.2%, respectively, of consolidated revenues. In 2011, our Core Assets recorded operating income of US\$ 5,670.5 million, and our Developing Assets recorded an operating loss of US\$ 1,355.6 million.

We require substantial funds to support our operations. Our cash outlays for capital expenditures in the years ended 31 December 2010 and 2011 were US\$ 4,179.6 million and US\$ 4,132.1 million, respectively. We have historically financed our cash requirements through operating cash flows and borrowings. Net cash provided by operating activities in the years ended 31 December 2010 and 2011 was US\$ 4,056.8 million and US\$ 5,571.4 million, respectively. The proceeds from long-term borrowings for the years ended 2010 and 2011 amounted to US\$ 5,459.4 million and US\$ 6,421.0 million, respectively. As of 31 December 2011, we had indebtedness of US\$ 16,409.9 million, including capital lease obligations, and our interest expense for 2011 was US\$ 1,742.7 million, net of amounts capitalised.

The table below sets forth capital expenditures at each of our Core Assets and Developing Assets for the periods indicated:

Subsidiary	Year Ended 31 December	
	2010	2011
	(\$ in millions)	
MTS	2,647.1	2,584.5
Bashneft	1,088.8	877.4
RTI.....	91.2	127.2
MTS Bank.....	19.2	34.4
SSTL	169.0	178.2
Other	105.3	321.7

The following table illustrates our ownership interests in our principal consolidated subsidiaries and equity holdings as of 31 December 2011.

Subsidiary	Industry	Beneficial ownership ⁽¹⁾	Voting interest ⁽²⁾
MTS	Telecommunications	53%	53%
Bashneft	Oil and gas production	69%	86%
RTI	Technology	85%	85%
MTS Bank.....	Banking	99%	99%
SSTL	Telecommunications	57%	57%
Bashkirenergo	Energy transmission and supply	39%	50%
Sistema Mass Media.....	Mass media	75%	75%
Detsky mir	Retail	75%	75%
Intourist.....	Travel services	66%	66%
Medsi	Healthcare services	100%	100%
Binnopharm.....	Pharmaceuticals	100%	100%
NIS ⁽³⁾	Technology	51%	51%

(1) Represents the percentage of ownership interests of the relevant entity that are beneficially owned by Sistema JSFC, directly or indirectly, based on its proportionate ownership of the relevant entity through its consolidated subsidiaries. Sistema's JSFC ownership interests in the subsidiaries presented above are calculated based on shares owned by us as well as shares owned by certain companies affiliated but not owned by us, which we are required to consolidate under U.S. GAAP as variable interest entities in which we are deemed to be the primary beneficiary.

(2) Represents the percentage of ownership interests of the relevant entity that Sistema JSFC or any of its consolidated subsidiaries has the power to vote.

(3) In February 2012, we increased our stake in NIS to 70%. See "Recent Developments."

Segment Reporting

In April 2011, we approved a new organisational and management structure, which classifies our assets into two business units based on their level of maturity: Core Assets and Developing Assets. This change in structure has caused the composition of our reportable segments to change. We currently have six reportable segments namely MTS and Bashneft, which form part of the Core Assets, RTI, MTS Bank and SSTL, which form part of the Developing Assets, and Corporate division. Information about our other operating segments that are not reportable due to their materiality is combined and disclosed in the "Other" category. These operating segments include Bashkirenergo, Sistema Mass Media, Detsky mir, Intourist, Medsi, Binnopharm and NIS.

To measure performance of these segments, we examine certain segment financial information, including net sales to external customers, intersegment sales and operating income. A significant share of total revenues is derived from

the MTS and Bashneft segments. In 2010 and 2011, MTS accounted for 42.1% and 37.4%, respectively, and Bashneft accounted for 43.7% and 50.2%, respectively, of our total revenues. See “Segment Financial Results Overview” below, for further discussion on our segments.

Recent Developments

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

In January 2012, Sistema JSFC signed a framework agreement with RTI and NVision Group Managing Company LLC about a potential transaction between RTI and CJSC NVision Group, one of the largest information and communication technology companies in Russia.

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

In March 2012, RTI made a voluntary offer to acquire up to a 36.9% stake in SITRONICS, representing all of the shares in SITRONICS that RTI currently does not own, at a cash price of RUB 0.55 per common share. Should the entire 36.9% stake be acquired, total cash consideration would equal RUB 1,939 billion. The offer is expected to remain open until 22 May 2012.

In April 2012, Medsi commenced the merger of assets with the State Unitary Enterprise Medical Centre under the Administration of the Mayor of Moscow and the Moscow Government (“SUE”), a large group of healthcare institutions in Moscow. Within the framework of the transaction, Medsi has initiated an additional share issuance via closed subscription in favour of two parties – SUE and a legal entity registered in the European Union, through which investment funds are expected to make their investments into Medsi. SUE is expected to pay for the shares issued to it with property, which currently has a market value of approximately RUB 6.043 billion. In exchange for this property, SUE is expected to receive a 25.02% stake in the integrated company. According to current plans, SUE is to become a shareholder of Medsi upon completion of the transfer of the designated healthcare assets, which is expected to occur by the end of 2012. The legal entity registered in the European Union is currently expected to purchase a 24.98% stake in Medsi via the additional share issuance in exchange for RUB 6.035 billion in cash. Should the legal entity participate in the issuance, Sistema JSFC plans to retain a 50% stake in the combined entity. Should the legal entity not participate in the issuance, Sistema JSFC will likely retain up to a 74.98% stake in the combined entity. The combined entity is expected to operate under the Medsi name.

Key Factors Affecting Our Results of Operations

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

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

General Factors

Russian and CIS Macroeconomic Conditions and Trends

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

Macroeconomic indicator	Year Ended 31 December	
	2010	2011
Real GDP growth (% , period-on-period).....	4.3	4.3
Inflation		
Consumer price inflation (%).....	8.8	6.1
Producer price inflation (%).....	16.7	12.0
Exchange rates		
Period-end exchange rate (RUB/\$).....	30.48	32.20
Average exchange rate (RUB/\$).....	30.37	29.38

Nominal rouble appreciation (depreciation) against U.S. dollar (based on period-end rates).....	(0.8)	(5.6)
Real rouble appreciation (depreciation) against U.S. dollar	9.7	8.8
Real disposable income growth (% , period-on-period)	5.1	0.8

Source: The Federal State Statistics Service (Rosstat).

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

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

Inflation

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

MTS' financial position and results of operations have been influenced by inflation in the various countries in which it conducts business, particularly Russia. In Ukraine, Uzbekistan and Armenia, where MTS also has operations, consumer price inflation totaled 8.0%, 7.6% and 7.7%, respectively, in the year ended 31 December 2011. We expect that inflation-driven increases in costs would put pressure on MTS' margins. While MTS could seek to raise its tariffs to compensate for such increase in costs, competitive pressures may not permit increases that are sufficient to preserve operating margins.

Bashneft's financial position and results of operations have also been affected by inflation levels in Russia, in particular, the impact of inflation on real exchange rate levels. See "Exchange rates movements" below. In addition, because Bashneft is engaged in a capital-intensive industry, and thus relies on the successful implementation of large-scale projects requiring significant capital expenditures, we expect that inflation in Russia would have a negative impact on the costs associated with such capital expenditures.

Exchange rate movements

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

The depreciation of the rouble against the U.S. dollar or the euro would likely have an overall negative effect on our financial position and results of operations. With respect to our financial position, rouble depreciation would lead to an increase in the rouble equivalent of our borrowings and other liabilities that are denominated in U.S. dollars or euros, and would subject our investments in rouble-denominated monetary assets to the risk of loss in U.S. dollar terms. As of 31 December 2011, our borrowings denominated in foreign currencies equaled US\$ 4,658.0 million. Rouble depreciation may also make it more difficult to timely fund cash payments on debt denominated in foreign currencies. The negative impact of rouble depreciation on our financial position would be partially offset, however, by an increase in the rouble equivalent of our monetary assets denominated in foreign currencies, such as the U.S. dollar or euro. With respect to our results of operations, rouble depreciation would have an adverse effect on our costs denominated in U.S. dollars or euros, including Bashneft's cost of purchased crude oil, gas and oil products, which is substantially linked to the U.S. dollar price of crude oil, gas and oil products. Depreciation of the rouble against the U.S. dollar would also increase our costs denominated in roubles, both in absolute terms and relative to rouble-denominated revenues.

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

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

Capital expenditures and the implementation of large-scale investment projects

We require substantial funds to support our operations and implement large-scale investment projects at our subsidiaries. Our portfolio companies require capital expenditures for various reasons. MTS, for example, needs to make significant capital expenditures, particularly in connection with the development, construction and maintenance of, and the purchasing of software for our mobile and fixed line networks. Bashneft, on the other hand, generally requires capital expenditures to modernise its facilities and improve its results of operations. Our results of operations, therefore, are impacted by our ability to raise adequate levels of debt financing and successfully complete capital investment projects in a timely manner and within budget.

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

The table below sets forth capital expenditures at each of our Core Assets and Developing Assets for the periods indicated:

Subsidiary	Year Ended 31 December	
	2010	2011
(\$ in millions)		
MTS	2,647.1	2,584.5
Bashneft	1,088.8	877.4
RTI	91.2	127.2
MTS Bank	19.2	34.4
SSTL	169.0	178.2
Other	105.3	321.7

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

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

Bashneft's results of operations are expected to depend on the successful development of the Trebs & Titov oil fields on a timely basis and within budget. According to Bashneft's current estimates, production at Trebs & Titov is expected to begin in 2013, and the peak production is expected to take place from 2018 through 2023. To develop these fields, Bashneft and Lukoil agreed to establish a joint venture, in which Bashneft's share is 74.9% and Lukoil's share is 25.1%. Bashneft and Lukoil are expected to finance development of the oil fields in proportion with their respective stakes in the joint venture. Nevertheless, these figures are subject to change, based on, among other factors, exchange rate movements, revisions to costs and design specifications and the availability of financing.

Acquisitions

Our investment approach is based on seeking opportunities to create value for our portfolio, including through acquisitions. Between 1 January 2010 and 31 December 2011, several of our acquisitions have had an impact on our results of operations and financial condition. The ability to carry out large-scale acquisitions successfully and on a timely basis is largely dependent on choosing the appropriate companies to acquire, securing the necessary financing and properly integrating the acquired companies into our portfolio.

Our ability to create value is dependent on our ability to choose the appropriate acquisitions to make. For this, we rely on various financial metrics including total shareholder return, or TSR, which is compared against internal hurdle rates for specific industries and investment types when making an acquisition.

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

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

Because of the number of significant transactions completed between 1 January 2010 and 31 December 2011, period-to-period comparisons of our results of operations need to be considered in light of the impact of such transactions. See “Acquisitions, Divestitures and Key Corporate Restructurings - Acquisitions.”

Factors Affecting MTS’ Results of Operations

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

Competition and Market Penetration

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

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

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

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

Tariff regulation

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

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

a telecommunications operator occupying a substantial position on the market, we believe that interconnect tariffs previously approved by the Federal Agency on Communications for Comstar-UTS also apply to MTS following the merger completed on 1 April 2011.

MGTS' tariffs for both residential and corporate customers have generally increased between 2009 and 2011, and we believe the tariffs currently set by the FTS and the Federal Agency on Communications are sufficient to compensate MTS for the costs of providing its services. Nevertheless, future tariffs may not be set at a level that is fully compensatory for the provision of these services or increased in parallel with corresponding increases in our costs and/or inflation.

Seasonality

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

Factors Affecting Bashneft's Results of Operations

Crude oil and oil product prices, together with refining margins

The principal factor affecting Bashneft's results of operations are the prices for crude oil and oil products, both in the international market and in Russia, together with its refining margins.

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

A decline in the price of crude oil has both a positive and negative effect on Bashneft's results of operations. A lower price for crude oil may lead to a lower cost of purchased crude oil, gas and oil products, and therefore potentially an increasing in profits from the sale of oil products. At the same time, a lower price for crude oil means that Bashneft would generate lower revenues from the sale of crude oil.

International crude oil and oil products prices

The following table shows the average and the end-of-period prices for crude oil and oil products exports for 2010 and 2011, respectively.

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

Source: Platts

(1) Average FOB Rotterdam/CIF NWE

(2) Average FOB Rotterdam/CIF NWE

(3) Average FOB Rotterdam/CIF NEW

(4) FOB NWE

Domestic crude oil and oil products sales

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

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

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

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

Source: Kortes/Argus

Taxation

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

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

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

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

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

Tax	Year Ended 31 December	
	2010	2011 ⁽¹⁾
Mineral extraction tax (roubles per tonne)		
Crude oil	3,074	4,455
Export duty (\$ per tonne)		
Crude oil	274	409
Light and medium distillates.....	197	274
Fuel oil.....	106	208
Excise taxes (roubles per tonne)⁽²⁾		
High octane gasoline.....	3,992	-
Low octane gasoline	2,923	-
Naphtha.....	4,290	-
Diesel fuel.....	1,188	-
Lubricants	3,246	-

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

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

Mineral extraction tax

The mineral extraction tax on crude oil increased by 44.9% from RUB 3,074 per tonne in 2010 to RUB 4,455 per tonne in 2011.

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

Mineral extraction tax	Year Ended 31 December	
	2010	2011
Base mineral extraction tax rates (\$/barrel)	13.9	20.8
Actual mineral extraction tax expenses (\$/barrel).....	10.7	16.1

Export duties on crude oil

The crude oil export duty rate is revised monthly on the basis of the crude oil price in the immediately preceding month. The government determines the export duty rate, which is dependent on the average Urals price for the monitoring period, according to the following table. Effective 1 January 2012, the maximum marginal export duty rate for crude oil exports was lowered from 65% to 60% as part of the 60-66-90 scheme (the “60-66-90 Scheme”), discussed below.

Quoted Urals price (P), US\$ per tonne	Maximum Export Duty Rate
0 – 109.50	0%
109.50 – 146.00	35% * (P – 109.50)
146.00 – 182.50	\$12.78 + 45% * (P – 146.00)
>182.50	\$29.20 + 65% * (P – 182.50)

Export duties on oil products

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

60-66-90 Scheme

The 60-66-90 Scheme is designed, in part, to stimulate the export of crude oil. It is also expected to incentivise downstream oil companies to increase refining depth in order to export a greater share of light oil products. At the same time, because the plan has raised export duty rates on heavy oil products from their previous level of 46.7% of the crude oil export duty, it is expected that it will become less profitable in the future to produce heavy oil products, such as fuel oil.

Excise taxes

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

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

Transportation of Crude Oil and Oil Products in Russia

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transport infrastructure and access to it. As a result, transportation costs are an important factor affecting Bashneft's results of operations.

2.2. Acquisitions, Divestitures and Key Corporate Restructurings

Between 1 January 2010 and 31 December 2011, we completed a number of acquisitions and divestitures, several of which have had a significant impact on our results of operations and financial condition, as well as a number of corporate restructurings. We consolidate revenues and expenses of newly acquired entities from the date we acquire a controlling interest in such entities.

Due to the number of significant transactions completed between 1 January 2010 and 31 December 2011, period-to-period comparisons of our results of operations need to be considered in light of the impact of such transactions.

Acquisitions

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

Below is a list of our major acquisitions of controlling stakes in businesses from third parties during the years ended 31 December 2010 and 2011. In the years ended 31 December 2010 and 2011, we spent US\$ 364.5 million and US\$ 375.2 million, respectively, on acquisitions of controlling stakes in businesses from third parties, net of cash acquired.

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

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

Company	Principal activity	Date of acquisition	Stake in acquired entity following acquisition	Acquiring entity	Purchase price ⁽¹⁾
(\$ in millions)					
Year ended 31 December 2010					
Sky Link ⁽²⁾	Mobile telephony	April 2010	100.0%	Sistema	168.5
Multiregion	Broadband/cable TV provider	July 2010	100.0%	MTS	123.6
Year ended 31 December 2011					
Orenburgnefteproduct	Wholesale and retail of oil products	April 2011	94.0%	Bashneft	119.3
BN-Nefteproduct ⁽³⁾	Wholesale and retail of oil products	July 2011	100.0%	Bashneft	101.7
TVT	Fixed line and internet services	October 2011	100.0%	MTS	162.5

(1) Excluding acquisition-related costs.

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

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

Acquisition of a non-controlling stake in RussNeft

In April 2010, we acquired a non-controlling 49% stake in RussNeft, an oil and gas company, for a total cash consideration of US\$ 20 million. The investment is accounted for using the equity method. As a result of the final

measurement of the equity interest in RussNeft and the ongoing operational losses, we recognised a loss of US\$ 20 million in the year ended 31 December 2010 bringing the carrying value of our investment in RussNeft to nil in our Financial Statements. Nothing has been recognised in 2011 for this investment as the net assets of RussNeft were still negative. See Note 15 of the Financial Statements.

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

Divestitures & Key Corporate Restructurings

MTS

In October 2009, Sistema JSFC sold its 50.91% stake in Comstar-UTS, held directly and through its wholly-owned subsidiaries, to MTS for approximately US\$ 1.32 billion. The transaction was accounted for directly in equity and resulted in an increase in non-controlling interests of US\$ 154.6 million.

In December 2009, through a series of transactions, a group of investment funds exchanged their joint 14.2% stake in MGTS for a 1.6% stake in MTS, previously held in treasury, and a cash payment of US\$ 7.3 million. Simultaneously, MTS received an 11.06% stake in Comstar-UTS from MGTS Finance S.A, a wholly-owned subsidiary of MGTS. As a result of these transactions, our effective ownership in MTS decreased from 55.7% to 54.8% and our effective ownership in Comstar-UTS increased from 33.1% to 35.1%.

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

In December 2010, MTS acquired 100% of Sistema Telecom from Sistema for RUB 11.59 billion (\$379.0 million as of December 27, 2010). Sistema Telecom's key assets consist of property rights in respect of the group of trademarks, including the distinctive "egg" trademarks of MTS, Comstar and MGTS, certain promissory notes previously issued by MTS in the amount of RUB 2.00 billion (\$65.5 million) and a 45% interest in TS-Retail, a 100% subsidiary of Sistema through direct and indirect ownership. The transaction was accounted for directly in equity and resulted in the decrease in noncontrolling interests by US\$ 198.7 million.

In December 2011, MTS acquired 29% of the ordinary shares of MGTS from Sistema for RUB 10.56 billion (\$336.3 million as of December 1, 2011). Upon completion of this transaction, MTS' ownership interest in MGTS increased to 99.01% of the ordinary shares and 69.7% of the preferred shares, which overall totals 94.1% of MGTS charter capital. The transaction was accounted for directly in equity and resulted in decrease in non-controlling interest for US\$ 178.7 million and increase in Additional paid-in capital for US\$ 118.6 million.

SSTL

In March 2011, the Russian Federal Agency for State Property Management acquired a 17.14% stake in SSTL through a secondary share issuance of SSTL shares. The Russian Federal Agency for State Property Management paid the rupee equivalent of US\$ 600 million for the stake in December 2010, and our stake in SSTL decreased to 57%. SSTL is using the proceeds of this issuance to further strengthen its position in wireless broadband services, to expand its mono-brand retail network in existing telecommunications circles and to launch in new circles

Sistema Hals

In December 2010, we disposed of our remaining stake in Sistema-Hals for a total cash consideration of US\$ 70 million.

Detsky mir

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

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

Bashkirenergo

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

Russian law requires the unbundling of power generation assets from power transmission and distribution assets. Consequently, Bashkirenergo is currently under a reorganisation, so that its power and heat generation assets and heat distribution assets are controlled by one company, Bashenergoaktiv, and its power transmission and distribution assets are controlled by another company, BESK. In December 2011, we and INTER RAO UES, a Russia energy holding company, entered into a non-binding memorandum of understanding expressing the intention of INTER RAO UES to buy, and our intention to acquire, the generation assets and heat distribution assets to INTER RAO UES. We expect this reorganisation to be completed by the end of 2012 and anticipate that we will hold a 75% stake in BESK and no stake in Bashenergoaktiv.

Bashneft

In January 2010, JFSC Sistema transferred its stake in Bashnefteproduct to Bashneft. This transaction was accounted for directly in equity and resulted in the increase in non-controlling US\$ 53.0 million.

RTI

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

In July 2011, we completed our sale of a 63% stake in SITRONICS to RTI for US\$ 0.9228 per GDR or US\$ 111 million. In March 2012, RTI made a voluntary cash offer to acquire the remaining 36.9% stake in SITRONICS for RUB 0.55 per share. The voluntary offer remains open until May 2012. Should the offer be accepted in full, RTI intends to delist SITRONICS' shares from the MICEX-RTS Stock Exchange and SITRONICS' GDRs from the London Stock Exchange.

2.3. Consolidated Financial Results Overview

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

	Years ended 31 December			
	2010	% of total revenues	2011	% of total revenues
(\$ in thousands, except percentages)				
Sales	26,222,373	97.8	32,452,236	98.4
Revenues from financial services	588,946	2.2	529,012	1.6
Total revenues	26,811,319	100.0	32,981,248	100.0
Cost of sales, exclusive of depreciation, depletion and amortisation shown separately below	(10,716,816)	(40.0)	(13,021,173)	(39.5)
Cost related to banking activities, exclusive of depreciation and amortisation shown separately below	(374,036)	(1.4)	(310,332)	(0.9)
Selling, general and administrative expenses	(3,747,805)	(14.0)	(3,936,588)	(11.9)
Depreciation, depletion and amortisation	(2,862,754)	(10.7)	(3,281,629)	(9.9)
Transportation costs	(535,391)	(2.0)	(789,785)	(2.4)
Provision for doubtful accounts	(161,519)	(0.6)	(135,967)	(0.4)
Loss from impairment and provisions of other assets	(313,381)	(1.2)	(1,031,262)	(3.1)
Taxes other than income tax	(4,106,338)	(15.3)	(6,257,642)	(19.0)

Other operating expenses, net	(260,271)	(1.0)	(458,852)	(1.4)
Equity in results of affiliates	92,235	0.3	120,929	0.4
Gain upon adoption of equity method.....	477,400	1.8	-	-
Gain on disposal of interests in subsidiaries and affiliates.....	-	-	62,514	0.2
Operating income	4,302,643	16.1	3,941,461	12.0
Interest income	131,534	0.5	176,584	0.5
Change in fair value of derivative instruments.....	(2,062)	(0.0)	(2,268)	(0.0)
Interest expense	(1,597,244)	(6.0)	(1,742,690)	(5.3)
Foreign currency transaction (losses)/gains ...	26,151	0.1	(326,415)	(1.0)
Income from continuing operations before income tax	2,861,022	10.7	2,046,672	6.2
Income tax expense	(1,065,480)	(4.0)	(1,088,546)	(3.3)
Income from continuing operations	1,795,542	6.7	958,126	2.9
Income/(loss) from discontinued operations ⁽¹⁾	(2,999)	(0.0)	71,233	0.2
Gain/(loss) from disposal of discontinued operations ⁽²⁾	324,656	1.2	161,817	0.5
Net income	2,117,199	7.9	1,191,176	3.6
Non-controlling interest.....	(1,198,502)	(4.5)	(973,174)	(3.0)
Net income attributable to Sistema JSFC	918,697	3.4	218,002	0.6
OIBDA ⁽³⁾	7,165,397	26.7	7,223,090	21.9

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

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

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

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

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

The following tables set forth a summary of revenues and operating income by reportable segment for the years ended 31 December 2010 and 2011. In April 2011, we adopted a new organizational and management structure which established two business units based on the level of maturity of the various assets under management, namely

“Core Assets” and “Developing Assets”. This change of the structure caused the composition of the Group’s reportable segments to change. The Group identified six reportable segments namely MTS and Bashneft, which form part of the Core Assets, and SSTL, MTS Bank and RTI which form part of the Developing Assets, and Corporate division. Information about operating segments that are not reportable due to their materiality (Bashkirenergo, Sistema Mass-Media, Detsky mir, Intourist, Medsi, Binnopharm and NIS) have been combined and disclosed in the “Other” category. Prior period segment data has been restated to reflect these changes.

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

Revenues by segment:

	Year ended 31 December			
	2010	% of total revenues	2011	% of total revenues
	<i>(\$ in thousands, except percentages)</i>			
MTS	11,299,056	42.1	12,318,688	37.4
Bashneft	11,706,740	43.7	16,549,086	50.2
SSTL	114,615	0.4	262,264	0.8
MTS Bank	613,745	2.3	560,782	1.7
RTI	1,631,816	6.1	2,093,039	6.4
Other	1,902,546	7.1	1,975,101	6.0
Corporate	63,312	0.2	64,549	0.2
Aggregated revenue	27,331,830	101.9	33,823,509	102.7
Intersegment eliminations	(520,511)	(1.9)	(842,261)	(2.7)
Total	26,811,319	100.0	32,981,248	100.0

Operating income/ (loss) by segment:

	Year ended 31 December			
	2010	% of total operating income	2011	% of total operating income
	<i>(\$ in thousands, except percentages)</i>			
<i>Core Assets</i>				
MTS	2,744,107	63.8	2,893,938	73.4
Bashneft	2,301,342	53.5	2,778,789	70.5
<i>Developing Assets</i>				
SSTL	(410,789)	(9.5)	(1,196,084)	(30.3)
MTS Bank	21,329	0.5	(23,510)	(0.6)
RTI	81,551	1.9	50,382	1.3
Other	85,304	2.0	(129,373)	(3.3)
Corporate	(288,791)	(6.7)	(228,712)	(5.8)
Aggregated operating income.....	4,534,053	5	4,145,430	105.2
Intersegment eliminations	(231,410)	(5.5)	(203,969)	(5.2)
Total	4,302,643	100.0	3,941,461	100.0

Explanation of Key Items in Statements of Operations

Sales

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

Revenues from banking activities

Revenues from banking activities consist of revenues of MTS Bank.

Cost of sales, exclusive of depreciation, depletion and amortisation

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

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

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

Selling, general and administrative expenses

Selling, general and administrative expenses are primarily incurred at MTS and Bashneft. In 2010 and 2011, selling, general and administrative expenses at MTS accounted for 55.6% and 53.4%, respectively, of our overall selling, general and administrative expenses. Bashneft accounted for 12.4% and 11.2% of our overall selling, general and administrative expenses in 2010 and 2011, respectively.

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

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

Depreciation, depletion and amortisation

Most of our depreciation, depletion and amortisation expenses are incurred at MTS and Bashneft. In 2010 and 2011, depreciation and amortisation at MTS accounted for 69.9% and 69.9%, respectively, of our overall depreciation, depletion and amortisation expenses. Bashneft accounted for 18.0% and 18.6% of our depreciation, depletion and amortisation expenses in 2010 and 2011, respectively.

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

Transportation costs

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

Taxes other than income tax

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

Operating income

Operating income is revenues less operating costs, plus equity in the results of affiliates, gain upon adoption of equity method and gain on the disposal of interests in subsidiaries and affiliates.

Interest expense

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

Foreign currency transaction gains/losses

Management has determined that the functional currency of most of our subsidiaries is the currency of the country where they principally operate, with the exception of certain subsidiaries whose functional currency is the U.S. dollar

due to the pervasive use of the U.S. dollar in their operations or whose functional currency is the currency of its parent company if the entity is a device or shell company for holding investments or obligations.

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

Income tax expense

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

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

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

Sales

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

The growth in overall sales was attributable primarily to the growth in revenues at our Core Assets, particularly Bashneft. Revenues at Bashneft grew by US\$ 4,842.3 million, or 41.4%, and revenues at MTS grew by US\$ 1,019.6 million, or 9.0%. With the exception of MTS Bank and Intourist, revenues at our Developing Assets also grew. Revenues at RTI grew by US\$ 461.2 million, or 28.3%, and revenues at SSTL grew by US\$ 147.6 million, or 128.8%. Revenues in our other segments grew by US\$ 72.4 million, or 3.8%. See “Revenues from banking activities,” below, for a discussion of MTS Bank revenues.

Bashneft is, together with MTS, one of our two largest revenue contributors. In the years ended 31 December 2010 and 2011, Bashneft’s share of our consolidated revenues was 43.7% and 50.2%, respectively. Bashneft’s revenues grew by 41.4% in 2011 compared to 2010 mainly due to revenue growth in the sale of crude oil and oil products, which, in turn, was both price and volume driven. See “Segment Financial Results Overview - Core Assets - Bashneft,” below, for further discussion of Bashneft’s results of operations.

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

Revenues at RTI increased by 28.3% in the year ended 31 December 2011 compared to the year ended 31 December 2010 mainly as a result of a significant increase in sales in the systems integration and microelectronics solutions units and the completion of an increased number of government defense contracts. See “Segment Financial Results Overview - Developing Assets - RTI,” below, for further discussion of RTI’s results of operations.

Revenues at SSTL grew by 128.8% in the year ended 31 December 2011 compared to the year ended 31 December 2010 due to growth in subscriber base and non-voice revenues from both mobile and data value-added services.

Revenues in our other operating segments increased by 3.8% in the year ended 31 December 2011 compared to the year ended 31 December 2010, mainly due to growth in revenues at Detsky mir, Medsi, Sistema Mass Media and Binnopharm. Revenues at Detsky-Mir grew by US\$ 123.0 million, or 18.6%; at Medsi by US\$ 42.5 million, or 27.2%; at Sistema Mass Media by US\$ 7.5 million, or 7.9%; and at Binnopharm by US\$ 6.4 million, or 19.9%. A five-fold increase in revenues at NIS, where total revenues exceeded US\$ 100 million in 2011, contributed to the overall revenue growth of other operating segments. In 2011 compared to 2010, revenues at Intourist declined by US\$ 241.6 million, or 46.6%, and revenues at Bashkirenergo declined by US\$ 4.1 million, or 1.0%. See “Segment Financial Results Overview - Other,” below, for further discussion of the results of operations of other operating segments.

Revenues from banking activities

Revenues from banking activities declined by US\$ 59.9 million, or 11.7%, from US\$ 588.9 million in the year ended 31 December 2010 to US\$ 529.0 million in the year ended 31 December 2011 mainly due to a reduction in average interest rates. Revenues from banking activities accounted for 2.2% of total revenues in 2010 and 1.6% of total revenues in 2011. See “Segment Financial Results Overview - Developing Assets - MTS Bank,” below, for further discussion of results of operations at MTS Bank.

Total revenues

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

Cost of sales, exclusive of depreciation, depletion and amortisation

Cost of sales, exclusive of depreciation, depletion and amortisation, increased by US\$ 2,304.4 million, or 21.5%, from US\$ 10,716.8 million in the year ended 31 December 2010 to US\$ 13,021.2 million in the year ended 31 December 2011. The increase in the cost of sales was primarily due to higher cost of sales at MTS and Bashneft. See “Segment Financial Results Overview - Core Assets - MTS” and “Segment Financial Results Overview - Core Assets - Bashneft.”

Cost related to banking activities, exclusive of depreciation and amortisation

Cost related to banking activities, exclusive of depreciation and amortisation, decreased by US\$ 63.7 million, or 17.0%, from US\$ 374.0 million in the year ended 31 December 2010 to US\$ 310.3 million in the year ended 31 December 2011 mainly as a result of substituting more expensive sources of funding raised during the crisis with less expensive funding sources and due to the extension of better quality loans in 2011 compared to 2010. Higher quality loans are generally associated with lower costs than loans of relatively worse quality.

Selling, general and administrative expenses

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

Depreciation, depletion and amortisation

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

Transportation costs

Transportation costs increased by US\$ 254.4 million, or 47.5%, from US\$ 535.4 million in the year ended 31 December 2010 to US\$ 789.8 million in the year ended 31 December 2011 due to an increase in transportation costs at Bashneft. Transportation costs at Bashneft increased primarily because of a 12.1% increase in export sales volumes of crude oil, a 17.7% increase in export sales volumes of oil products, a 24.0% increase in domestic sales volumes of oil products and a rise in transport tariffs. See “Segment Financial Results Overview - Core Assets - Bashneft,” below, for further discussion of transportation costs at Bashneft.

Provision for doubtful accounts

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

Loss from impairment and provisions of other assets

Loss from impairment and provisions of other assets increased by US\$ 717.9 million from US\$ 313.4 million in the year ended 31 December 2010 to US\$ 1,031.3 million in the year ended 31 December 2011. In the year ended 31 December 2010, we recorded an impairment loss of US\$ 137.8 million in connection with the suspension of MTS’ licences in Turkmenistan. In the year ended 31 December 2011, we recorded an impairment loss of US\$ 694.7 million in connection with the suspension of certain of SSTL’s operating licences in India. See also Note 11 of the Financial Statements.

Taxes other than income tax

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

Export duties on crude oil increased from US\$ 876.0 million in 2010 to US\$ 1,466.0 million in 2011 due to a 12.1% increase in export sales volumes and a 49.3% increase in the export duty rate. Export duties on crude oil increased from US\$ 586.0 million in 2010 to US\$ 1,792 million in 2011 due to a 17.7% increase in export sales volumes and a 39.1% increase in the export duty rate on light and medium distillates and a 96.2% export duty rate on fuel oil.

Excise taxes increased from US\$ 672 million in 2010 to US\$ 974 million in 2011 due to the 17.7% increase in export sales volumes of oil products and to an increase in the excise tax rates for all of Bashneft’s principal oil products exports.

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

See “Segment Financial Results Overview - Core Assets - Bashneft” and “Key Factors Affecting Our Results of Operations - Factors Affecting Bashneft’s Results of Operations - Taxation,” for further discussion.

Equity in results of affiliates

In the year ended 31 December 2010, we recorded a gain of US\$ 92.2 million in our equity in the results of affiliates.

In the year ended 31 December 2011, we recorded a gain of US\$ 120.9 million in our equity in the results of affiliates mainly because of higher profitability at Belkamneft. We concluded that, although we retained a 74.9% interest in Bashneft-Polus, the shareholders agreement imparts substantive participating rights in Bashneft-Polus to Lukoil. Therefore, we began accounting for the entity under the equity method from the date control over the subsidiary was relinquished.

Gain upon adoption of equity method

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

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

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

Operating income

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

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

Interest income

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

Change in fair value of derivative instruments

In the years ended 31 December 2010 and 2011, we recorded losses of US\$ 2.1 million and US\$ 2.3 million, respectively, reflecting an increase in the fair value of RUSNANO’s put option to sell its shares in the SITRONICS-Nano joint venture to Sistema.

Interest expense

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

Foreign currency transaction gains/losses

In the year ended 31 December 2010, we recorded a foreign currency transaction gain of US\$ 26.2 million, which was mainly due to the appreciation of the rouble against the U.S. dollar in 2010.

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

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

Income from continuing operations before income tax

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

Income tax expense

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

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

	For the year ended 31 December			
	2010		2011	
	(\$ in thousands, except percentages)			
Current provision	1,089,577	102.3%	1,103,480	101.4%
Deferred income tax benefit.....	(24,097)	(2.3)%	(14,934)	(1.4)%
Total income tax expense.....	1,065,480	100.0%	1,088,546	100.0%

Our effective tax rate was 37.3% in 2010 and 53.2% in 2011. The increase in our effective tax rate in 2011 compared to 2010 was mainly due to certain non-recurring events in 2011 that are not tax deductible, such as the impairment loss of US\$ 1,031.3 million in the year ended 31 December 2011, compared to the impairment loss of US\$ 313.4 million in the year ended 31 December 2010. See “Loss from impairment and provisions of other assets,” above, and Note 11 of the Financial Statements.

Income from continuing operations

For the reasons set forth above, our income from continuing operations decreased by US\$ 837.4 million, or 46.6%, from US\$ 1,795.5 million in the year ended 31 December 2010 to US\$ 958.1 million in the year ended 31 December 2011.

Gain/ (loss) from discontinued operations

In the year ended 31 December 2010, we recorded a loss from discontinued operations of US\$ 3.0 million.

In the year ended 31 December 2011, we recorded a gain of US\$ 71.2 million, which reflected gains attributable to Bashkirenergo’s power generation business.

Gain/ (loss) on disposal of discontinued operations

In the year ended 31 December 2010, we recorded a gain of US\$ 324.7 million in connection with the disposal of Sky Link in October 2010. See Notes 3 and 4 of the Financial Statements.

In the year ended 31 December 2011, we recorded a gain of US\$ 161.8 million mainly in connection with the disposal of ESKB.

Net income

For the reasons set forth above, net income decreased by US\$ 926.0 million, or 43.7%, from US\$ 2,117.2 million in the year ended 31 December 2010 to US\$ 1,191.2 million in the year ended 31 December 2011.

Non-controlling interest and net income attributable to Sistema JSFC

Non-controlling interests equaled US\$ 1,198.5 million in the year ended 31 December 2010 and US\$ 973.2 million in the year ended 31 December 2011. Net income attributable to Sistema JSFC decreased by US\$ 700.7 million, or 76.3%, from US\$ 918.7 million in the year ended 31 December 2010 to US\$ 218.0 million in the year ended 31 December 2011.

2.4. Segment Financial Results Overview

The following analysis concentrates on our five reportable segments – MTS, Bashneft, RTI, MTS Bank and SSTL – and other operating segments which comprise Bashkirenergo, Detsky mir, Intourist, Sistema Mass Media, Medsi, Binnopharm and NIS. Segment results are presented after elimination of intra-segment transactions, but prior to elimination of transactions between segments.

Core Assets

MTS

MTS is a leading telecommunications provider in Russia and the CIS, providing a wide range of mobile and fixed line voice and data telecommunications services, including transmission, broadband, pay-TV and various value added services, as well as selling equipment and accessories.

Capital expenditures at MTS totaled US\$ 2,647.1 million and US\$ 2,584.5 million, respectively, in 2010 and 2011 and were spent on network development in Russia and the other countries where MTS operates.

For the years ended 31 December 2010 and 2011, MTS' revenues accounted for 42.1% and 37.4%, respectively, of Sistema's consolidated revenues.

Certain Operating Data

Below we provide certain operating data useful for evaluating MTS' business and results. The data focuses primarily on MTS' mobile operations, particularly in Russia and Ukraine, which comprise the most significant share of MTS' revenue in the periods presented, and is among the information routinely reviewed by MTS' management as part of their regulation evaluation of MTS' performance.

Mobile Subscriber Data

The following table shows MTS' mobile subscribers by country as of the dates indicated:

	<u>At 31 December</u>	
	<u>2010</u>	<u>2011</u>
	<i>(millions)</i>	
Subscribers⁽¹⁾		
Russia.....	71.4	70.0
Ukraine ⁽²⁾	18.2	19.5
Uzbekistan.....	8.8	9.3
Armenia.....	2.5	2.4
Turkmenistan ⁽³⁾	2.4	n/a
Total consolidated	<u>103.3</u>	<u>101.2</u>
MTS Belarus (unconsolidated).....	4.7	4.9

(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 its pre-paid tariffs) or whose account does not have a negative balance for more than this period.

(2) Including CDMA (Code Division Multiple Access) subscribers starting 2011.

(3) MTS does not present subscribers for 2011 as its operations in Turkmenistan have been terminated

Mobile Churn Rate

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

	<u>Year Ended</u> <u>31 December</u>	
	<u>2010</u>	<u>2011</u>
Subscriber Churn		
Russia	45.9%	47.6%
Ukraine	31.0%	30.7%

The churn rate is highly dependent on competition in MTS' licence areas and those subscribers who migrate as a result of such competition.

MTS' churn rate in Russia equaled 47.6% during the year ended 31 December 2011, up from 45.9% in the year ended 31 December 2010. The increase in churn rate was mainly attributable to MTS' mobile subscribers becoming more price sensitive and more likely to switch tariffs and switch to operators with lower-price tariff plans and offers due to continued economic uncertainty. In addition, due to the financial distress experienced by several mobile retailers in Russia, many increased their sales efforts in 2011 relative to 2010 to stimulate revenue earned from subscription fees, which MTS management believes led to a decline in the loyalty of new subscribers.

MTS' churn rate in Ukraine remained stable at 31.0% and 30.7%, respectively, in the years ended 31 December 2010 and 2011. The churn rate remains high due to the competitive environment among mobile operators in Ukraine, which has significantly intensified in recent years.

Mobile ARPU

MTS calculates mobile average monthly service revenue per subscriber by dividing its service revenues for a given period, including interconnect, guest roaming fees and connection fees, by the average number of its subscribers during that period and dividing by the number of months in that period.

The following table shows MTS' average monthly service revenue per Russian and Ukrainian subscriber based on this calculation methodology and average monthly minutes of use per Russian and Ukrainian subscriber for the periods indicated.

	<u>Year Ended 31 December</u>	
	<u>2010</u>	<u>2011</u>
Average monthly service revenue per subscriber		
Russia.....	\$8.3	\$9.3
Ukraine.....	\$4.8	\$4.9
Average monthly minutes of use per subscriber		
Russia.....	234	269
Ukraine.....	535	580

The average monthly service revenue per subscriber in Russia increased to US\$ 9.3 in the year ended 31 December 2011 from US\$ 8.3 in the year ended 31 December 2010, mainly due to price increases and an increase in the disposable income of the general population.

The average monthly service revenue per subscriber in Ukraine increased to US\$ 4.9 in the year ended 31 December 2011 from US\$ 4.8 in the year ended 31 December 2010, mainly due to the introduction of a wide range of attractive tariffs aimed at stimulating traffic, such as inexpensive intra-network rates, as well as the increased use by subscribers of tariffs that include a flat amount of minutes per month.

Results of Operations

The following table presents the results of operations for MTS for the periods under discussion:

	<u>Year ended 31 December</u>			
	<u>2010</u>	<u>% of</u> <u>revenues</u>	<u>2011</u>	<u>% of</u> <u>revenues</u>
	(\$ in thousands, except percentages)			
Revenues ⁽¹⁾	11,299,056	100.0	12,318,688	100.0
Cost of sales, exclusive of depreciation	(3,857,166)	(34.1)	(4,547,348)	(36.9)

and amortisation shown separately below)	
Selling, general and administrative expenses.....	(2,084,261)	(18.4)	(2,101,316)	(17.1)
Equity in net income of investees	70,649	0.6	49,443	0.4
Interest income.....	84,396	0.7	62,559	0.5
Interest expense.....	(777,288)	(6.9)	(656,898)	(5.3)
Depreciation and amortisation			(2,293,021)	
	(2,000,495)	(17.7)		(18.6)
Operating income.....	2,744,107	24.3	2,893,938	23.5
OIBDA ⁽²⁾	4,744,602	42.0	5,186,959	42.1

(1) Includes net sales to external customers and intersegment sales. Intersegment sales accounted for US\$ 3,805 thousand and US\$ 6,187 thousand in the years ended 31 December 2010 and 2011, respectively.

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

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

	For the year ended	
	2010	2011
	<i>(\$ in thousands)</i>	
Operating income	2,744,107	2,893,938
Depreciation and amortisation.....	2,000,495	2,293,021
OIBDA	4,744,602	5,186,959

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

Revenues

Revenues increased by US\$ 1,019.6 million, or 9.0%, from US\$ 11,299.1 million in the year ended 31 December 2010 to US\$ 12,318.7 million in the year ended 31 December 2011. The growth in revenues in the year ended 31 December 2011 was mainly due to the increase in the usage of value-added services by MTS subscribers, which, in turn, was the result of MTS' active promotion of these services, the increase of mobile Internet penetration, active 3G network expansion and the consequent improvement of the quality of value-added services.

In Russia, revenues increased by US\$ 1,217.4 million, or 12.9%, from US\$ 9,414.9 million in the year ended 31 December 2010 to US\$ 10,632.3 million in the year ended 31 December 2011. The increase in revenues was primarily the result of growth in value-added services, interconnect revenues, fixed revenues and sales of handsets and accessories. Revenues from value-added services grew mainly due to the increase in data traffic volumes attributable to the introduction of new marketing initiatives aimed at stimulating greater usage of value-added services among MTS' subscribers as well as to the overall improvement of quality of these services. Interconnect revenues increased due to the growth in the volume of traffic from MTS' competitors. Fixed revenues grew primarily due to the continued growth in domestic and international long distance and "calling party pays" traffic volumes, growth in the broadband Internet business and regulatory price increases for residential and corporate voice services. MTS' continued expansion of its monobrand retail chain in 2011 caused sales of handsets and accessories to increase.

In Ukraine, revenues increased by US\$ 69.8 million, or 6.5%, from US\$ 1,072.8 million in the year ended 31 December 2010 to US\$ 1,142.6 million in the year ended 31 December 2011. Revenues increased primarily due to subscriber growth and an increase in usage of value-added services. MTS' subscriber base in Ukraine increased from

18.2 million in 2010 to 19.5 million in 2011. The revenue growth from value added services was mainly due to the active promotion of these services among MTS subscribers.

Revenues from other countries decreased mainly due to MTS' ceasing to provide mobile telecommunications services in Turkmenistan at the end of 2010.

Cost of sales, exclusive of depreciation and amortisation

Overall cost of sales, which includes cost of services and cost of handsets and accessories, exclusive of depreciation and amortisation, increased by US\$ 690.2 million, or 17.9%, from US\$ 3,857.2 million in the year ended 31 December 2010 to US\$ 4,547.3 million in the year ended 31 December 2011. MTS' overall cost of services and cost of handsets and accessories increased mainly due to the expansion of MTS' retail operations, which generally have lower margins than communications service operations.

The cost of services and cost of handsets and accessories in Russia increased by US\$ 602.3 million, or 23.4%, from US\$ 2,571.5 million in the year ended 31 December 2010 to US\$ 3,173.8 million in the year ended 31 December 2011. The increase was primarily due to the increase in outgoing traffic volumes, the cost of handsets and accessories and the cost of value-added services. Interconnect expenses increased mainly due to the growth in outgoing network traffic.

The cost of services and cost of handsets and accessories in the Ukraine segment increased by US\$ 7.2 million, or 2.3%, from US\$ 313.77 million in the year ended 31 December 2010 to US\$ 320.9 million in the year ended 31 December 2011 primarily due to an increase in regular payments for radio frequencies and growth of electricity tariffs regulated by the government and was partially offset by a decrease in interconnect expenses, due, in turn, to the decrease in interconnect rates charged by Kyivstar.

The cost of services and cost of handsets and accessories in the other countries and business activities of MTS decreased due mainly to MTS' discontinuation of mobile telecommunications services in Turkmenistan at the end of 2010.

Selling, general and administrative expenses

Selling, general and administrative expenses at MTS increased by US\$ 17.1 million, or 0.8%, from US\$ 2,084.3 million in the year ended 31 December 2010 to US\$ 2,101.3 million in the year ended 31 December 2011. The increase was partly attributable to a general increase in expenses caused by the growth in MTS' operations, growth in sales and marketing expenses and the appreciation of the functional currencies in countries in which MTS operates against the U.S. dollar. Sales and marketing expenses grew slightly on account of an increase in commissions payable to dealers, which, in turn, was mainly the result of dealers acquiring subscribers with a higher ARPU. Improvements in operational efficiencies partially offset this increase in selling, general and administrative expenses. For example, in order to reduce operating expenses, MTS' contact centers were relocated in 2011 from regions where property ownership was expensive to other Russian regions where such costs are lower. MTS also consolidated its contact centers into three key locations in Russia

Interest expense

Interest expense decreased by US\$ 120.4 million, or 15.5%, from US\$ 777.3 million in the year ended 31 December 2010 to US\$ 656.9 million in the year ended 31 December 2011 as a result of several factors. The amortisation of MTS' debt issuance costs were lower in 2011 than in 2010. This was due to the voluntary repayment before the due date of approximately US\$ 1.4 billion of MTS' debt balance outstanding as of 31 December 2010, which resulted in an immediate write-off of the related debt issuance cost in a total amount of US\$ 24.3 million. Additionally, in 2010, MTS renegotiated the interest rates and maturities of several credit facilities, which led to a significant modification of the related debt agreements and the consequent write-off of capitalised issuance costs totaling US\$ 26.4 million. None of the amendments to MTS' credit facilities agreements in 2011 were considered to be substantial, so that no additional expense occurred. In addition, hedging activities in 2011 resulted in an interest expense decrease. Furthermore, the extension of MTS' construction activities in 2011 allowed MTS to capitalise more interest expense in 2011 than in 2010. The remaining decrease was due to the decrease in MTS' weighted average interest rate in 2011.

Depreciation and amortisation

Depreciation and amortisation of property, network equipment, numbering capacity, licence costs and other intangible assets increased by US\$ 292.5 million, or 14.6%, from US\$ 2,000.5 million in the year ended 31 December 2010 to US\$ 2,293.0 million in the year ended 31 December 2011. The increase was due to MTS' increased asset base resulting from the continued expansion of its network through build-outs, as well as due to the decrease in the estimated useful life of certain equipment which MTS intends to replace.

Segment operating income

For the reasons stated above, operating income at MTS increased by US\$ 149.8 million, or 5.5%, from US\$ 2,744.1 million in the year ended 31 December 2010 to US\$ 2,893.9 million in the year ended 31 December 2011.

Bashneft

Bashneft is a vertically integrated oil company with upstream and downstream assets mainly located in the Republic of Bashkortostan.

For the years ended 31 December 2010 and 2011, Bashneft's revenues accounted for 43.7% and 50.2%, respectively, of Sistema's consolidated revenues.

Capital expenditures at Bashneft totaled US\$ 1,088.8 million and US\$ 877.4 million, respectively, in 2010 and 2011.

Certain Operating Data

Production

The following table presents Bashneft's production levels during the periods indicated:

	For the year ended 31 December	
	2010	2011
Crude oil production (million metric tonnes).....	14.1	15.1
Average daily production of crude oil (thousand barrels/day)	282.9	302.1

Refining

The following table presents certain information about Bashneft's refining operations during the periods indicated:

	For the year ended 31 December			
	2010		2011	
<i>(thousand tonnes, except percentages)</i>				
Crude oil refining	21,193		21,062	
Oil product output				
Gasoline ⁽¹⁾	4,742	24.4%	4,919	25.6%
Diesel	7,665	39.5%	7,413	38.6%
Fuel oil	2,646	13.6%	2,610	13.6%
Vacuum gasoil	1,699	8.7%	1,891	9.9%
Other	2,676	13.8%	2,351	12.3%
Total oil products	19,428	100.0%	19,184	100.0%
Refining depth ⁽²⁾	86.3%		85.9%	
Share of light products ⁽³⁾	61.8%		59.9%	

(1) Includes stable natural gasoline.

(2) Based on weighted average of refining depth of each of Bashneft's refineries.

(3) The principal light products produced by Bashneft include gasoline and diesel.

Results of Operations

The following table presents the results of operations for Bashneft for the periods under review:

	Year ended 31 December			
	2010	% of revenues	2011	% of revenues
(\$ in thousands, except percentages)				
Revenues ⁽¹⁾	11,706,740	100.0	16,549,086	100.0
Cost of sales, exclusive of depreciation, depletion and amortisation shown separately below	(4,448,371)	(38.0)	(5,871,359)	(35.5)
Taxes other than income tax	(3,939,677)	(33.7)	(6,065,437)	(36.7)
Transportation costs	(535,206)	(4.6)	(787,819)	(4.8)
Selling, general and administrative expenses	(465,494)	(4.0)	(442,313)	(2.7)
Equity in net income of investees	36,074	0.3	75,245	0.5
Interest income	74,511	0.6	74,021	0.4
Interest expense	(327,852)	(2.8)	(559,806)	(3.4)
Depreciation, depletion and amortisation	(591,477)	(5.1)	(611,876)	(3.7)
Operating income	2,301,432	19.7	2,778,789	16.8
OIBDA ⁽²⁾	2,892,910	24.7	3,390,665	20.5

(1) Includes net sales to external customers and intersegment sales. Intersegment sales amounted to US\$ 772 thousand and US\$ 11,969 thousand in the years ended 31 December 2010 and 2011, respectively.

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

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

	For the year ended	
	2010	2011
(\$ in thousands)		
Operating income	2,301,432	2,778,789
Depreciation, depletion and amortisation	591,477	611,876
OIBDA	2,892,910	3,390,665

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

Revenues

Revenues from our Bashneft segment increased by US\$ 4,842.3 million, or 41.4%, from US\$ 11,706.7 million in the year ended 31 December 2010 to US\$ 16,549.1 million in the year ended 31 December 2011, mainly due to revenue growth in the sale of crude oil and oil products.

Revenue growth in the sale of crude oil and oil products was both volume and price driven. Bashneft recorded revenue growth in the export of both crude oil and oil products and in the domestic sale of both crude oil and oil products.

The tables below present certain information about the revenue and volume breakdowns of Bashneft for the periods indicated:

	For the year ended 31 December				% change
	2010		2011		
	(\$ in millions, except percentages)				
		%		%	
Revenue					
Export sales of crude oil	1,783	15.2	2,814	17.0	57.8
Domestic sales of crude oil.....	212	1.8	328	2.0	54.7
<i>Total crude oil sales</i>	1,995	17.0	3,142	19.0	57.5
Oil product exports outside the CIS.....	3,526	30.1	5,333	32.2	51.2
Oil product exports to the CIS countries.....	726	6.2	1,334	8.1	83.7
Domestic sales of oil products.....	5,111	43.7	6,339	38.3	24.0
<i>Wholesale</i>	4,620	39.5	5,369	32.4	16.2
<i>Retail</i>	491	4.2	970	5.9	97.6
<i>Total oil product sales</i>	9,363	80.0	13,006	78.6	38.9
Other sales	349	3.0	401	2.4	14.9
Total revenue	11,707	100.0	16,549	100.0	41.4

	For the year ended 31 December				% change
	2010		2011		
	(thousand tonnes, except percentages)				
		%		%	
Sales volumes					
Export sales of crude oil	3,210	14.6	3,599	15.0	12.1
Domestic sales of crude oil	908	4.1	1,026	4.3	13.0
<i>Total crude oil sales</i>	4,118	18.7	4,625	19.3	12.3
Oil product exports outside the CIS	6,515	29.6	6,956	29.0	6.8
Oil product exports to the CIS countries	1,282	5.8	2,222	9.3	73.3
Domestic sales of oil products	11,099	50.4	10,171	42.4	(8.4)
<i>Wholesale</i>	10,483	47.6	9,148	38.2	(12.7)
<i>Retail</i>	616	2.8	1,023	4.3	66.1
<i>Total oil product sales</i>	18,896	85.8	19,349	80.7	2.4
Total sales of crude oil and oil products	22,014	100.0	23,974	100.0	4.2

Export sales of crude oil

Revenue from export sales of crude oil increased by US\$ 1,031 million, or 57.8%, from US\$ 1,783 million in the year ended 31 December 2010 to US\$ 2,814 million in the year ended 31 December 2011. The increase was due to an increase in volume and price. The volume of export sales of crude oil increased by 389 thousand tonnes, or 12.1%, from 3,210 thousand tonnes in the year ended 31 December 2010 to 3,599 thousand tonnes in the year ended 31 December 2011 due mainly to an increase in oil production in 2011. The average sales price of Urals crude oil sold on the export market increased by US\$ 30.8/barrel, or 39.3%, from US\$ 78.3/barrel in the year ended 31 December 2010 to US\$ 109.1/barrel in the year ended 31 December 2011.

Domestic sales of crude oil

Revenue from domestic sales of crude oil increased by US\$ 116 million, or 54.7%, from US\$ 212 million in the year ended 31 December 2010 to US\$ 328 million in the year ended 31 December 2011. The increase was due to an increase in volume and price. The volume of domestic sales of crude oil increased by 118 thousand tonnes, or 13.0%, from 908 thousand tonnes in the year ended 31 December 2010 to 1,026 thousand tonnes in the year ended 31 December 2011. The average sales price of Urals crude oil sold on the domestic market increased by US\$ 82.2/tonne, or 37.0%, from US\$ 222.2/tonne in the year ended 31 December 2010 to US\$ 304.4/tonne in the year ended 31 December 2011.

Export of oil products

Revenue from the export of oil products increased by US\$ 2,415 million, or 56.8%, from US\$ 4,252 million in the year ended 31 December 2010 to US\$ 6,667 million in the year ended 31 December 2011. This increase was, in turn, driven by an increase in revenues from the export of oil products outside the CIS and to other CIS countries. Revenues from exports outside the CIS grew by US\$ 1,807 million, or 51.2%, from US\$ 3,526 million in the year ended 31 December 2010 to US\$ 5,333 million in the year ended 31 December 2011, while revenues from exports to other CIS countries grew by US\$ 608 million, or 83.7%, from US\$ 726 million in the year ended 31 December 2010 to US\$ 1,334 million in the year ended 31 December 2011.

The increase in revenues from oil product exports was both volume and price driven.

The volume of oil products exported to countries outside the CIS increased by 441 thousand tonnes, or 6.8%, from 6,515 thousand tonnes in the year ended 31 December 2010 to 6,956 thousand tonnes in the year ended 31 December 2011, and the volume of oil products exported to CIS countries increased by 940 thousand tonnes, or 73.3%, from 1,282 thousand tonnes in the year ended 31 December 2010 to 2,222 thousand tonnes in the year ended 31 December 2011. By volume, Bashneft's principal oil products exports as a share of total oil products exports consisted of fuel oil (55.2% in 2010 and 58.0% in 2011), vacuum gas oil (21.6% in 2010 and 20.7% in 2011), fuel oil (9.4% in 2010 and 10.5% in 2011), naphtha (5.2% in 2010 and 4.0% in 2011) and high-octane gasoline (6.7% in 2010 and 4.6% in 2011).

The average export sales price of oil products increased in 2011 compared to 2010: the price of fuel oil (average FOB/Rotterdam/CIF NWE) increased by 37.7% to US\$ 607.2/tonne; the price of vacuum gas oil (FOB NWE) increased by 40.8% to US\$ 769.0/tonne; the price of diesel fuel (average FOB Rotterdam/CIF NWE) increased by 39.0% to US\$ 933.8/tonne; the price of naphtha (average FOB Rotterdam/CIF NWE) increased by 30.7% to US\$ 929.2/tonne.

Oil product sales on the domestic market

Revenue from domestic sales of oil products increased by US\$ 1,228 million, or 24.0%, from US\$ 5,111 million in the year ended 31 December 2010 to US\$ 6,339 million in the year ended 31 December 2011 due to 16.2% revenue growth in wholesale deliveries and 97.6% revenue growth in retail sales. In 2010 and 2011, wholesale revenues accounted for 90.4% and 84.7%, respectively, of Bashneft's revenues from domestic oil products sales. The overall increase in revenues was due to growth in prices.

The average domestic sales price of oil products increased in 2011 compared to 2010: the price of fuel oil increased by 18.8% to US\$ 299.5/tonne; the price of diesel fuel (summer grade) increased by 42.7% to US\$ 670.0/tonne; the price of diesel fuel (winter grade) increased by 36.3% to US\$ 741.6/tonne; the price of jet fuel increased by 43.1% to US\$ 701.8/tonne; the price of high-octane gasoline increased by 19.9% to US\$ 821.5/tonne; and the price of low-octane gasoline increased by 32.3% to US\$ 753.0/tonne.

The overall decrease in the volume of domestic oil products sales partially offset the increase in sales prices. The volume of domestic sales of oil products decreased by 928 thousand tonnes, or 8.4%, from 11,099 thousand tonnes in the year ended 31 December 2010 to 10,171 thousand tonnes in the year ended 31 December 2011, attributable to a 12.7% decline in wholesale deliveries. Domestic retail sales volumes of oil products increased by 66.1% in 2011 compared to 2010 due in part to the acquisition of Orenburgnefteproduct and the consolidation of BN-Nefteproduct in 2011. In 2010 and 2011, wholesale deliveries accounted for 94.4% and 89.9%, respectively, of Bashneft's domestic oil products sales volumes.

Taxes other than income tax

Taxes other than income tax increased by US\$ 2,125.8 million, or 54.0%, from US\$ 3,939.7 million in the year ended 31 December 2010 to US\$ 6,065.4 million in the year ended 31 December 2011 mainly as a result of an increase in export duties, excise taxes and the mineral extraction tax.

Export duties on crude oil increased by US\$ 590 million, or 67.4%, from US\$ 876 million in the year ended 31 December 2010 to US\$ 1,466 million in the year ended 31 December 2011 due to an increase in export sales volumes and export duties. Export sales volumes of crude oil increased by 12.1% in 2011 compared to 2010. See "Revenues - export sales of crude oil." The crude oil export duty increased by 49.3% from US\$ 274/tonne in the year ended 31 December 2010 to US\$ 409/tonne in the year ended 31 December 2011.

Export duties on oil products increased by US\$ 587 million, or 48.6%, from US\$ 1,205 million in the year ended 31 December 2010 to US\$ 1,792 million in the year ended 31 December 2011 due to an increase in export sales volumes and export duties. Export sales volumes of oil products increased by 17.7% in 2011 compared to 2010. See *“Revenues - export of oil products.”* Export duties on light and medium distillates increased by 39.1% from US\$ 197/tonne in the year ended 31 December 2010 to US\$ 274/tonne in the year ended 31 December 2011, and export duties on fuel oil increased by 96.2% from US\$ 106/tonne in the year ended 31 December 2010 to US\$ 208/tonne in the year ended 31 December 2011.

Excise taxes increased by US\$ 302 million, or 44.9%, from US\$ 672 million in the year ended 31 December 2010 to US\$ 974 million in the year ended 31 December 2011 due to an increase in excise tax rates in 2011 compared to 2010. Export sales volumes of oil products increased by 17.7% in 2011 compared to 2010. Effective 1 January 2011, the Russian government introduced new legislation whereby excise tax rates are set based on fuel quality. Excise tax rates for high- and low-octane gasoline were RUB 3,992/tonne and RUB 2,923/tonne, respectively, in 2010, compared to a range of rates in 2011 from RUB 5,143/tonne for Euro 4 and 5 compliant gasoline to RUB 5,672/tonne for Euro 3 compliant gasoline and RUB 5,995/tonne for lower quality gasoline. Excise tax rates for naphtha increased from RUB 4,290/tonne in 2010 to RUB 6,089/tonne in 2011. Excise tax rates on diesel fuel increased from RUB 1,188/tonne in 2010 to RUB 2,247/tonne for Euro 4 and 5 compliant diesel fuel, to RUB 2,485/tonne for Euro 3 compliant diesel fuel and to RUB 2,753/tonne for diesel fuel of lower quality.

The mineral extraction tax increased by US\$ 646 million, or 58.3%, from US\$ 1,108 million in the year ended 31 December 2010 to US\$ 1,754 million in the year ended 31 December 2011 primarily as a result of an increase in both the mineral extraction tax rate and the volumes of oil produced. The mineral extraction tax rate increased from US\$ 10.7/barrel in 2010 to US\$ 16.1/barrel in 2011, and the volume of crude oil production increased by 961 thousand tonnes, or 6.8%, from 14,145 thousand tonnes in 2010 to 15,106 thousand tonnes in 2011. The mineral extraction tax rate takes into account discounts extended to Bashneft due to the fact that certain of its fields were characterised by depletion levels of greater than 80%. Had these discounts not been in effect, Bashneft would have been subject to mineral extraction tax rates of US\$ 13.9/barrel in 2010 and US\$ 20.8/barrel in 2011. See *“Key Factors Affecting Our Results of Operations - Factors Affecting Bashneft’s Results of Operations -Taxation,”* for further discussion.

Cost of sales, exclusive of depreciation, depletion and amortisation

Cost of sales, which consists of the cost of purchased crude oil and oil products and production and operating expenses, increased by US\$ 1,423.0 million, or 32.0%, from US\$ 4,448.4 million in the year ended 31 December 2010 to US\$ 5,871.4 million in the year ended 31 December 2011. The increase in the cost of sales was largely driven by an increase in the cost of purchased crude oil, gas and petroleum products and in production and operating expenses.

In addition to extracting its own crude oil, Bashneft also purchases West-Siberian oil and gas condensate for processing at its refineries. Spending on crude oil and gas condensate purchases increased by 38.6%, from US\$ 2,882 million in the year ended 31 December 2010 to US\$ 3,994 million in the year ended 31 December 2011, mainly as a result of the rise in domestic prices for crude oil. The average price of Urals crude increased by 39.3% from US\$ 78.3/barrel in the year ended 31 December 2010 to US\$ 109.1/barrel in the year ended 31 December 2011. The increase in price was partially offset by a decrease in the volumes of purchased crude oil and gas from 11.0 million tonnes in the year ended 31 December 2010 to 10.7 million tonnes in the year ended 31 December 2011, which, in turn, was due to an increase in the share of Bashneft’s own crude oil used for refining. In 2011, Bashneft also purchased 378 thousand tonnes of oil products, compared to 2010, when it engaged in no such purchases. The principal reason for these purchases was Bashneft’s acquisition of Orenburgnefteproduct and the consolidation of BN-Nefteproduct in 2011. These companies, in turn, purchased oil products from third-party suppliers to meet demand in the regions where they operate.

Production and operating expenses increased by US\$ 248 million, or 17.3%, from US\$ 1,436 million in the year ended 31 December 2010 to US\$ 1,684 million in the year ended 31 December 2011 mainly due to an increase in expenses in Bashneft’s production and refining units. Production expenses increased by 21.6% to US\$ 759 million in 2011 mainly due to the 6.8% growth in crude oil production and the 15.0% increase in unit lifting costs for crude oil from US\$ 6.0/barrel in 2010 to US\$ 6.9/barrel in 2011, as well as to a rise in electricity prices in 2011. Refining expenses increased by 23.1% to US\$ 859 million in 2011 mainly due to the 24.4% increase in unit refining costs from US\$ 4.5/barrel in 2010 to US\$ 5.6/barrel in 2011, the repair works at Ufaneftkhim, Novoil and Ufimsky Refinery and an increase in prices for electricity.

The table below sets forth the breakdown in Bashneft's production and operating expenses for the periods indicated:

	For the year ended 31 December				% change
	2010		2011		
	(\$ in millions, except percentages)				
		%		%	
Production.....	624	43.5	759	45.1	21.6
Refining	698	48.5	859	51.0	23.1
Other	114	10.0	66	3.9	(42.1)
Total	1,436	100.0	1,684	100.0	17.3

Transportation expenses

Transportation expenses, which represent all expenses incurred in the transportation of crude oil and oil products via the Transneft pipeline network or by railway or other transportation means, increased by US\$ 252.6 million, or 47.2%, from US\$ 535.2 million in the year ended 31 December 2010 to US\$ 787.8 million in the year ended 31 December 2011, mainly due to the 16.1% increase in the export sales volumes of crude oil and oil products, a rise in transport and appreciation of the rouble against the U.S. dollar.

Selling, general and administrative expenses

Selling, general and administrative expenses decreased by US\$ 23.2 million, or 5.0%, from US\$ 465.5 million in the year ended 31 December 2010 to US\$ 442.3 million in the year ended 31 December 2011, primarily due to a decrease in management compensation in 2011.

Equity in net income of investees

In 2010, Bashneft recorded equity in the net income of investees of US\$ 36.1 million due to (i) the reclassification of its 38.5% stake in Belkamneft as an investment in associates, which, in turn, was due to Sistema JSFC's purchase of a 49.0% interest in RussNeft, Belkamneft's parent company; and (ii) its acquisition in July 2010 of a 49.99% interest in ASPEC, which is engaged in the wholesale and retail of oil products and real estate development and also owns an automotive retail business.

In 2011, Bashneft recorded equity in the net income of investees of US\$ 75.2 million, which reflected its share of the profits of BN-Nefteproduct, of which it is a 100% shareholder since July 2011. In July 2011, Bashneft swapped its 49.99% interest in ASPEC for a 100% stake in BN-Nefteproduct as part of the reorganisation of ASPEC into two entities: ASPEC and BN-Nefteproduct which accumulated ASPEC's petroleum products trading business.

Interest income

Interest income remained stable in 2010 and 2011, amounting to US\$ 74.5 million in the year ended 31 December 2010 and US\$ 74.0 million in the year ended 31 December 2011.

Interest expense

Interest expense increased by US\$ 232.0 million, or 70.7%, from US\$ 327.9 million in the year ended 31 December 2010 to US\$ 559.8 million in the year ended 31 December 2011, mainly due to an increase in Bashneft's borrowings and to a premium on bonds redeemed in the year ended 31 December 2011.

Depreciation, depletion and amortisation

Depreciation, depletion and amortisation expense increased by US\$ 20.4 million, or 3.4%, from US\$ 591.5 million in the year ended 31 December 2010 to US\$ 611.9 million in the year ended 31 December 2011. The increase was mainly attributable to growth in depreciation costs in the exploration and production divisions, which, in turn, was due to the 6.8% increase in crude oil production in 2011 relative to 2010 and to a review of the evaluation of Bashneft's reserves in the fourth quarter of 2011.

Segment operating income

For the reasons set forth above, Bashneft's operating income increased by US\$ 477.4 million, or 20.7%, from US\$ 2,301.3 million in the year ended 31 December 2010 to US\$ 2,778.8 million in the year ended 31 December 2011. Bashneft's operating income margin decreased from 19.7% in 2010 to 16.8% in 2011.

Developing Assets

RTI

RTI is a leading Russian technology holding company in the fields of defence, complex security systems, systems integration, microelectronics and high-tech R&D. Its principal assets include a 97% stake in RTI Systems Concern, a large military-industrial holding, and a 63% stake in SITRONICS, a high-tech company operating in the fields of telecommunications solutions, information technologies, systems integration and consulting.

We and the Bank of Moscow formed RTI in February 2011. We took an 84.6% stake in RTI in exchange for our 97% stake in RTI Systems Concern, and the Bank of Moscow acquired a 15.4% in RTI in exchange for RUB 3 billion.

RTI is comprised of five principal business units: defense solutions, complex defence systems, telecom solutions, microelectronic solutions and systems integration. The financial results of RTI Systems Concern and SITRONICS are consolidated into RTI's financial results starting from July 2011. The figures in the table below for 2010 were restated to show the effect of this consolidation.

For the years ended 31 December 2010 and 2011, RTI's sales accounted for 6.1% and 6.3%, respectively, of Sistema's consolidated revenues. Capital expenditures at RTI totaled US\$ 91.2 million and US\$ 127.2 million, respectively, in 2010 and 2011.

The following table presents the results of operations for RTI for the periods under discussion:

	Year ended 31 December			
	2010	% of revenues	2011	% of revenues
Revenues ⁽¹⁾	1,631,816	100.0	2,093,039	100.0
Cost of sales, exclusive of depreciation and amortisation shown separately below	(1,270,476)	(77.9)	(1,688,375)	(78.9)
Selling, general and administrative expenses	(172,903)	(10.6)	(215,117)	(10.3)
Equity in net income of investees	1,389	0.1	-	-
Interest income	7,774	0.5	13,028	0.6
Interest expense	(87,923)	(5.4)	(83,403)	(4.0)
Depreciation and amortisation	(97,950)	(6.3)	(104,010)	(5.0)
Operating income	81,551	5.0	50,382	2.4
OIBDA ⁽²⁾	179,501	11.0	154,392	7.4

(1) Includes net sales to external customers and intersegment sales. Intersegment sales amounted to US\$ 462,473 thousand and US\$ 737,676 thousand in the years ended 31 December 2010 and 2011, respectively.

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

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

	For the year ended	
	2010	2011
	<i>(\$ in thousands)</i>	
Operating income.....	81,551	50,382
Depreciation and amortisation	97,950	104,010
OIBDA.....	<u>179,501</u>	<u>154,392</u>

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

Revenues

Revenues at RTI increased by US\$ 461.2 million, or 28.3%, from US\$ 1,631.8 million in the year ended 31 December 2010 to US\$ 2,093.0 million in the year ended 31 December 2011 mainly as a result of a significant increase in sales in the systems integration and microelectronics solutions units and the completion of an increased number of government defence contracts in the defence solutions unit.

Cost of sales, exclusive of depreciation, depletion and amortisation

Cost of sales, exclusive of depreciation and amortisation, increased by US\$ 380.6 million, or 30.0%, from US\$ 1,270.5 million in the year ended 31 December 2010 to US\$ 1,651.1 million in the year ended 31 December 2011 in line with the growth in revenues, described above, and, in particular, the growth in the volume of supply contracts as a share of RTI's overall operations. Supply contracts generally result in relatively higher costs since they entail greater spending on purchases of materials and greater reliance on the use of contractors.

Selling, general and administrative expenses

Selling, general and administrative expenses increased by US\$ 42.2 million, or 24.4%, from US\$ 172.9 million in the year ended 31 December 2010 to US\$ 215.1 million in the year ended 31 December 2011 mainly due to the expansion and diversification of RTI's operations.

Segment operating income

For the reasons set forth above, RTI recorded operating income of US\$ 81.6 thousand in the year ended 31 December 2010 and US\$ 50.4 million in the year ended 31 December 2011.

MTS Bank

MTS Bank provides a broad range of banking services, maintaining a diversified corporate loan portfolio and playing an active role in the Russian investment banking market. In 2010, MTS Bank resumed its retail lending program, including mortgage, credit card and emergency loans. For the years ended 31 December 2010 and 2011, MTS Bank's revenues accounted for 2.3% and 1.7%, respectively, of our consolidated revenues. Capital expenditures at MTS Bank totaled US\$ 19.2 million and US\$ 34.4 million, respectively, in 2010 and 2011.

The following table presents the results of operations for MTS Bank for the periods under discussion:

	Year ended 31 December			
	2010	% of revenues	2011	% of revenues
	<i>(\$ in thousands, except percentages)</i>			
Revenues ⁽¹⁾	613,745	100.0	560,906	100.0
Financial services related costs	(416,275)	(67.8)	(353,522)	(63.0)
Selling, general and administrative expenses.....	(173,027)	(28.2)	(209,171)	(37.3)
Net interest expenses ⁽²⁾	(24,444)	4.0	(1,912)	(0.3)
Depreciation and amortisation	(18,571)	(3.0)	(17,339)	(3.1)
Operating income/(loss).....	21,329	3.5	(23,510)	(4.2)

	Year ended 31 December			
	2010	% of revenues	2011	% of revenues
	(\$ in thousands, except percentages)			
OIBDA ⁽³⁾	39,828	6.5	(6,170)	(1.1)

- (1) Includes net sales to external customers and intersegment sales. Intersegment sales amounted to US\$ 11,588 thousand and US\$ 31,894 thousand in the years ended 31 December 2010 and 2011, respectively.
- (2) MTS Bank derives a majority of its revenue from interest. In addition, management primarily relies on net interest revenue, not the gross revenue and expense amounts, in managing MTS Bank. Therefore, only the net amount is disclosed.
- (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 service debt. While depreciation and amortisation are considered operating costs under U.S. GAAP, these expenses primarily represent non-cash current period allocation of costs associated with long-lived assets acquired or constructed in prior periods.

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

	For the year ended	
	2010	2011
	(\$ in thousands)	
Operating income.....	21,329	(23,510)
Depreciation and amortisation	18,571	17,339
OIBDA.....	39,899	(6,171)

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

Revenues

MTS Bank derives a majority of its revenue from interest income.

Revenues decreased by US\$ 53.0 million, or 8.6%, from US\$ 613.7 million in the year ended 31 December 2010 to US\$ 560.8 million in the year ended 31 December 2011 due mainly to a reduction in average interest rates.

Interest income decreased by US\$ 84.4 million, or 16.0%, from US\$ 529.7 million in the year ended 31 December 2010 to US\$ 445.3 million in the year ended 31 December 2011.

Loans to customers and banks (gross), including leases, increased by US\$ 123.2 million, or 2.4%, from US\$ 5,152.7 million in the year ended 31 December 2010 to US\$ 5,275.9 million in the year ended 31 December 2011. In 2010 and 2011, inter-company loans accounted for 5.2% and 2.5%, respectively, and loans to related parties accounted for 0.6% and 0.2%, respectively, of total loans to customers and banks. Loans to third-party customers (gross), including leases, increased by US\$ 421.6 million, or 9.0% from US\$ 4,675.2 million in the year ended 31 December 2010 to US\$ 5,096.8 million in the year ended 31 December 2011.

Non-interest income increased by US\$ 31.5 million, or 37.4%, from US\$ 84.0 million in the year ended 31 December 2010 to US\$ 115.5 million in the year ended 31 December 2011.

Financial services related costs

Financial services related costs decreased by US\$ 62.8 million, or 15.1%, from US\$ 416.3 million in the year ended 31 December 2010 to US\$ 353.5 million in the year ended 31 December 2011 due to the extension of better quality loans in 2011 compared to 2010 and as a result of substituting more expensive sources of funding raised during the crisis with less expensive funding sources.

Selling, general and administrative expenses

Selling, general and administrative expenses increased by US\$ 36.1 million, or 20.9%, from US\$ 173.0 million in the year ended 31 December 2010 to US\$ 209.2 million in the year ended 31 December 2011 mainly as a result of employee growth following further expansion of retail operations.

Segment operating income

For the reasons set forth above, MTS Bank recorded an operating gain of US\$ 21.3 million in the year ended 31 December 2010 and an operating loss of US\$ 23.5 million in the year ended 31 December 2011.

SSTL

SSTL is an Indian mobile and fixed communication operator with a spectrum in 22 licence circles covering a total population of approximately 1.2 billion people located in all of the 28 administrative states and seven union territories. For the years ended 31 December 2010 and 2011, SSTL's revenues accounted for 0.4% and 0.8%, respectively, of Sistema's consolidated revenues. Capital expenditures at SSTL totaled US\$ 169.0 million and US\$ 178.2 million, respectively, in 2010 and 2011.

The following table presents the results of operations for SSTL for the periods under review:

	Year ended 31 December			
	2010	% of revenues	2011	% of revenues
(\$ in thousands, except percentages)				
Revenues ⁽¹⁾	114,615	100.0	262,264	100.0
Cost of sales, exclusive of depreciation and amortisation shown separately below	(188,778)	(164.7)	(274,302)	(104.6)
Selling, general and administrative expenses	(190,129)	(165.9)	(275,115)	(104.9)
Impairment loss and provisions of other assets	(3,625)	(3.2)	(717,675)	(133.8)
Interest income	4,971	4.3	34,152	13.0
Interest expense	(91,982)	(80.3)	(162,442)	(61.9)
Depreciation and amortisation	(81,822)	(71.4)	(99,424)	(37.9)
Operating loss	(410,789)	(358.4)	(1,196,084)	(456.1)
OIBDA (negative) ⁽²⁾	(328,967)	(287.0)	(1,096,660)	(418.2)

(1) Consists of net sales to external customers. SSTL recorded no intersegment sales in the years ended 31 December 2010 and 2011.

(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 amortisation are considered operating costs under U.S. GAAP, these expenses primarily represent non-cash current period allocation of costs associated with long-lived assets acquired or constructed in prior periods.

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

	For the year ended	
	2010	2011
(\$ in thousands)		
Operating loss	(410,789)	(1,196,084)
Depreciation and amortisation	81,822	99,424
OIBDA (negative)	(328,967)	(1,096,660)

Revenues

Revenues at SSTL grew by US\$ 147.6 million, or 128.8%, from US\$ 114.6 million in the year ended 31 December 2010 to US\$ 262.3 million in the year ended 31 December 2011 due to growth in its subscriber base and non-voice revenues from both mobile and data value-added services.

SSTL's mobile subscriber base reached 15 million customers in 2011, compared to 8.4 million customers in 2010. Mobile broadband subscribers also increased to 1.3 million subscribers as of 31 December 2011, from 0.4 million as of 31 December 2010. Non-voice revenues from mobile value-added and data services increased by US\$ 61 million, or 327%, from US\$ 18 million in the year ended 31 December 2010 to US\$ 79 million in the year ended 31 December 2011. SSTL's ARPU decreased by 4% from US\$ 1.8 in the year ended 31 December 2010 to US\$ 1.72 in the year ended 31 December 2011.

In 2011, SSTL launched new networks in an additional seven telecom circles, bringing its coverage to 22 circles, and expanded its high-speed data network to over 300 locales.

Cost of sales, exclusive of depreciation and amortisation

Cost of sales, exclusive of depreciation and amortisation, increased by US\$ 85.5 million, or 45.3%, from US\$ 188.8 million in the year ended 31 December 2010 to US\$ 274.3 million in the year ended 31 December 2011 due mainly to the increase in SSTL's customer base.

Selling, general and administrative expenses

Selling, general and administrative expenses increased by US\$ 84.9 million, or 44.7%, from US\$ 190.1 million in the year ended 31 December 2010 to US\$ 275.1 million in the year ended 31 December 2011 mainly in connection with the continued expansion of SSTL's operations, including the rollout of mobile networks in new circles.

Impairment loss

SSTL recorded a loss from impairment and provisions of other assets of US\$ 717.7 million mainly in connection with the suspension of 21 of its 22 operating licences in India.

Interest expense

Interest expense increased by US\$ 70.5 million, or 76.6%, from US\$ 92.0 million in the year ended 31 December 2010 to US\$ 162.4 million in the year ended 31 December 2011 due to an increase in SSTL's indebtedness from US\$ 1,245.9 million as of 31 December 2010 to US\$ 1,573.5 million at 31 December 2011.

Depreciation and amortisation

Depreciation and amortisation increased by US\$ 17.6 million, or 21.5%, from US\$ 81.8 million in the year ended 31 December 2010 to US\$ 99.4 million in the year ended 31 December 2011 mainly due to the increase in SSTL's asset base.

Segment operating income

For the reasons set forth above, SSTL's operating losses increased by US\$ 785.3 million, or 191.2%, from a loss of US\$ 410.8 million in the year ended 31 December 2010 to a loss of US\$ 1,196.1 million in the year ended 31 December 2011.

Other

Our other operating segments include the following assets: Bashkirenergo, Detsky mir, Intourist, Medsi, Sistema Mass Media, Binnopharm and NIS.

Russian law requires the unbundling of power generation assets from power transmission and distribution assets. Consequently, Bashkirenergo is currently under a reorganisation, so that its power and heat generation assets and heat distribution assets are controlled by one company, Bashenergoaktiv, and its power transmission and distribution assets are controlled by another company, BESK. In December 2011, we and INTER RAO UES, a Russia energy holding company, entered into a non-binding memorandum of understanding with expressing the intention of INTER RAO UES to acquire, and us to sell, the generation assets and heat distribution assets to INTER RAO UES. We expect this reorganisation to be completed by the end of 2012 and anticipate that we will hold a 75% stake in BESK and no stake in Bashenergoaktiv. Consequently, the results of Bashkirenergo's generation business were reported in discontinued operations for the years ended 31 December 2010 and 2011.

Historically, substantially all of Bashkirenergo's revenues were attributable to its generation business, not its transmission or distribution operations. Therefore, we expect that, following the sale of its generation assets, Bashkirenergo's power transmission and distribution assets will account for a very small portion of our results of operations. For this reason, in the Financial Statements, we have excluded Bashkirenergo from our reportable segments. Prior periods have been restated to provide for comparability across the periods presented.

For the years ended 31 December 2010 and 2011, revenues from other operating segments accounted for 7.1% and 6.0%, respectively, of our consolidated revenues. Capital expenditures in other operating segments totaled US\$ 105.3 million and US\$ 321.7 million in 2010 and 2011, respectively.

The following table presents the results of operations for other operating for the periods under discussion:

	Year ended 31 December			
	2010	% of revenue s	2011	% of revenues
	<i>(\$ in thousands, except percentages)</i>			
Revenues ⁽¹⁾	1,902,546	100.0	1,974,977	100.0
Cost of sales, exclusive of depreciation and amortisation shown separately below	(1,232,561)	(64.3)	(1,133,845)	(57.4)
Selling, general and administrative expenses	(380,012)	(19.8)	(435,053)	(22.0)
Equity in net income of investees	(15,877)	(0.8)	(3,759)	(0.2)
Interest income	4,145	0.2	74,310	3.8
Interest expense	(120,654)	(6.3)	(110,684)	(5.6)
Depreciation and amortisation	(64,895)	(3.1)	(146,560)	(7.4)
Operating income/(loss)	84,251	4.5	(129,373)	(6.6)
OIBDA ⁽²⁾	149,146	7.6	12,187	0.9

(1) Includes net sales to external customers and intersegment sales. Intersegment sales amounted to US\$ 3,926 thousand and US\$ 27,537 thousand in the years ended 31 December 2010 and 2011, respectively.

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

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

	For the year ended	
	2010	2011
	<i>(\$ in thousands)</i>	
Operating income/(loss)	84,251	(129,373)
Depreciation and amortisation	64,895	146,560
OIBDA	<u>149,146</u>	<u>12,187</u>

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

Revenues

Revenues of our other operating segments increased by US\$ 72.6 million, or 3.8%, from US\$ 1,902.5 million in the year ended 31 December 2010 to US\$ 1,975.1 million in the year ended 31 December 2011 mainly due to the growth in sales at Detsky mir, Medsi, Sistema Mass Media and Binnopharm. This increase in revenues was supported by sales growth at NIS which commenced its active operations in 2010. Overall growth in other operating segments was partially offset by a decline in sales at Intourist.

Detsky mir is a leading Russian operator in children's goods retail, maintaining a chain of over 150 stores. Sales at Detsky mir increased by US\$ 123.0 million, or 15.7%, from US\$ 659.9 million in the year ended 31 December 2010

to US\$ 782.9 million in the year ended 31 December 2011 mainly due to the opening of 21 new stores and improved sales performance.

Medsi is one of Russia's leading national networks of private clinics, providing healthcare services in Moscow and other Russian regions. Sales at Medsi increased by US\$ 42.5 million, or 27.2%, from US\$ 156.5 million in the year ended 31 December 2010 to US\$ 199.0 million in the year ended 31 December 2011 mainly due to an increase in services provided, client visits and the average bill.

Sistema Mass Media is a holding company which manages assets in pay TV, premium movie and TV content production and advertising. Sales of Sistema Mass-Media increased by US\$ 6.9 million, or 7.3%, from US\$ 94.0 million in the year ended 31 December 2010 to US\$ 101.9 million in the year ended 31 December 2011 primarily due to a 15.8% increase in the subscriber base for STREAM TV, growth in content aggregation and more than a two-fold increase in advertising revenue.

Binnopharm is a pharmaceuticals company managing one of the largest full-cycle facilities in Russia for the manufacturing of bio-technology drugs in line with GMP (Good Manufacturing Practice) international quality standards. Sales at Binnopharm increased by US\$ 6.4 million, or 19.9%, from US\$ 32.1 million in the year ended 31 December 2010 to US\$ 38.5 million in the year ended 31 December 2011 mainly due to the launch of new drugs into production and to new contracts signed with ViiV Healthcare in 2011.

Intourist's sales decreased by US\$ 241.6 million, or 46.6%, from US\$ 518.2 million in the year ended 31 December 2010 to US\$ 276.6 thousand in the year ended 31 December 2011. The decline in revenues was mainly due to the deconsolidation of tour operating and retail divisions, as well as to the loss on disposal of the Pekin Hotel, which Intourist sold in March 2011. The deconsolidation was a result of the creation of a joint venture in July 2011 between Intourist and Thomas Cook. The joint venture, in which Intourist holds a 49% interest and which is therefore no longer consolidated, was established to manage Intourist's tour operating assets and retail sales network. Partially offsetting the decrease in tour revenues, the increase of revenue from hotel business due to the fact that the average price per hotel room per night increased by 1.5% from RUB 2,682 in 2010 to RUB 2,723 in 2011, and revenue per room increased by 5.8% from RUB 1,395 to RUB 1,476.

Cost of sales, exclusive of depreciation and amortisation

Cost of sales, exclusive of depreciation and amortisation, decreased by US\$ 98.7 million, or 8.0%, from US\$ 1,232.6 million in the year ended 31 December 2010 to US\$ 1,133.8 million in the year ended 31 December 2011 mainly as a result of Intourist's exit from the tour operating and retail business, discussed above. Intourist's cost of sales decreased by US\$ 226.1 million, or 49.6%, from US\$ 455.8 million in 2010 to US\$ 229.7 million in 2011. A 26.9% increase in cost of sales at Detsky mir partially offset this overall decrease in cost of sales of other operating segments.

In 2010, cost of sales at Detsky mir, Intourist and Bashkirenergo accounted for 29.7%, 37.0% and 19.3%, respectively, of overall cost of sales of other operating segments. In 2011, cost of sales at Detsky mir, Intourist and Bashkirenergo accounted for 40.9% and 20.3% and 21.1%, respectively, of overall cost of sales of other operating segments.

Selling, general and administrative expenses

Selling, general and administrative expenses increased by US\$ 55.0 million, or 14.5%, from US\$ 380.0 million in the year ended 31 December 2010 to US\$ 435.1 million in the year ended 31 December 2011, mainly due to a 16.8% increase in such expenses at Detsky mir. In 2010 and 2011, Detsky mir accounted for 62.9% and 64.2%, respectively, of overall selling, general and administrative expenses of other operating segments.

Depreciation and amortisation

Depreciation and amortisation increased by US\$ 86.2 million, or 125.8%, from US\$ 64.9 million in the year ended 31 December 2010 to US\$ 146.6 million in the year ended 31 December 2011 mainly due to overall growth of depreciable assets.

Segment operating income/(loss)

Bashkirenergo recorded operating income of US\$ 55.9 million in 2010 and US\$ 57.7 million in 2011. Detsky-Mir had operating income of US\$ 24.4 million in 2010 and US\$ 9.8 million in 2011. Intourist had operating income of US\$ 34.5 million in 2011, compared to an operating loss of US\$ 4.0 million in 2010. Medsi recorded operating income of US\$ 8.1 million in 2010 and US\$ 19.6 million in 2011. Sistema Mass Media had an operating loss of US\$ 73.7 million in 2011, largely due to an impairment loss at RWS, reflecting a downward revision of secondary sales forecasts of Sistema Mass Media's content library. Sistema Mass Media had operating income of US\$ 2.2 million in 2010. Binnopharm recorded operating losses in both 2010 and 2011.

For the reasons discussed above, our other operating segments, in aggregate, recorded an operating loss of US\$ 129.4 million in 2011, compared to an operating gain of US\$ 85.3 million in 2010.

Liquidity and Capital Resources

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

We expect to repay all long-term debts as they become due from our operating cash flows, including distributions received from subsidiaries, or through re-financings. See Notes 19 and 20 to our Financial Statements for a description of our indebtedness.

Dividend policy

Our parent company, Sistema JSFC, is a holding company, and its ability to repay its debts depends in large part on the receipt of dividends, distributions and other payments from our subsidiaries, proceeds from the sale of our subsidiaries and from additional borrowings.

Because most of our operating subsidiaries are incorporated in Russia, their ability to pay dividends to Sistema JSFC is limited by the provisions of the Russian law. For example, the 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. Our subsidiaries located in other jurisdictions are likely to be subject to similar or other limitations on their ability to declare and pay dividends as a result of regulatory, fiscal and other restrictions.

In October 2011, the Board of Directors approved our dividend policy, which sets forth recommendations on the size of dividends as well as our obligations on dividend payments and relevant disclosures. According to the dividend policy, dividends shall be paid in cash and shall be equal to at least 10% of Sistema's consolidated net income attributable to Sistema JSFC (net of any special dividends paid). In the event of a cash transaction, such as a large asset sale, the Board of Directors may also recommend a special dividend that equals at least 10% of the net gain from such transaction. No dividends were declared or paid in 2009. In June 2010, Sistema JSFC declared dividends for the year ended 31 December 2009 of RUB 530.8 million (\$17.5 million). In June 2011, Sistema declared and paid dividends for the year ended 31 December 2010 of RUB 2.509 billion (\$87.1 million), or RUB 0.26 per share.

Stock-Option Plans

Sistema JSFC and several of its subsidiaries operate share-based compensation plans for their employees. Sistema JSFC operates two such plans: an equity plan, in which employees may exercise options granted to them in exchange for shares, and the three-year Motivation Programme.

According to the Motivation Programme, participants were granted phantom shares in Sistema JSFC upon their continued employment with Sistema. Participants had the right to convert up to 2/3 of their phantom shares prior to 31 December 2010 into cash based on the weighted-average market price of our ordinary shares on MICEX for 60 trading days preceding 31 December 2010. The remaining shares, plus any additional shares granted in 2011, were converted into ordinary shares of Sistema JSFC in January 2012. See "Recent Developments."

Cash Flows

A summary of our cash flows is presented in the table below for the periods indicated:

	Year ended 31 December	
	2010	2011
	(\$ in thousands)	
Cash flows		
Net cash from operating activities	4,056,752	5,571,408
Net cash used in investing activities	(4,839,344)	(5,185,884)
Net cash used in financing activities.....	(6,878)	(481,938)
Decrease in cash and cash equivalents.....	(799,580)	(250,798)

Net cash from operating activities

Despite the decline in net income from US\$ 2,117.2 million in 2010 to US\$ 1,191.2 million in 2011, net cash from operating activities increased by US\$ 1,514.6 million, or 37.4%, from US\$ 4,056.8 million in the year ended 31 December 2010 to US\$ 5,571.4 million in the year ended 31 December 2011. This increase was the net effect of the following adjustments to net income and changes in working capital:

- The US\$ 717.9 million, or 229.1%, increase in the loss from impairment and provision of other assets, which was due, in turn, to the write-down as of 31 December 2011 of operating licences in India and goodwill in the amount of US\$ 694.7 million. See Note 11 of the Financial Statements for a discussion of the suspension of SSTL's operating licences in India.
- No gain upon adoption of equity method in 2011, compared to a gain of US\$ 477.4 million in 2010 in connection with the acquisition of significant influence over Belkamneft following the purchase of a 49.0% stake in its parent company OJSC RussNeft.
- A US\$ 418.9 million, or 14.6%, increase in depreciation, depletion and amortisation in 2011 compared to 2010, which, in turn reflected the increase in our depreciable assets, including the increased asset base at MTS which led to higher depreciation of property, plant and equipment.
- A US\$ 326.4 million foreign currency transaction loss in 2011, compared to a US\$ 26.2 million foreign currency transaction gain in 2010, due to depreciation of the rouble against the U.S. dollar in 2011 and appreciation of the rouble against the dollar in 2010.
- A US\$ 574.6 million increase in accounts payable in 2011, compared to a US\$ 226.2 million increase in 2010.
- A US\$ 186.1 million increase in accounts receivable in 2011, compared to a US\$ 417.6 million increase in accounts receivable in 2010.
- A US\$ 190.8 million increase in inventories and spare parts in 2011, compared to a US\$ 395.1 million increase in 2010, which was mainly due to the overall increase in sales at our subsidiaries in 2011.
- A US\$ 167.4 million increase in VAT receivable in 2011, compared to a US\$ 467.6 million increase in VAT receivable in 2010.
- A US\$ 198.9 million decrease in accrued expenses and other liabilities in 2011, compared to an increase of US\$ 406.0 million in 2010.

Net cash outflow from investing activities

Net cash outflow from investing activities increased from US\$ 4,839.3 million in the year ended 31 December 2010 to US\$ 5,185.9 million in the year ended 31 December 2011. This increase was primarily due to (i) a 94.2% increase in purchases of long-term investments from US\$ 478.5 million in 2010 to US\$ 929.1 million in 2011; (ii) a US\$ 341.1 million net decrease in loans to customers and banks in 2011, compared to a US\$ 107.9 million net increase in loans in 2010; and (iii) a 39.9% decrease in proceeds from the sale of subsidiaries, net of cash disposed, from US\$ 307.4 million in 2010 to US\$ 184.6 million in 2011. This increase in net cash outflow from investing activities was offset by several factors, the most significant of which were the following: (i) a 156.4% increase in proceeds from the sale of short-term investments from US\$ 461.9 million in 2010 to US\$ 1,184.1 million in 2011; (ii) a 35.0% decrease in purchases of intangible assets from US\$ 693.1 million in 2010 to US\$ 451.2 million in 2011; and (iii) a significant increase in proceeds from the sale of property, plant and equipment from US\$ 18.8 million in 2010 to US\$ 170.2 million in 2011.

Net cash outflow from financing activities

Net cash outflows from financing activities increased from US\$ 6.9 million in the year ended 31 December 2010 to US\$ 481.9 million in the year ended 31 December 2011 due mainly to the following factors: (i) principal payments on short-term borrowings of US\$ 276.9 million in 2011, compared to proceeds from short-term borrowings of US\$ 460.6 million in 2010; (ii) a net decrease in deposits from customers in the banking division of US\$ 651.1 million in 2011, compared to a net increase of US\$ 597.9 million in 2010; (iii) the US\$ 602.3 million advance received in 2010 for shares in SSTL; and (iv) a 103.0% net increase in debt securities issued and other liabilities by the banking division from US\$ 225.5 million in 2010 to US\$ 457.9 million in 2011. The increase in net cash outflows from financing activities was offset principally by two factors: (i) a 18.3% decrease in principal payments on long-term borrowings from US\$ 5,302.6 million in 2010 to US\$ 4,331.5 million in 2011; and (ii) a 66.8% decrease in outflows on the acquisition of noncontrolling interests in existing subsidiaries from US\$ 787.4 million in 2010 to US\$ 261.2 million in 2011.

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 31 December 2011, we had a positive working capital of US\$ 1,543.4 million, compared to positive working capital of US\$ 1,555.8 million as of 31 December 2010.

Capital Requirements

Sistema JSFC and each of its subsidiaries require funding to finance the following:

- capital expenditures, which consist of purchases of property, plant and equipment and intangible assets;
- acquisitions;
- repayment of debt;
- changes in working capital;
- general corporate activities, including dividends;
- potential payments of obligations under judgments; and
- potential payments of obligations under other contractual obligations.

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

Our capital expenditures in the years ended 31 December 2010 and 2011 were US\$ 4,179.6 million and US\$ 4,005.0 million, respectively. We expect to continue to finance most of our capital expenditure needs through our operating cash flows, and to the extent required, additional indebtedness, such as borrowings or additional capital raising activities. From 2010 through 2011, a significant portion of our capital expenditures was related to the installation and build-out of our telecommunication networks, in particular, the upgrade of MTS' 3G network, to the development of MTS' retail business and to MTS' expansion into new licence areas. We have also begun to spend a greater share of our capital expenditures on investment programmes at Bashneft. We expect that capital expenditures will remain a large portion of our cash outflows, especially in light of the proposed development of the Trebs & Titov oil fields and if new telecommunications technologies become available and/or the full digitalisation of the Moscow public switch telephone network is implemented.

In addition to our capital expenditures, we spent US\$ 1,152.0 million and US\$ 636.5 million in the years ended 31 December 2010 and 2011, respectively, on acquisitions, including acquisitions of non-controlling interests in existing subsidiaries. See "Acquisitions, Divestitures and Key Corporate Restructurings - Acquisitions," above, and Notes 3 and 4 of the Financial Statements for further description of our acquisitions. We may continue to expand our business through acquisitions. Our cash requirements relating to potential acquisitions can vary significantly based on market opportunities. For a discussion of acquisitions made after 31 December 2011, see "Recent Developments," above.

In 2010 and 2011, we restructured certain of our debt obligations. As of 31 December 2011, short-term debt equaled US\$ 4,396.7 million, of which US\$ 4,097.1 million represented the current portion of long-term debt. As of 31 December 2010, short-term debt equaled US\$ 3,177.5 million, of which US\$ 2,103.4 million represented the current portion of long-term debt. As of 31 December 2010 and 2011, short-term debt (including the current portion of long-term debt) accounted for 19.7% and 36.6%, respectively, of our overall debt.

Capital Resources

We plan to finance our capital requirements through operating cash flows and financing activities, as described above.

Cash

As of 31 December 2010 and 2011, excluding our assets from banking activities, we had cash and cash equivalents of US\$ 2,245.9 million and US\$ 2,924.0 million, respectively.

As of 31 December 2010 and 2011, the current portion of our assets from banking activities amounted to US\$ 5,502.7 million and US\$ 4,205.0 million, respectively.

Loans and Borrowings

As of 31 December 2011, our indebtedness consisted mainly of notes and corporate bonds and loans from banks and financial institutions. Total indebtedness as of 31 December 2011 was US\$ 16,409.9 million, consisting of US\$ 12,013.2 million in long-term debt, US\$ 4,097.1 million in long-term debt maturing within one year and US\$ 299.6 million in short-term loans payable. The table below sets forth our notes and corporate bonds and loans from banks and financial institutions outstanding as of 31 December 2011. See Note 20 to our Financial Statements for further description of our material debt obligations.

	<u>Currency</u>	<u>Annual interest rate</u>	<u>31 December 2011</u>
Notes and Corporate Bonds		<i>(Actual at 31 December 2011)</i>	<i>(\$ in thousands)</i>
MTS International Notes due 2020	USD	8.6%	750,000
MTS Notes due 2016	RUB	14.3%	465,895
MTS Notes due 2020	RUB	8.2%	457,928
MTS Notes due 2014	RUB	7.6%	422,988
MTS Finance Notes due 2012	USD	8.0%	400,000
Bashneft Bonds due 2016	RUB	12.5%	357,301
Sistema JSFC Bonds due 2014	RUB	14.8%	352,641
Sistema JSFC Bonds due 2016	RUB	7.7%	349,940
MTS Notes due 2017	RUB	8.7%	310,597
Bashneft Bonds due 2014	RUB	9.4%	310,597
MTS Notes due 2018	RUB	8.0%	298,499
Sistema JSFC Bonds due 2016	RUB	12.5%	247,333
MTS Notes due 2015	RUB	7.8%	234,706
Sistema JSFC Bonds due 2013	RUB	9.8%	154,829
SITRONICS Bonds due 2013	RUB	10.8%	93,179
Intourist Bonds due 2013	RUB	14.0%	62,119
SITRONICS Bonds due 2013	RUB	11.8%	39,011
DM-Center Bonds due 2015	RUB	8.5%	35,719
MTS Notes due 2013	RUB	7.0%	13,318
Less unamortized discount			(17)
Total Notes and Corporate Bonds			5,356,583

Bank Borrowings

Calyon, ING Bank N.V, Nordea Bank AB, Raiffeisen Zentralbank Osterreich AG	USD	LIBOR +1.15% (1.96%)	580,742
Deutsche Bank	USD	LIBOR +1.55% (1.85%)	300,000
China Development Bank	USD	LIBOR +1.5% (2.31%)	249,616
Gazprombank	USD	LIBOR +4.9% (5.48%)	229,309
Skandinaviska Enskilda Banken AB	USD	LIBOR +0.23%-1.8% (1.03%-2.61%)	204,507
Bank of China	USD	LIBOR +1.5%-1.95% (2.31%-2.76%)	139,805
Bank of Moscow	USD	LIBOR +6.75%-9.5% (7.33%-9.8%)	117,450
EBRD	USD	LIBOR +1.51%-3.1% (2.32%-3.91%)	83,333
HSBC Bank; ING BHF Bank AG	USD	LIBOR +0.3% (1.11%)	51,503
HSBC Bank; ING Bank AG; Bayerische Landesbank	USD	LIBOR +0.3% (1.11%)	42,961

	Currency	Annual interest rate	31 December 2011
Citibank International plc; ING Bank AG; HSBC Bank plc	USD	LIBOR +0.43% (1.23%)	40,688
Commerzbank AG; ING Bank AG; HSBC Bank plc	USD	LIBOR +0.3% (1.11%)	36,495
Golden Gates (Bank of Moscow)	USD	9.75%	20,000
Societe Generale	USD	LIBOR +1.25% (2.06%)	18,860
Royal Bank of Scotland	USD	LIBOR +0.35% (1.16%)	12,574
Other	USD	Various	6,324
Total USD-denominated debt			2,134,167
Bank of China	EUR	EURIBOR +1.95% (3.57%)	116,812
Syndicated Loan to Intracom Telecom	EUR	EURIBOR +4.5% (5.61%)	116,487
EBRD	EUR	EURIBOR +5.2% (6.49%)	77,658
BNP Paribas	EUR	EURIBOR +1.65% (3.27%)	64,033
LBWW	EUR	EURIBOR +0.75% (2.37%)	36,215
Royal Bank of Scotland	EUR	EURIBOR 0.35% (1.97%)	8,958
Other	EUR	Various	16,282
Total EUR-denominated debt			436,445
Sberbank	RUB	7.75%-8.90%	4,388,106
Gazprombank	RUB	8.75%-9.00%	1,830,699
Bank of Moscow	RUB	MosPrime+7.25% (14.47%); 7.8%- 10.25%	590,309
Raiffeisenbank	RUB	MosPrime +3% (9.37%-10.22%)	83,861
Unicredit	RUB	MosPrime +4.5%-7.5% (10.87%-13.87%)	69,271
ING Bank	RUB	10.74%	32,613
Other	RUB	Various	6,875
Total RUB denominated debt			7,001,734
State Bank of India	INR	13.5%	396,095
Other	Various	Various	357,757
Total debt denominated in other currencies			753,852
Total Bank Borrowings			10,326,198

The following table presents the aggregate scheduled maturities of debt principal outstanding as of 31 December 2011:

Payments due in the year ended 31 December	(\$ in thousands)
2012	4,097,076
2013	2,354,096
2014	1,467,499
2015	2,363,042
2016	2,189,133
Thereafter.....	3,639,427
Total	16,110,273⁽¹⁾

(1) Includes only long-term debt and current portion of long-term debt. Does not include US\$ 299.6 million in short-term loans payable in 2012.

Commitments and Contingencies

For further discussion of our commitments and contingencies, see Note 27 of our Financial Statements.

Operating leases

We lease land, buildings and office space mainly from municipal organisations through contracts which expire in various years through 2060. In 2010 and 2011, we had total rental expenses under operating leases of US\$ 678.1 million and US\$ 759.2 million, respectively. See “Tabular disclosure of contractual obligations” below, for the amount of operating lease payments expected in 2012-2016 and thereafter.

Capital commitments

As of 31 December 2011, we had executed agreements valued at approximately US\$ 764.1 million to acquire property, plant and equipment and intangible assets.

Guarantees

As of December 31, 2011, MTS Bank and its subsidiaries guaranteed loans for several companies, including related parties, which totaled US\$ 304.3 million. These guarantees would require payment by the Group only in the event of default on payment by the respective debtor. As of December 31, 2011, no event of default has occurred under any of the guarantees issued by the Group.

Commitments on loans and unused credit lines

As of 31 December 2011, MTS Bank had US\$ 528.6 million of commitments on loans and unused credit lines available to its customers.

Agreement with Apple

In 2008, MTS entered into an unconditional purchase agreement with Apple Sales International to buy 1.5 million iPhone handsets at the list price on the purchase date over a three year period. Pursuant to the agreement, MTS is also required to incur certain iPhone promotion costs. MTS did not fulfill its commitment under the agreement, having made 28.6% of the total purchase installment as of 31 December 2011. In 2009, 2010 and 2011, the total amount paid for handsets purchased under the agreement amounted to US\$ 3.4 million, US\$ 79.4 million and US\$ 140.8 million, respectively.

Taxation

In 2010 and 2011, the Russian tax authorities completed a number of tax audits at our subsidiaries. Based on the results of these audits, we were assessed additional taxes, penalties and fines in the amount of US\$ 17.4 million payable as of 31 December 2010 and US\$ 61.8 million payable as of 31 December in 2011. We have appealed certain of these assessments.

Credit Ratings

Our credit ratings impact our ability to obtain short- and long-term financing, and the cost of such financing. In determining our credit ratings, the rating agencies consider a number of factors, including our operating cash flows, total debt outstanding, commitments, interest requirements, liquidity needs and availability of liquidity. Other factors considered may include our business strategy, corporate governance, the condition of our industry and our position

within the industry. Although we understand that these and other factors are among those considered by the rating agencies, each agency might calculate and weigh each factor differently.

The credit ratings of our parent company, MTS and Bashneft as of April 20, 2012 were as follows:

Name of issuer	Rating Agency	Date of Rating	Rating	Outlook
Sistema	S&P	3 February 2012	BB	Stable
Sistema	Fitch	28 November 2011	BB-	Stable
Sistema	Moody's	12 April 2012	Ba3	Stable
MTS	S&P	3 February 2012	BB	Stable
MTS	Moody's	12 April 2012	Ba2	Stable
MTS	Fitch	28 November 2011	BB+	Stable
Bashneft	Moody's	19 April 2012	Ba2	Stable

Market Risks

We are exposed to a variety of market risks, including foreign currency risk, interest rate risk, credit risk and liquidity risk. We actively seek to minimise the potential adverse effects of these risks on our financial performance, and, in particular, use derivative instruments, including swap, forward and option contracts to manage foreign currency and interest rate risks. We do not use derivatives for trading purposes. See “Key Factors Affecting Our Results of Operations - General Factors - Russian Macroeconomic Conditions and Trends” above, for a discussion of our foreign currency and inflation risks.

Interest Rate Risk

Interest rate risk is the risk that changes in variable interest rates will adversely impact our financial results. Our interest rate risk arises from fixed-rate and variable-rate loans and borrowings. Borrowings issued at fixed rates expose us to fair value interest rate risk, while borrowings issued at variable rates, particularly fluctuations in LIBOR, EURIBOR and MosPrime, expose us to cash flow interest rate risk.

As of 31 December 2011, approximately US\$ 2,835 million, or 17.3% of our total indebtedness was variable interest rate debt, while US\$ 13,575 million, or 82.7% of our total indebtedness was fixed interest rate debt.

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 31 December 2011.

December 31,									Average rate at December 31, 2011
	Currency	2012	2013	2014	2015	2016	Thereafter	Total	
Calyon, ING Bank N.V, Nordea Bank AB, Raiffeisen Zentralbank Osterreich AG	USD	62,010	74,186	74,186	74,186	74,186	221,988	580,742	1.96%
Deutsche Bank	USD	50,000	150,000	100,000				300,000	1.85%
China Development Bank	USD	20,801	41,603	41,603	41,603	41,603	62,403	249,616	2.31%
Gazprombank	USD	229,309	-	-	-	-	-	229,309	5.48%
Skandinaviska Enskilda Banken AB	USD	37,506	37,506	37,506	37,506	35,094	19,389	204,507	1.30%
Bank of China	USD	6,307	26,699	26,699	26,700	26,700	26,700	139,805	2.54%
Bank of Moscow	USD	2,450	-	-	-	-	115,000	117,450	7.38%

EBRD	USD	33,334	33,334	16,665	-	-	-	83,333	2.73%
HSBC Bank plc and ING BHF Bank AG	USD	19,741	19,741	12,021	-	-	-	51,503	1.11%
HSBC Bank plc, ING Bank AG and Bayerische Landesbank	USD	16,609	16,609	8,726	1,017	-	-	42,961	1.11%
Citibank International plc and ING Bank N.V.	USD	21,800	18,888	-	-	-	-	40,688	1.23%
Commerzbank AG, ING Bank AG and HSBC Bank plc	USD	14,790	14,790	6,915	-	-	-	36,495	1.11%
Societe Generale	USD	3,785	3,768	3,769	3,769	3,769	-	18,860	2.06%
The Royal Bank of Scotland	USD	6,287	6,287	-	-	-	-	12,574	1.16%
Total USD variable debt		524,729	443,412	328,090	184,780	181,352	445,480	2,107,843	-
Weighted average USD interest rate		2.49%	2.42%	2.63%	2.87%	3.18%	3.41%	-	-
Bank of China	EUR	23,362	23,362	23,362	23,364	23,362	-	116,812	3.57%
Syndicated Loan to Intracom Telecom	EUR	116,487	-	-	-	-	-	116,487	5.61%
EBRD	EUR	77,658	-	-	-	-	-	77,658	6.49%
BNP Paribas	EUR	8,963	8,963	8,963	8,963	8,962	19,219	64,033	3.27%
LBWW	EUR	6,036	6,036	6,036	6,036	6,035	6,036	36,215	2.37%
The Royal Bank of Scotland	EUR	4,479	4,479					8,958	1.97%
Total EUR variable debt		236,985	42,840	38,361	38,361	38,361	25,255	420,163	
Weighted average EUR interest rate		4.11%	3.27%	3.26%	3.23%	3.17%	3.05%		
Bank of Moscow	RUB	310	1,864	3,727	8,131	-	112,960	126,992	10.72%
Raiffeisenbank	RUB	-	-	83,861	-	-	-	83,861	9.75%
Unicredit	RUB	8,200	12,800	19,500	15,900	12,871	-	69,271	12.26%
Total RUB variable debt		8,510	14,664	107,088	24,031	12,871	112,960	280,124	
Weighted average RUB interest rate		10.79%	10.73%	10.81%	10.95%	10.80%	10.72%		

Credit Risk

Credit risk is the risk of financial loss to us if a customer or counterparty to a financial instrument fails to meet its contractual obligations, and arises principally from cash and cash equivalents, assets from banking activities, short-term investments, net accounts receivable and long-term investments. .

Credit risk with regard to assets from banking activities is managed by evaluating the creditworthiness of our customers.

Credit risk with respect to short-term and long-term investments is managed by assessing the creditworthiness of each borrower, taking into account the type of security that can be pledged, as well as the purpose of each investment or loan.

Credit risk connected with other current assets is managed by assessing the creditworthiness of each customer, taking into account its financial position, past experience and other factors.

The carrying amount of our financial assets represents our maximum credit exposure. The following table sets forth the maximum exposure to credit risk as at the periods indicated:

	Year ended 31 December	
	2010	2011
	<i>(\$ in thousands)</i>	
Cash and cash equivalents	2,245,884	2,923,957
Assets from banking activities	6,508,081	7,302,349
Short term investments	879,680	763,631
Accounts receivable, net	1,780,423	1,756,278
Long-term investments	1,294,687	469,742
Total	12,610,768	13,215,957

Liquidity Risk

Liquidity risk is the risk that we will not be able to settle all liabilities as they become due. Our approach to managing liquidity is to ensure, as far as possible, that we will always have sufficient liquidity to meet our liabilities when due, under both normal and stressed conditions, without incurring unacceptable losses or risking damage to our reputation. Our liquidity in the future will primarily depend on our ability to maintain adequate cash flows from operations to meet our debt obligations as they become due, on our ability to obtain adequate external financing to meet our committed future capital expenditures and on the extent to which we will be obligated to make payments under certain judgments and other contractual obligations. Our operating cash flows could be adversely affected by numerous factors beyond our control, including but not limited to, fluctuations in exchange rates and inflation, the price of acquisitions, the change in telecommunications tariffs, changes in crude oil and oil products' prices, taxation, feedstock prices in the oil industry or increased competition. Our ability to obtain external financing depends on numerous factors, including but not limited to, our financial performance and creditworthiness as well as our relationships with lenders.

Critical Accounting Policies

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

Revenue Recognition

Revenue recognition policies have a significant impact on our results of operations. Generally, revenues are recognized when all of the following conditions have been met: (i) there is persuasive evidence of an arrangement; (ii) delivery has occurred; (iii) the fee is fixed and determinable; and (iv) collectability of the fee is reasonably assured. Revenue amounts are presented net of value added taxes.

Revenues under arrangements specific to the our respective segments are recognized as follows:

MTS

Revenues derived from wireless, local telephone, long distance, data and video services are recognized when services are provided. This is based upon either usage (minutes of traffic processed, volume of data transmitted) or period of time (monthly subscription fees).

The content revenue is presented net of related costs when MTS acts as an agent of the content providers while the gross revenue and related costs are recorded when MTS is a primary obligor in the arrangement.

Upfront fees received for connection of new subscribers, installation and activation of wireless, wireline and data transmission services ("connection fees") are deferred and recognized over the estimated average subscriber life, as follows:

Mobile subscribers	1-5 years
Residential wireline voice phone subscribers	15 years
Residential subscribers of broadband internet service	1 year
Other fixed line subscribers	3-5 years

MTS calculates an average life of mobile subscribers for each region in which it operates and amortizes regional connection fees.

Incentives provided to customers are usually offered on signing a new contract or as part of a promotional offering. Incentives, representing the reduction of the selling price of the service (free minutes and discounts) are recorded in the period to which they relate, when the respective revenue is recognized, as a reduction to both accounts receivable and revenue. However, if the sales incentive is a free product or service delivered at the time of sale, the cost of the free product or service is classified as an expense. In particular, the Group sells handsets at prices below cost to contract subscribers. Such subsidies are recognized in the cost of handsets and accessories when the sale is recorded.

Bashneft

Revenues from the production and sale of crude oil and petroleum products are recognised when title passes to customers at which point the risks and rewards of ownership are assumed by the customer and the price is fixed and determinable. Revenues include excise taxes on petroleum products sales and duties on export sales of crude oil and petroleum products. Excise taxes, which are re-charged to third parties under the terms of processing agreements, are excluded from revenues.

Revenue from a contract to provide services is recognised by reference to the stage of completion of the contract. Revenue from time and material contracts is recognised at the contractual rates as labour hours are delivered and direct expenses are incurred.

Construction contracts revenue includes the initial amount agreed in the contract plus any variations in contract work, claims and incentive payments, to the extent that it is probable that they will result in revenue and can be measured reliably. As soon as the outcome of a construction contract can be estimated reliably, contract revenue is recognised in profit or loss in proportion to the stage of completion of the contract. Contract expenses are recognised as incurred unless they create an asset related to future contract activity. The stage of completion is assessed by reference to surveys of work performed. When the outcome of a construction contract cannot be estimated reliably, contract revenue is recognised only to the extent of contract costs incurred that are likely to be recoverable. An expected loss on a contract is recognised immediately in profit or loss.

RTI

Revenues from the long-term contracts are recognized by reference to the stage of completion of the contract activity at the statement of financial position date when the outcome of a contract can be estimated reliably. This is normally measured by the proportion that contract costs incurred for work performed to date relate to the estimated total contract costs, except where this would not be representative of the stage of completion. Variations in contract work, claims and incentive payments are included to the extent that they have been agreed with the customer. Where the outcome of a contract cannot be estimated reliably, contract revenue is recognized to the extent of contract costs incurred where it is probable that such costs will be recoverable. When it is probable that total contract costs will exceed total contract revenue, the expected loss is recognized immediately.

The sales of software products and system integration services are generally multiple-element arrangements, involving the provision of related services, including customization, implementation and integration services, as well as ongoing support and maintenance provided to customers.

A multiple-element arrangement is separated into more than one unit of accounting if all of the following criteria are met: (a) the delivered items have value to the customer on a standalone basis; (b) there is objective and reliable evidence of the fair value of the undelivered items; and (c) the arrangement includes a general right of return relative to the delivered items, delivery or performance of the undelivered items is considered probable and substantially in the control of the Group.

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

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

When sale agreements provide price protection to the dealer, the revenue is deferred until the dealer sells the merchandise to a third party due to the frequent sales price reductions and rapid technology obsolescence.

Certain products of this segment are generally sold with a limited warranty for product quality. The product return reserves and other post-contract support obligations are accrued at the time of sale. The segment accrues for estimated incurred but unidentified issues based on historical activity.

MTS Bank

Revenues from interest income are recognized on an accrual basis using the effective interest method. The effective interest method is a method of calculating the amortized cost of a financial asset or a financial liability (or group of financial assets or financial liabilities) and of allocating the interest income or interest expense over the relevant period.

The effective interest rate is the rate that exactly discounts estimated future cash receipts (including all fees on points paid or received that form an integral part of the effective interest rate, transaction costs and other premiums or discounts) through the expected life of the debt instrument, or (where appropriate) a shorter period, to the net carrying amount on initial recognition.

SSTL

Service revenues are recognized as services are rendered, net of discounts and waivers. Processing fees and activation revenues on recharge vouchers and start-up kits are recognized as revenues net of discounts, as and when they get activated.

Revenues from infrastructure services are recognized as services are rendered, in accordance with the terms of the related contracts. Indefeasible right of use contracts are accounted for as operating leases and revenues are recognized over the term of the lease.

Other businesses

Our other businesses recognize revenue when products are shipped or when services are rendered to customers. In cases where we act as an agent, only the net agency fee is recognized as revenue.

Licence Costs and Other Intangible Assets

Other intangible assets include billing, telecommunication and other software, operating licences, acquired customer bases, radio frequencies, trademarks and telephone numbering capacity. Licence costs are capitalized as a result of (a) the purchase price allocated to licences acquired in business combinations; and (b) licences purchased directly from government organizations which require licence payments.

All finite-life intangible assets are being amortized using the straight-line method utilizing estimated useful lives of the assets as follows:

Billing and telecommunication software	1-20 years
Operating licences	3-15 years
Acquired customer base	1-8 years
Numbering capacity with finite contractual life	2-10 years
Acquired radio frequencies	2-15 years

Trademarks and telephone numbering capacity with unlimited contractual life are not amortized, but are reviewed, at least annually, for impairment. If the fair value of the intangible asset is less than its carrying value, an impairment loss is recognized in an amount equal to the difference. We also evaluates the remaining useful life of its intangible assets that are not subject to amortization on an annual basis to determine whether events and circumstances continue to support an indefinite useful life. If an intangible asset that is not being amortized is subsequently determined to have a finite useful life, that asset is tested for impairment.

Property, Plant and Equipment

Property, plant and equipment are stated at historical cost. Cost includes major expenditures for improvements and replacements, which extend useful lives of the assets or increase their revenue generating capacity. Repairs and maintenance, including preventative maintenance, are charged to the consolidated statement of operations as incurred.

We recognize the costs of overhauls and preventive maintenance performed with respect to oil refining assets as expenses when incurred. Cost of major overhauls and replacements, which extend useful lives of the assets or increase their revenue generating capacity are capitalized to the cost of the assets.

Depreciation for property, plant and equipment other than depletion on oil and gas properties is computed under the straight-line method utilizing estimated useful lives of the assets as follows:

Buildings	20-50 years
Leasehold improvements	Lesser of the estimated useful life or the term of the lease
Switches and transmission devices	7-31 years
Network and base station equipment	4-12 years
Refining, marketing, distribution and chemicals	3-40 years
Exploration and production assets	3-19 years
Power and utilities	3-47 years
Other plant, machinery and equipment	3-25 years

Depletion of proved oil and gas properties is calculated using the unit-of-production method based on total proved reserves. Depletion expense of other capitalized costs related to oil and gas production is calculated using the unit-of-production method based on proved developed reserves.

Assets held under capital leases are initially recognized as our assets at their fair value at the inception of a lease or, if lower, at the present value of minimum lease payments. The discount rate used in determining the present value of the minimum lease payments is our incremental borrowing rate, unless (1) it is practicable to determine the implicit rate computed by the lessor; and (2) the implicit rate is less than the our incremental borrowing rate. If both of those conditions are met, the interest rate implicit in the lease is used.

Items of property, plant and equipment that are retired or otherwise disposed of are eliminated from the consolidated statement of financial position along with the corresponding accumulated depreciation and depletion. Any gain or loss resulting from such retirement or disposal is included in the determination of consolidated net income.

Construction in-progress and telecommunications equipment for installation are not depreciated until an asset is placed into service.

Impairment of long-lived assets other than goodwill and indefinite lived intangible assets

We periodically evaluates the recoverability of the carrying amount of its long-lived assets. Whenever events or changes in circumstances indicate that the carrying amounts of those assets may not be recoverable, we compare the undiscounted net cash flows estimated to be generated by those assets to the carrying amount of those assets. When these undiscounted cash flows are less than the carrying amounts of the assets, we record impairment losses to write the asset down to fair value, measured by the estimated discounted net future cash flows expected to be generated from the use of the assets

Income taxes

Income taxes of our Russian entities have been computed in accordance with RF laws. The corporate income tax rate in the RF is 20%. The income tax rate on dividends paid within Russia is 9%. Our foreign subsidiaries are paying income taxes in their respective jurisdictions.

Deferred tax assets and liabilities are recognized for differences between the carrying amounts of assets and liabilities in the consolidated financial statements and the tax bases of assets and liabilities that will result in future taxable or deductible amounts. The deferred tax assets and liabilities are measured using the enacted tax laws and rates applicable to the periods in which the differences are expected to affect taxable income. Deferred tax assets are reduced by a valuation allowance when, in the opinion of management, it is more likely than not that some portion or all of the deferred tax assets will not be realized. In making such determination, we consider all available positive and negative evidence, including future reversals of existing taxable temporary differences, projected future taxable income, tax planning strategies and recent financial operations.

Uncertain tax positions are recognized in the consolidated financial statements for positions which are considered more likely than not of being sustained based on the technical merits of the position on audit by the tax authorities. The measurement of the tax benefit recognized in the consolidated financial statements is based upon the largest amount of tax benefit that, in management's judgment, is greater than 50% likely of being realized based on a cumulative probability assessment of the possible outcomes. We recognize interest and penalties relating to unrecognized tax benefits and penalties within income taxes.

New Accounting Pronouncements

During the periods under review, the Financial Accounting Standards Board has issued certain new accounting pronouncements that were either adopted during the periods under review or are to be adopted in future periods. These pronouncements are described in Note 2 of the Financial Statements.

We do not expect the application of these pronouncements will have a material impact on our consolidated financial statements.

2.5. Risks

The main risk factors relating to Sistema JSFC

The risks the corporation may face are diverse, many of which represent manifestations of processes and factors, on many of which Sistema JSFC has limited, or no, influence. Hence, effective assessment and management of risks remains an important component of Sistema's strategy.

We have introduced an integrated enterprise risk management system (ERM) that is designed to provide a means of allowing us to achieve our strategic goals while keeping the level of risk within limits that are acceptable for Sistema's shareholders and management. The ERM system at Sistema was established in compliance with international standards, recommendations and best practices in risk management.

External risks

A significant part of Sistema JSFC's business is carried out in the Russian Federation, so we face significant risks specific to the Russian Federation. In addition, many of our subsidiaries maintain operations in other emerging markets, including Ukraine, Uzbekistan, Armenia, Belarus and India, which exhibit many risks similar to those described below

Economic risks

- Sistema's business is substantially affected by the state of the Russian economy, which is, to a significant degree, dependent on exports of key commodities, such as oil, gas and other raw materials.
- Weak macroeconomic conditions in many of the countries in which we operate could require the reassessment of the value of goodwill on certain of our assets.
- An increase in inflation could increase certain of our costs and thereby exert downward pressure on our profit margin and may also negatively impact domestic demand for the products of our subsidiaries.
- Depreciation of the rouble against the U.S. dollar and Euro could increase our costs and reduce our revenues, or make it more difficult for us to comply with financial ratios and to repay our debts
- Exchange controls and repatriation restrictions could adversely affect our ability to transact business and may lower the value of our investments in the Russian Federation.
- The poor condition or further deterioration of the Russian Federation's physical infrastructure may harm the national economy, disrupt the transportation of goods and supplies, add costs to doing business in the Russian Federation and interrupt business operations, all of which may have a material adverse effect on our business, results of operations, financial condition or prospects.

Political and social risks

- Future political instability and any significant struggle over the direction of future political developments could lead to increased capital flight and an overall deterioration in the Russian Federation's investment climate.
- Unlawful, selective or arbitrary government action could create a difficult business climate in the Russian Federation.
- Terrorist attacks or the involvement of the Russian Federation in any future economic and military conflicts could lead to instability and hinder our planning ability.
- Organised crime, fraud, corruption and social instability could create an uncertain operating environment for us and make it more costly to conduct business.
- Conflicts between Russian federal and regional authorities and legislation could create an uncertain operating environment for us.

Legal risks and uncertainties

- Weakness related to the legal system. Risks associated with the Russian legal system include, to varying degrees, the following:
 - ✓ inconsistencies among, and ambiguities and anomalies regarding: (i) federal laws; (ii) decrees, orders and regulations issued by the President, the government and federal ministers; and (iii) regional and local laws, rules and regulations;

- ✓ the relative unavailability of Russian legislation and court and administrative decisions in an organised manner that facilitates understanding of such legislation and court decisions;
 - ✓ substantial gaps in the legal framework due to the delay or absence of implementing regulations for certain legislation;
 - ✓ a lack of judicial independence from political, social and commercial forces;
 - ✓ alleged corruption within the judiciary and the governmental authorities;
 - ✓ ambiguous and inconsistent court practice with regard to interlocutory remedies that may disrupt our ordinary business activities.
- Lack of developed corporate and securities laws and regulations in the Russian Federation may limit our ability to attract future investment.
 - It is not yet clear how the Strategic Foreign Investment Law will affect us and our foreign shareholders.
 - The accession of the Russian Federation into the World Trade Organisation may lead to uncertain legislative and other changes in our operating environment.
 - Shareholder liability under Russian corporate law could result in us becoming liable for the obligations of our subsidiaries.
 - If the FAS was to conclude that Sistema JSFC or any of its significant subsidiaries acquired or created a new company in contravention of antimonopoly legislation, or otherwise violated competition rules, it could impose administrative sanctions.
 - Russian legal entities may be forced into liquidation, their ownership structure may be challenged or their subsidiaries' indebtedness may be accelerated on the basis of formal non-compliance with certain requirements of Russian law.

Russian Taxation System

- Russian tax laws, regulations and practice are complex, uncertain and often not well developed and are subject to frequent changes, which could have an adverse effect on us.
- Russian transfer pricing legislation may require pricing adjustments and impose additional tax liabilities with respect to controlled transactions.

Stock markets

There is a risk that the shares of Russian companies will grow more slowly than those of their counterparts in other emerging markets. The key reason for this may be a substantial outflow of capital from the Russian market, caused both by the political and economic factors inside the country and the situation on the world stock exchanges.

Risks related to the Sistema JSFC's operations

Implementing business strategy

The key elements of the strategy are to develop a balanced and a diversified asset portfolio, to focus on sectors and geographies where Sistema JSFC has a competitive advantage, to pursue an active portfolio management approach and to attract leading international and local companies as partners in portfolio companies. There can be no assurance, however, that we will be able to achieve the targets set out in the strategy, or that current portfolio companies will be managed effectively, while at the same time new investment opportunities are identified.

There are risks of untimely or incomplete transformation of the organisational structure and the respective human resources. Furthermore, even if our initiatives of transformation into an investment holding can be implemented, we cannot assure you that these initiatives will allow Sistema to increase revenues from existing services or products of its subsidiaries.

The success of Sistema's new strategy depends on many factors, including, but not limited to, receipt of necessary government approvals, proper identification of customer needs, successful development of technology, the ability to manage costs and expenses, timely completion and introduction of new services and products by our subsidiaries, differentiation from offerings of our subsidiaries' competitors and market acceptance.

Identifying profitable opportunities, both for acquisitions and disposals, and integrating acquisitions

Sistema has in the past, and may in the future, expand operations through acquisitions or change its asset portfolio through acquisitions and disposals. The process of identifying and implementing acquisitions entails certain risks, including the failure to identify and approach new suitable acquisition targets, the failure to conduct adequate due diligence on the target's operations and/or financial condition, the overvaluation of the target and thus overpayment for the target, the incurrence of significantly higher than anticipated financing-related risks and operating expenses, and the discovery of larger than anticipated or previously undisclosed liabilities.

Acquiring additional businesses could also place increased pressures on Sistema's cash flows, especially if the acquisition is paid for in cash. Furthermore, if an acquisition is not completed, or is not completed in a timely manner, this may adversely impact Sistema's strategic growth objectives or have a material adverse effect on current business, results of operations, financial condition or prospects.

In addition, Sistema may experience problems in integrating acquisitions into current business and managing them optimally or in implementing necessary restructurings. These risks include failing to effectively assimilate and integrate the operations and personnel of an acquired company into our business, failing to install and integrate all necessary systems and controls, including logistics and distribution facilities and arrangements, conflicts between majority and minority shareholders, hostility and/or lack of cooperation from the acquisition's management and the potential loss of the acquisition's customers.

Our ability to maintain our competitive position and to implement our business strategy is dependent to a large degree on the services of our senior management team and other key personnel.

Our senior management team is essential to the implementation of our business strategy. Furthermore, the continued success of our core and developing businesses and the ability to execute our overall strategy effectively, including our growth and expansion plans, will depend, in large part, on the efforts of our separate management teams supervising each asset within our holding structure.

Ability to meet costs depends to a large extent upon receipt of sufficient funds from our subsidiaries

Sistema JSFC depends in part on dividends from its subsidiaries to generate the funds necessary to meet its financial obligations, including the payment of principal and interest on its present debt and any of our borrowings incurred in the future. Our subsidiaries may from time to time be subject to restrictions on their ability to make such payments as a result of regulatory, fiscal or other restrictions. For example, certain loans to Sistema JSFC's subsidiaries are subject to restrictive covenants, including, but not limited to, compliance with certain financial ratios, limitations on dispositions of assets and limitations on transactions within Sistema JSFC's portfolio companies. There can be no assurance that such restrictions will not have a material adverse effect on Sistema JSFC's ability to service its borrowings or meet any other costs it may incur.

We are dependent to a material extent on the success of MTS and Bashneft

Sistema JSFC financial results are dependent to a material extent on the financial results of MTS and Bashneft. The inability of these businesses to generate necessary earnings may adversely affect Sistema's ability to service our debt obligations and sustain our growth and expansion through restructurings and acquisitions. As a consequence, risks and events that have a material adverse effect on MTS' and Bashneft's business, results of operations, financial condition or prospects could, in turn, have a material adverse effect on Sistema's business, results of operations, financial condition or prospects.

Obtaining adequate capital or financing

Future financings and cash flow from Sistema's operations may not be sufficient to meet planned needs in the event of various unanticipated potential developments, including the following:

- lack of external financing sources;
- changes in the terms of existing financing arrangements;
- pursuit of new business opportunities or investing in existing businesses that require significant investment;
- slower than anticipated revenue growth;
- regulatory developments;
- changes in existing interconnect arrangements; or
- deterioration in the economies of the countries where Sistema JSFC operates

Restrictive covenants, which may limit ability to incur debt, finance capital expenditures and to engage in various activities

Sistema JSFC bank loans, as well as bank loans and notes of certain subsidiaries contain restrictive covenants. These covenants impose restrictions with respect to, *inter alia*, incurrence of indebtedness, creation of liens on the properties, disposal of assets and transactions with affiliates. Such restrictive covenants may limit our operations, including the financing of capital expenditures, or impede our ability to pay off our indebtedness on a timely basis, or at all. Should the operations of our subsidiaries be limited, the earnings of our subsidiaries may fall, which, in turn, may limit our ability to use such earnings to service indebtedness or finance operations. Further, mergers and reorganisations of our subsidiaries could, under certain circumstances, trigger the restrictive covenants under their credit agreements, which may lead to acceleration of debt repayment under such credit facilities. Any invocation of these cross-acceleration or cross-default clauses could cause some or all of the other debt to accelerate, creating liquidity pressures and affecting our business and operations.

The licences and permits required for Sistema's business may be invalidated, suspended or may not be issued or renewed, or may contain onerous terms and conditions that restrict Sistema's ability to conduct its operations

Our operations and properties are subject to regulation by various government entities and agencies in connection with obtaining and renewing various licences, approvals, authorisations and permits, as well as with ongoing compliance with existing laws, regulations and standards. Regulatory authorities exercise considerable discretion in matters of enforcement and interpretation of applicable laws, regulations and standards, the issuance and renewal of licences, approvals, authorisations and permits and in monitoring licensees' compliance with the terms thereof. No

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

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

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

In the event that any of our privatised companies are subject to challenge as having been improperly privatised and we are unable to defeat this claim, we risk losing our ownership interest in the company or its assets, which could materially adversely affect our business, financial condition, results of operations and prospects.

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

Any investigation of any potential violations of the FCPA, the U.K. Bribery Act or other anti-corruption laws by U.S., U.K. or foreign authorities could also have an adverse impact on our brand image, business, financial condition and results of operations.

Risks related to Sistema JSFC portfolio

Risks related to our Technology and Telecommunication Business include, to varying degrees, the following:

- Ability to implement the necessary infrastructure to manage its growth and partnerships, develop its network and avoid service disruptions;
- Failure to effectively implement geographic expansion strategy could hamper its continued growth and profitability;
- Proper functioning of MTS network systems and MTS ability to avoid disruptions;
- Ability to respond to rapid technological change;
- MTS ability to develop additional sources of revenue;
- Maintaining MTS distribution network;
- Ability to interconnect cost-effectively with other telecommunications operators to provide services at competitive prices;
- Realisation of the benefits MTS expects to receive from its investments in and MTS is subject to extensive regulation of its tariffs, and these tariffs may not fully compensate MTS for the cost of providing required services;
- Changes to the rules and regulations;
- High competition;
- Compliance with the new regulations on International Mobile Equipment Identity (“IMEI”) numbers;
- Failure to fulfill the terms of MTS’ licences, renew and receive renewed or new licences with similar terms to MTS’ existing licences;
- Failure to manage MGTS’s infrastructure modernization timely.

Risks related to our Oil and Energy Business include, to varying degrees, the following:

- Uncertainties related to the ability of the Russian government to mandate deliveries of crude oil and refined products, including at less than market prices.
- An increase in export duties on oil products, including the introduction of the proposed “60-66-90” export duty regime, could materially adversely affect Bashneft’s business, financial condition, results of operations or prospects.
- Uncertainties and operating risks associated with Bashneft’s development, exploration and production
- Bashneft ability to compete in the oil products retail sector, which is highly competitive, find suitable locations to open new gas stations or encounter delays or greater than anticipated costs in remodelling existing gas stations;
- Risks related to Bashneft and Bashkirenergo corporate reorganisations;

- A substantial or extended decline in crude oil, refined products, natural gas, power or petrochemical products prices would have a material adverse effect on the businesses of Bashneft and Bashkirenergo;
- Unexpectedly long scheduled repair and maintenance shutdowns or unscheduled shutdowns at Bashneft's production facilities;
- Prices for refined products in the Russian market may be subject to government control.
- Bashneft's failure to develop its fields;
- Bashneft and Bashkirenergo are dependent upon the services provided by, and the assets and infrastructure of, third parties.
- Reform of the Russian wholesale electricity market, price liberalisation and tariff regulation in the heat and electricity industry are associated with a number of risks that may materially adversely affect our energy business.
- Bashkirenergo's transmission assets may not be able to address daily, seasonal or yearly fluctuations in demand for electricity, which may adversely affect Bashkirenergo's business and operations.

Risks related to our Consumer, High tech, Healthcare and Banking Business include, to varying degrees, the following:

- The decline in demand for consumer goods and services, as well as slow development of consumer lending;
- Insufficient purchasing power of the population;
- Underdeveloped transportation and information infrastructure in the regions and, consequently, the barriers to development in the regions;
- Further concentration and consolidation on the consumer market and in the banking sector;
- The risk of tighter regulations in relevant sectors;
- Stronger competition, including the competition from the world's leading companies;
- The possible loss, termination or weakening of connections with suppliers and sellers;
- The risk of increased prices for raw materials, spare parts and services;
- The risk of fluctuations in demand due to the expected change of product generations or technological cycles;
- The risk of decreased volume of government orders due to reduction of budget funds allocated for the high-tech products;
- The risks related to small immature companies, including operational and financial instability, frequent corrections of strategy, difficult working environment due to high competition.

3. Corporate governance

3.1. Principles of Corporate Governance

Maintaining corporate governance and the information transparency system at the highest international level is one of the elements of the strategy of Sistema JSFC as an investment company. Sistema's corporate governance is based on the following core principles:

- Transparency of all processes for investors and partners.
- A proactive and professional Board of Directors.
- A consistent and collective approach to decision-making.

Sistema is guided by these principles in all of its activities, including strategic and financial management, corporate governance throughout the group, reporting, control and audit, risk management, HR and social policy.

The principles and procedures of Sistema's corporate governance are set out in its Charter and in a number of publicly available bylaws that, together, determine the structure and the scope of its governance and control bodies. The Corporate Conduct Code and the Ethics Code contain additional commitments relating to transparency, social responsibility, and ethical principles of business.

Sistema makes every effort to bring its corporate governance practices in line with the guidelines set out in the Corporate Conduct Code, recommended in Executive Order from the Federal Commission for the Securities Market of Russia No. 421/r dated 4 April 2002,¹ and in the UK Combined Code on Corporate Governance.² The consistency of Sistema's corporate governance practice with the standards set out in the Corporate Conduct Code and the UK Combined Code on Corporate Governance is analysed in the annex to this report. Should Sistema's corporate governance practice diverge from the standards recommended in the above documents, the Corporation provides an explanation as to how else it makes sure it observes the balance of interests fixed in the applicable corporate governance standards.

3.2. Corporate Governance in 2011

In 2011 the Corporation took a number of measures to further develop its corporate governance system.

After electing its new members, the Board of Directors took the decision to update the profile of the Board of Directors' committees. For a successful transition to an investment company model, it was also necessary to increase the engagement of the Board of Directors in important aspects of the Corporation's work according to the new model. To achieve this, the procedural powers of the Committees were specified and the competence of the existing Board of Directors' committees updated.

Starting from 2011, as a rule, only members of the Board of Directors are elected to Committees. The Committees of the Board of Directors have extended procedural powers, the right to use external expertise and other resources of the Corporation. Every Committee is responsible for a relevant field of the Corporation's activity, which is constantly monitored by every member of a Committee. These developments have helped increase the Board of Directors' involvement in the strategic management of the Corporation.

In June 2011, a number of new people became members of the Board of Directors. Independent directors Serge Tchuruk and David Iakobachvili were elected to the Board for the first time. Mikhail Shamolin was also elected a member of the Board of Directors as the President of Sistema. Using their vast practical experience in organising and managing large companies, the new members will significantly strengthen the Board's business competencies.

In 2011, in accordance with best practices in corporate governance, the Board of Directors decided to separate the internal control and internal audit services. The Internal Control Service has kept the functions of carrying out regular audits of business operations. The Internal Audit Service has retained the functions of assessing the efficiency of the risk management system, the quality of the management business processes and assessing the efficiency of the internal control system.

The Board of Directors adopted a new dividend policy in September 2011. It sets out a new principle of calculating the recommended dividends Sistema shares. The recommended amount of dividends shall be determined by the Board of Directors based on the annual financial results of the Corporation and shall amount at least to 10% of the Company's net income under US GAAP (net of the special dividends paid). Following the recommendations of the

¹ The text of the Corporate Conduct Code is available at the following address:

http://www.fcsm.ru/ru/legislation/corp_management_study/corp_codex/

² The text of the UK Combined Code on Corporate Governance is available at the following address:

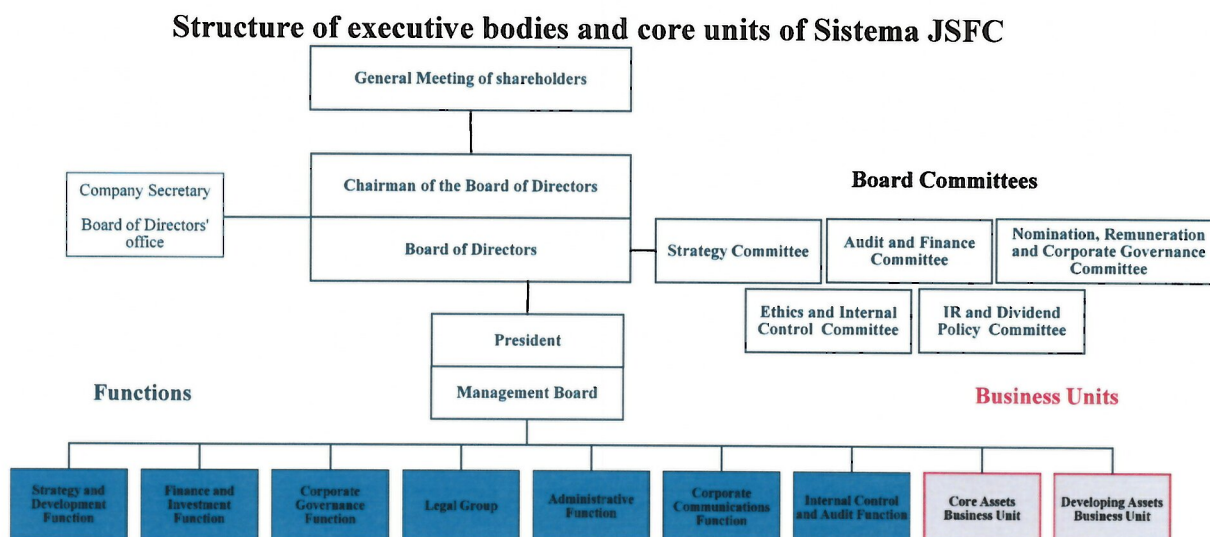
http://www.fsa.gov.uk/pubs/ukla/lr_comcode2003.pdf

Board of Directors the Company may pay special dividends in the minimum amount of 10% of net income of the transactions with incoming cash flow such as sale of assets, determined by the Board of Directors. Meanwhile, according to the Russian legislation the aggregate amount of the paid dividends is limited by the amount of the non-consolidated net income under Russian accounting standards (RAS).³

3.3. Corporate Governance Structure

The Corporation's central governance bodies are: the General Meeting of shareholders, the Board of Directors, the President and the Management Board. The Board of Directors and the President have committees that work out recommendations for Sistema JSFC policy in the relevant areas. Sistema's organisational structure includes seven functions and two business units that manage the Core Assets and the Developing Assets portfolios.

Sistema adopted the current organisational structure in April 2011 and it reflects Sistema's migration towards an investment company model. At the beginning of 2011 Sistema's organisational structure comprised nine functions and four industrial business units.



3.4. General Meeting of Shareholders

Principles of operation

The General Meeting of shareholders is the supreme governance body of Sistema JSFC. Its operation is regulated by the laws of the Russian Federation on joint-stock companies, the provisions of its Charter, and the Corporation's bylaws. The procedure of conducting the General Meeting of shareholders aims to make sure that it respects the rights of the shareholders and observes all legal requirements, as well as best practices in corporate governance.

Information and materials for the meeting are made available to the shareholders in Russian and in English, and are published on the official web site of Sistema. Along with the notice of the forthcoming meeting, shareholders get voting ballots. Venues of all meetings of Sistema shareholders are conveniently located not far from the Corporation's head office. Holders of the company's depositary receipts have the opportunity to vote on the agenda items by means of proxy voting via Deutsche Bank Trust Company Americas, the depositary of Sistema GDR program.

Global Equity Services,

Trust and Securities Services,

Email: gm.communications@db.com

Observance of shareholders' rights to participate in running the company

³ According to the requirements of the Russian legislation the dividends are payable to the Company shareholders from the Company income after tax (net income) which is calculated on the basis of financial statements compiled in accordance with the Russian legislation. When recommending the amount of dividends to the shareholders' meeting the Company's Board of Directors is also guided by the net income indicators determined on the basis of consolidated financial statements of Sistema JSFC and subsidiaries and compiled according to the US generally accepted accounting principles (GAAP) under the guidance of the requirements of the Russian law.

Sistema aims to ensure maximum protection of shareholders' rights to participate in running the Company. The fundamental right of a shareholder in this respect is the right to participate in the work of the General Meeting of shareholders and the right to vote on items on the agenda. For this right to be secured, notice of the conduct of the General Meetings is circulated to all shareholders at least 30 days before the meeting, and all materials are published on the company website in Russian and in English (www.sistema.ru). Besides the notice of the General Meeting, Sistema also sends a voting ballot to each shareholder. This can be filled out by the shareholder in advance and mailed to the Company at the address specified in the ballot. Sistema will take into account the vote of the shareholder when counting the results.

Holders of depositary receipts for the Corporation's shares have the opportunity to vote by means of proxy voting through Deutsche Bank Trust Company Americas, the depositary of Sistema JSFC GDR programme. The votes are collected by the depositary, Deutsche Bank Trust Company Americas, through clearing systems and are included in the general voting ballot of the depositary, with all votes cast for the proposed draft resolution, against it, and abstentions specified.

Each shareholder can also attend General Meetings of shareholders in person⁴ and vote on the agenda items directly at the meeting. Venues of the meetings are conveniently located close to Sistema's head office.

One of the important rights of the shareholder in relation to participating in running the Company is the right to access the documents the Company is obliged to keep in line with the provisions of the Federal Law 'On Joint-Stock Companies'. To exercise this right, a shareholder should send a written request to the Corporate Secretary of the Company asking for access to the documents the shareholder wishes to see. After the time for providing the documents is agreed, the documents will be provided to the shareholder.

Holders of material blocks of shares are entitled to make proposals for the General Meeting agenda, and to nominate candidates to the Corporation's governance and control bodies.⁵ Proposals for the AGM agenda are accepted in a written form, within 100 days after the end of the financial year.⁶ The Board of Directors considers proposals received from shareholders and, if the proposals meet the legal requirements to the work of the General Meeting, they are included in the agenda.

General Meetings held in 2011 and their results

In 2011, Sistema held *two* General Meetings of the Company's shareholders.

The Annual General Meeting of the shareholders of Sistema JSFC took place on 25 June 2011. The meeting approved the annual report, the annual accounts, including the profit and loss report of Sistema JSFC for 2010, approved the amount, the procedure, the forms and the timelines for paying dividends on the shares of the Company, elected members of the Board of Directors and the Revision Commission, and approved the auditors of the Corporation.

Proceeding from the amount of the consolidated net income of Sistema JSFC for 2010 (RUB 27,900 million, US\$ 918.7 million), the Board of Directors of Sistema JSFC recommended that RUB 2,509 million be used to pay out the 2010 dividends on the shares, which accounted for 8.99% of the consolidated 2010 net income of the Corporation according to US GAAP, and is in line with the principles of the Corporation's dividend policy.

As resolved by the Annual General Meeting of shareholders following this recommendation, RUB 2,509,000,000.00 were allotted to pay out the dividends, which equalled RUB 0.26 per each ordinary share of Sistema JSFC. The amount of the dividend was more than 4.5 times as much as in 2010.⁷

The following auditors of Sistema JSFC were elected for 2011:

- CJSC BDO - to hold the Russian accounting standards audit;
- CJSC Deloitte and Touche CIS - to hold the US GAAP audit.

The auditors were suggested following an open tender organised by the Audit Committee of the Board of Directors of Sistema JSFC.

In 2011, *one Extraordinary General Meeting of shareholders* was also held in the form of a letter ballot:

JSFC and subsidiaries and compiled according to the US generally accepted accounting principles (GAAP) under the guidance of the requirements of the Russian law.

⁴ Or via a representative.

⁵ Holders of 10 and more % of the Company's voting shares also have the right to request an Extraordinary General Meeting of shareholders to be conducted.

⁶ In the event an Extraordinary General Meeting of shareholders is conducted with its agenda containing an item on the election of the Board of Directors, holders of sufficient blocks of shares have the right to nominate candidates to the Board of Directors. Proposals to this effect must be received by the Company no later than 30 days before the date of such a meeting.

⁷ In 2010, RUB 530,750,000.00 was allotted to pay out dividends.

The following agenda item was considered: **Approval of a related party transaction: acquisition of the OJSC RTI shares issued upon incorporation of the company.**

The establishment of OJSC RTI has the goal of laying the foundation for a new Russian high-tech industrial Concern being a supplier of comprehensive innovative engineering, IT and microelectronics solutions for control and monitoring systems, systems for identifying and responding to threats to the state, business and individuals.

At the stage of incorporating OJSC RTI it is planned to place its shares with two founders with the following target ownership structure:

- Sistema JSFC: 84.6% of the shares placed;
- Bank of Moscow: maximum 15.4 % of the shares placed.

It is proposed that Sistema JSFC shall contribute 97% of ordinary shares of OJSC RTI-Systems Concern at the valuation of RUB 13,600,000 and cash in the amount equivalent to US\$ 96 million in rubles at the exchange rate of the Bank of Russia as of the date of the transaction - as payment for the shares of OJSC RTI that are being acquired. The value of the controlling stake in OJSC RTI-Systems Concern for the valuation purposes was defined based on the independent valuation by Ernst&Young.

Consolidation of the controlling stake in OJSC RTI-Systems Concern at the new company is the first step towards creating the new Concern.

The General Meeting of shareholders approved the proposed transaction

3.5. Board of Directors

The Board of Directors of Sistema JSFC is responsible for strategic governance of Sistema JSFC. It determines the strategy for the Corporation's development, works out strategic and financial development plans, sets the principles for investing, appraises executive performance and assesses risks, approves principles for corporate governance procedures, approves transactions and controls the work of the Corporation in general. The scope of powers of the Board of Directors is set out in the Charter of Sistema JSFC.

Board of Directors membership

The Board of Directors in place at 31.12.2011 was elected by the General Meeting of shareholders on 25 June 2011. The Board of Directors has 12 members:

BoD membership as elected on 25 June 2011 *

1	Vladimir Evtushenkov	<i>Chairman</i>
2	Alexander Goncharuk	
3	Ron Sommer	
4	Dmitry Zubov	<i>Deputy Chairman</i>
5	Vyacheslav Kopiev	
6	Robert Kocharyan	
7	Roger Munnings	
8	Leonid Melamed	<i>Deputy Chairman</i>
9	Evgeny Novitsky	
10	Serge Tchuruk	
11	Mikhail Shamolin	

Overall membership of the Board of Directors includes:		
Executive Director	1 (8.3%)	M. Shamolin
Non-executive directors	6 (50.0%)	V. Evtushenkov, A. Goncharuk, R. Sommer, D. Zubov, V. Kopiev, L. Melamed**
Independent directors	5 (41.7%)	R. Kocharyan, R. Munnings, E. Novitsky, S. Tchuruk, D. Iakobachvili

*** The powers of L. Melamed as the President and the Chairman of the Management Board of Sistema JSFC were terminated on 09 March 2011. Also, R. Sommer was relieved of his duties as First Vice President of Sistema JSFC.*

Changes in the membership of the Board of Directors

The new Board of Directors does not include former members R. Mehrotra and S. Cheremin. At the same time, new independent directors have been elected to the Board: S. Tchuruk, D. Iakobachvili, who have extensive practical experience in managing large companies, as well as M. Shamolin as the President of Sistema JSFC.

Meetings of the Board of Directors

Meetings of the Board of Directors are pre-scheduled. The Corporation has an annual calendar planning cycle (from January 1 to December 31). This practice makes it possible for the newly-elected Board of Directors to maintain continuity and act on the basis of the previously approved plan. The agendas of the Board meetings are set proceeding from the logics of the strategic planning and the reporting cycle of Sistema JSFC. Extraordinary meetings are called when it becomes necessary to review any urgent issues. The unplanned issues which may arise in the course of the Corporation's operations, and which had not been included in the work plan of the Board of Directors, are put on the agendas of the Board meetings as necessary upon the decision of the Board Chairman.

In 2011 the Board of Directors had ten sessions: eight scheduled meetings and two extraordinary sessions in the form of a letter ballot on urgent matters. In 2010 the Board of Directors considered 108 items in total.

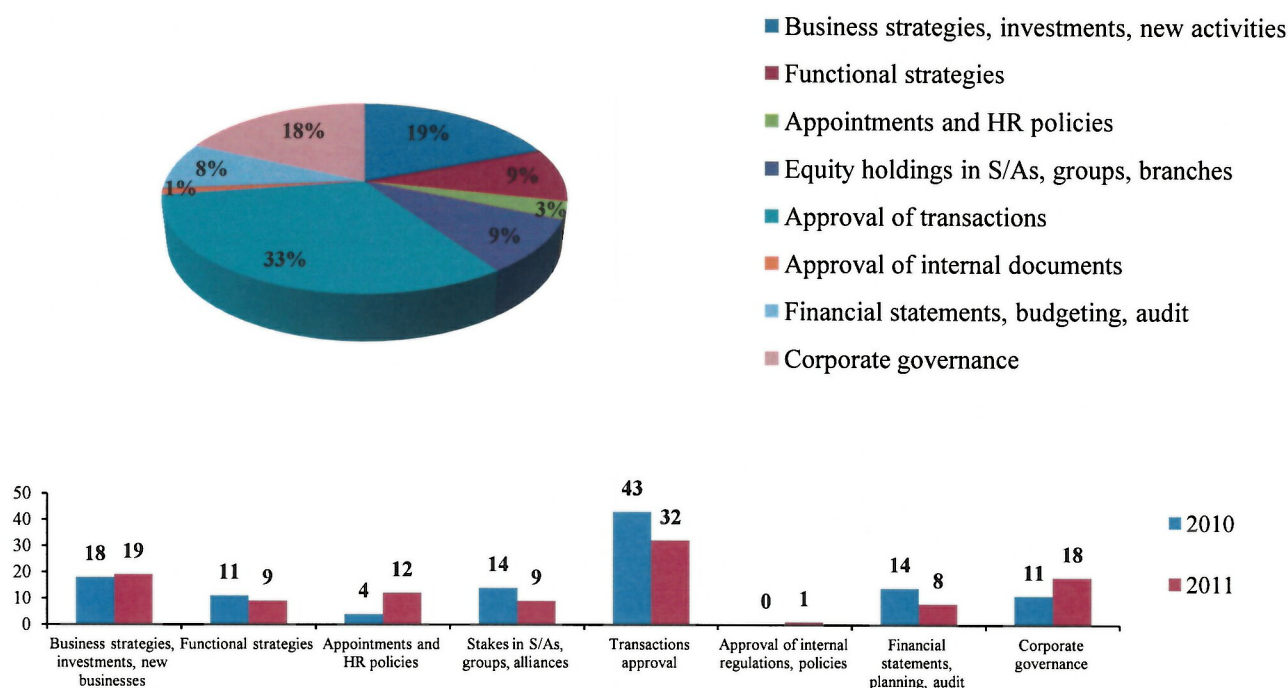
	2011	2010
Number of meetings held	8	8
Number of letter ballots	2	8
Number of items on the BoD work plan	44	46
Number of items considered by the BoD	108	115

In 2011 the Board of Directors considered the following key items:

- 1) Strategy of Sistema JSFC.
- 2) Development strategies of the Business Units of Sistema JSFC.
- 3) Development strategy of the main portfolio assets:
 - banking industry;
 - telecom assets;
 - oil assets;
 - electric power and grid assets;
 - development of the pan-Indian project on the basis of Sistema Shyam TeleServices Limited;
 - healthcare assets;
 - pharmaceutical assets;
 - implementation status of the RTI-SITRONICS merger project.
- 4) Entering the agricultural industry.
- 5) The results of the analysis of the world regions or countries from the viewpoint of opportunities for entering new markets and selling and acquiring undervalued assets, or assets that have synergies with the current assets of the Sistema Group.
- 6) Development of innovations and R&D activities of Sistema JSFC companies;
- 7) Implementation status of the strategy for managing the subsidiaries and affiliates of Sistema JSFC.
- 8) Financial performance results;
- 9) Approval of the consolidated budget of Sistema and Key Performance Indicators of the management for 2012.
- 10) Long-term financial and economic model of the Corporation's development.
- 11) The dividend policy of the Corporation.

- 12) Approval of a new organisational structure and new Management Board membership of Sistema JSFC.
- 13) Improving the performance of the Sistema Board of Directors and its Committees.
- 14) Implementing the Corporation's strategy in HR, approving the long-term incentive programme and improving the existing incentive systems for the personnel of Sistema JSFC and the Sistema Group of companies.
- 15) Report on risk management in the Corporation.
- 16) Programme of preparation for compliance with the UK Bribery Act;
- 17) Functional strategy in internal control and audit.
- 18) Sistema's strategy in the sphere of GR and participation in the national projects and federal target programmes of the government.
- 19) Sistema's strategy in the sphere of public relations and investor relations.
- 20) Corporate social responsibility.
- 21) Convening the Annual General Meeting of shareholders, reports from the Committees of the Board of Directors, report on the quality of corporate governance;
- 22) Approval of transactions.

Items reviewed by the Board of Directors in 2011



In addition to approving transactions, most of the items reviewed by the Board in 2011 are related to strategy, corporate governance, shareholdings in subsidiaries and consideration of functional strategies aimed at supporting and improving the efficiency of efforts taken by the business subdivisions of the Corporation.

The high proportion of the items relating to corporate governance and functional strategies reviewed by the Board in 2011 shows the Board members devote particular attention to the company's transformation to the new 'investment company' governance model. This makes it necessary to change some elements of corporate governance and refocus some of the functional units.

Board of Directors	Strategy Committee	Audit and Finance Committee	Nomination, Remuneration and Corporate Governance Committee	Ethics and Internal Control Committee	Investor Relations and Dividend Policy Committee
<i>Participation in meetings</i>					
V. Evtushenkov	10/10	4/5			
A. Goncharuk	10/10	0/1	10/10		1/1
R. Sommer	10/10	2/5	2/3		3/4
D. Zubov	10/10	3/3	8/10		
V. Kopiev	9/10		2/2	7/7	1/1
R. Kocharyan	10/10		6/10	2/2	3/3

R. Munnings	10/10		10/10	4/4	7/7	1/1
L. Melamed	10/10	4/5		10/10	2/2	
E. Novitsky	9/10	1/1	7/10			
S. Tchuruk	4/4	0/1				1/1
M. Shamolin	4/4	1/1		3/4	0/2	
D. Iakobachvili	4/4		2/3			1/1
R. Mehrotra	6/6		6/7			
S. Cheremin	6/6	0/4		6/6		2/3

The high proportion of the items relating to equity holdings in subsidiaries reviewed by the Board shows that the Board members followed the investment activities of the Corporation closely, as this represents one of the key characteristics of the new governance model.

Preparation for the meetings and quorum of the Board of Directors

In 2011, the process of preparing for Board meetings changed significantly. As before, the materials on the agenda items are provided to the Board members ten days before the meeting, allowing them to form their voting position. However, from 2011, all the items of the main agenda are subject to mandatory review at the Board Committee meetings, while the Board of Directors determines in advance the committees which should be responsible for considering certain items.

Members of the Board of Directors meet with the key speakers and the management at a business dinner the evening before the meeting, to receive explanations of the materials for the Board of Directors, and clarify the voting positions of the parties in an informal environment.

The meetings of the Board of Directors usually have quite high attendance rates. Over the past few years there have been no cases registered where a Board meeting had to be rescheduled due to the lack of quorum.

Participation of the members of the Board of Directors in the meetings of the Board of Directors and its committees in 2011

Note. The first number denotes the number of meetings participated by the Board member, the second number stands for the total number of meetings the member could participate in.

Committees of the Board of Directors⁸

In 2011, after the new Board members were elected, the Board took the decision to renew the profiles of the Board Committees. The Corporation needs to finish its transition to the investment company model. For successful transition to this new model it was also necessary to increase the engagement of the Board of Directors in the important aspects of the Corporation's work according to the new model. To achieve this, the procedural powers of the Committees were specified and the competence of the existing Committees of the Board of Directors updated.

Sistema JSFC has five committees of the Board of Directors:

- Strategy Committee.
- Audit and Finance Committee.
- Nomination, Remuneration and Corporate Governance Committee.
- Ethics and Internal Control Committee
- Investor Relations and Dividend Policy Committee

Starting from 2011, as a rule, only members of the Board of Directors are elected to Committees. The main role of the Committees is to provide assistance in preparing and adopting concepts and solutions in the respective functional areas, as well as in ensuring in-depth scrutiny of the issues submitted for consideration of the Board of Directors. The Board Committees have considerable procedural powers, and a right to bring in external experts and use other resources of the Corporation.

Strategy Committee

The Strategy Committee includes seven Board members: Chairman of the Committee: V. Evtushenkov; Committee members: A. Goncharuk, R. Sommer, E. Novitsky, L. Melamed, M. Shamolin, S. Tchuruk.

The Committee conducts analysis of the strategic management issues of Sistema and also monitors the strategic planning cycle, including:

⁸ All the information provided regarding the work of the committees is as of 31.12.2011.

- strategic planning methodology;
- preliminary approval of the strategy;
- preliminary approval of Sistema's strategic goals;
- reviewing M&A transactions and large investment projects of Sistema JSFC

The Committee also reviews important investment projects, conducts assessment of risks, sets priorities and takes decisions on project development. The Committee recommends projects to be submitted to the Board, performs assessment and makes adjustments in projects' implementation.

In 2011, five meetings of the Committee were held, and eight items were considered, including: five items relating to the strategy of the Corporation, three relating to non-organic growth deals and projects.

Audit and Finance Committee

The Audit and Finance Committee includes five Board members: Chairman of the Committee: R. Munnings; Committee members: R. Sommer, D. Zubov, E. Novitsky and D. Iakobachvili.

The Audit Committee supervises the preparation of financial reports and oversees the internal audit of Sistema and its subsidiaries. Moreover, the Committee oversees the work of external auditors, makes recommendations for their appointment and remuneration, and also appraises the risk management system and monitors its operation. The Committee monitors compliance with legislation and regulations in the sphere of finance and reporting. The new function of the Committee is to assist in the budgeting process: preliminary review of the materials at the budget development stage, preliminary review of the financial model of Sistema and also approval of the valuation of related-party and large-scale transactions.

In 2011 the Audit and Finance Committee held nine meetings where 55 items were considered, including 16 items related to financial accounting and reporting, five items – to internal control and audit, 14 items – consideration of related-party and major transactions, five items dealt with financial planning and risk management, 15 items – with housekeeping matters.

Nomination, Remuneration and Corporate Governance Committee

The Nomination, Remuneration and Corporate Governance Committee include six Board members: Chairman of the Committee: L. Melamed; Committee members: A. Goncharuk, D. Zubov, R. Kocharyan, R. Munnings, M. Shamolin

The Nomination, Remuneration and Corporate Governance Committee is in charge of preliminary consideration of the nominees to the top management positions in Sistema and the candidates to the boards of directors of the main subsidiaries, participating in the development and preliminary consideration of draft policies in HR and incentive and remuneration programmes for the company's personnel; it also provides the results of the appraisal of the top management's performance to the Board of Directors. The Committee also facilitates development of corporate governance practices in Sistema and its subsidiaries and affiliates.

In 2011 the Nomination, Remuneration and Corporate Governance Committee held ten meetings. The Committee considered 17 items, including seven items relating to improving the incentive system, four – HR policy and approval of the key nominees to the top management positions in Sistema JSFC, two items touched upon changes in the organisational structure of Sistema JSFC, two items dealt with the key performance indicators (KPIs) and two items with developing corporate governance.

Ethics and Internal Control Committee

The Ethics and Internal Control Committee includes five Board members: Chairman of the Committee: R. Kocharyan; Committee members: V. Kopiev, R. Munnings; L. Melamed, M. Shamolin

The Ethics and Internal Control Committee serves the purpose of forming an efficient system of economic security, internal control, and prevention of fraud and other misconduct which involves violations of the current legislation. Moreover, the Committee monitors compliance with the requirements of the Code of Ethics of Sistema JSFC.

In 2011 the Ethics and Internal Control Committee held two meetings where seven items were considered, of which four items were related to functional strategies in internal control and security, two items to compliance with the requirements of legislation and corporate governance and one item dealt with housekeeping matters.

Investor Relations and Dividend Policy Committee

The Investor Relations and Dividend Policy Committee include six Board members: Chairman of the Committee: D. Iakobachvili; Committee members: A. Goncharuk, R. Sommer, V. Kopiev, R. Munnings, S. Tchuruk.

The main task of the Committee is to facilitate the formation of a system aimed at maintaining effective relations with the financial community, the public and government agencies, as well as increasing the appeal of Sistema's shares to investors. At the same time, the Committee provides assistance in forming and maintaining a transparent and stable dividend policy for Sistema. The activities of the Committee should contribute to the growth of the Company's capitalisation and promotion of the shareholders' interests.

In 2011 the Committee held six meetings where 14 items were reviewed, including 11 items related to investor relations and dividend policy, one item related to public relations and two housekeeping matters.

3.6. Remuneration of Board of Directors Members and Top Officers

The remuneration of the members of Sistema JSFC Board of Directors is calculated according to the Policy on remuneration and compensations payable to the members of the Board of Directors of the Company, approved by resolution of the General Meeting of shareholders of Sistema JSFC on 30 June 2006 (Minutes #1-06), and amended by resolution of the same on 16 February 2009 (Minutes #1-09). The Policy provides for the payment of the following to members of the Board of Directors:

- Fixed amounts for participating in meetings of the Board of Directors and its committees.
- Fixed amounts for acting in the capacity of Chairman or Deputy Chairman of the Board of Directors, and for chairing the committees under the Board.
- Additional performance-related remuneration, as a fixed amount, half of which is payable in shares (US\$ 250,000 - 325,000).
- Additional remuneration amounting to 0.1% of the incremental capitalisation, given that the capitalisation of the Corporation has grown over the year.

The short-term (up to 1 year) incentive scheme for the top executives of Sistema JSFC in 2011 consisted of the following elements:

- Monthly fixed salary determined in line with the internal system of job categories (grades).
- Four quarterly bonuses payable for meeting functional key performance indicators set individually for each top executive for the respective reporting period.
- An annual bonus paid for achieving investment key performance indicators set for the Corporation as a whole, and its business units, for the respective reporting period.
- Additional remuneration paid for generating cash income for the Corporation in the year.
- An additional bonus paid only following a decision of the Board of Directors.

Following the three-year, long-term incentive programme (2009-2011), about 1% of the ordinary shares of Sistema JSFC were distributed to top and middle managers and to some members of the Board of Directors. The new holders of the shares may dispose of them at their own discretion, in view of the regulatory restrictions, rules and requirements set in the laws of Russia and the UK, and the policy of Sistema JSFC on insider information.

In 2011, the Board of Directors of Sistema JSFC approved two new long-term incentive programmes for the management:

- A new three-year long-term Material Incentive Program (2012-2014) aimed at building the shareholder value of Sistema JSFC and at creating long-term pre-conditions for maintaining employment relations and corporate relations between the Company and its management.
- An option programme for initiating and developing M&A projects. This aims to strengthen management interest in searching for, acquiring and developing new assets that increase the shareholder value and the market capitalisation of Sistema JSFC.

No remuneration is paid for the executive work of the managers sitting on the Management Board of Sistema JSFC.

Top executives of the Corporation were paid a total of RUB 3,450,065,590 in remuneration for the calendar year 2011. Payments to members of the Board of Directors of Sistema JSFC for the year 2011 amounted to RUB 118,580,297 (*members of the Board of Directors employed by the Corporation received remuneration to the amount of RUB 1,093,985,438 within the framework of that employment*).

3.7. Management

President

The President of Sistema JSFC is a permanent sole executive body with the main objective of managing the day-to-day activities aimed at ensuring profitability of the Corporation and securing the rights and legitimate interests of its shareholders. The President acts within his remit and reports to the Board of Directors and the General Meeting of the Company's shareholders.

The President of Sistema JSFC is Mikhail Shamolin appointed by the Board of Directors on 10 March 2011. At the beginning of the year, the post of the President of Sistema JSFC was held by Leonid Melamed.

Mikhail Shamolin	Mikhail Shamolin was born in 1970.
President of Sistema JSFC	In 1992 he graduated from the Moscow Automobile and Road Technical Institute.
Chairman of the Sistema JSFC Management Board.	In 1993 Mikhail received his second diploma from the Russian Academy of Public Administration under the President of the Russian Federation.
	In 1996-97 he completed the finance and management course for top managers at the Wharton Business School.
	In 1998-2004 he worked at the international consulting company McKinsey&Co.
	In 2004-05 Mikhail was Managing Director for the Ferroalloys Division at Interpipe Corp (Ukraine).
	Since 2005 Mr Shamolin has been Vice President for Sales and Customer Service and Head of the MTS Russia business unit. From 2008 to March 2011 he worked as President of MTS.
	On 10 March 2011, Mikhail Shamolin was appointed President of Sistema JSFC.

Management Board

The Management Board of Sistema is responsible for the day-to-day management of the company. It determines the methods of implementing the Corporation's development strategy, works out development plans, sets investment procedures and controls their observance, appraises the performance of the personnel, and pre-considers items submitted to the Board of Directors. Meetings of the Management Board are normally held once a week.

Members of the Management Board:

- | | | |
|---|-----------------|--------------------------------------------------------------------|
| 1 | M. Shamolin | <i>Chairman of the Management Board, President of Sistema JSFC</i> |
| 2 | A. Abugov | |
| 3 | A. Buyanov | |
| 4 | A. Goldin | |
| 5 | S. Drozdov | |
| 6 | F. Evtushenkov | |
| 7 | R. Nagapetyants | |
| 8 | A. Terebenin | |

In 2011, the Management Board of the Company held 39 meetings and considered 124 agenda items dealing with all the areas of business activity of the Corporation. In 2011 the Management Board considered the agenda items in the following key areas:

- 1) preliminary consideration of items put forward to the Board of Directors; the strategies of the Corporate Center and the Business Units were reviewed in the first place;
- 2) financial activities, forecasts and performance on the quarterly, half-year and annual budgets of Sistema JSFC Group; risk management and a risk map; internal control; financial and economic model of the Corporation's development;
- 3) procedures for the investment projects management;
- 4) analysis of the organisational maturity of subsidiaries and affiliates;
- 5) HR and social policies; training and development of the employees of Sistema JSFC Group; charity work;
- 6) consideration and preliminary approval of transactions;
- 7) analytical reviews of the media's and investment community's perception of the performance results of the Corporation.

Changes in top management in 2010

There were a number of changes in the top management of the Company in 2011:

L. Melamed was relieved of his duties as President of Sistema JSFC on 9 March 2011.

M. Shamolin was appointed President of Sistema JSFC on 10 March 2011.

S. Boyev was relieved of his duties as Vice President, Head of the High Technology and Industry Business Unit on

17 February 2011 and was appointed Vice President and Head of the High Technologies and Industry Business Unit on 1 March 2011.

A. Korsik was relieved of his duties as Vice President and Head of the Oil and Energy Business Unit on 6 April 2011 and was appointed President of Bashneft.

F. Evtushenkov was transferred from his position of Vice President, Head of the Consumer Assets Business Unit to the position of First Vice President, Head of the Core Assets Business Unit on 21 April 2011.

R. Sommer was relieved of his duties as First Vice President, Head of the Telecom Assets Business Unit on 13 May 2011.

R. Almakayev was relieved of his duties as Vice President, Head of Administrative Function on 31 May 2011.

A. Krupkin was appointed Executive Vice President, Head of the Internal Control and Audit Function of Sistema JSFC on 23 May 2011.

R. Nagapetyants was appointed Senior Vice President, Head of the Developing Assets Business Unit on 22 August 2011.

Specifics of the risk management, internal control and audit system

Sistema's risk management system is based on the ERM (COSO) principles that include the following key functional elements:

- identification of risks at all levels of the management (from the top to the line management), which includes finding the risk owner and making a risk passport;
- assessment and analysis of the identified risks (based on VaR methodology), ranging the risks by management level;
- development of risk mitigation plans and further monitoring of their implementation;
- risk monitoring, quarterly reports on the risks of the company.

Sistema's risk management procedures are carried out by a dedicated unit - the Risk Management Division of Sistema.

Regular monitoring of the Corporation's risks is performed at the level of the Management Board and the Risk Management Sub-Committee of Sistema JSFC by reviewing the effects of the mitigation and response measures taken and by reassessing the already identified and/or new risks.

The President of Sistema JSFC presents a regular report on risk management in the Corporation to the Audit Committee of the Board of Directors of Sistema JSFC. A similar report and a risk map are presented to the members of the Board of Directors.

In 2011, the Board of Directors took the decision to separate the functions of internal control and internal audit of the Corporation.

The Internal Control Service reports to the President and the Ethics and Internal Control Committee of the Sistema Board of Directors. The Internal Control Service is responsible for:

- targeted actions for control of business processes and financial and administrative activities;
- control of elimination of the systemic deficiencies of business processes;
- control of compliance with internal procedures and legal requirements;
- control of reports on the results of operations and fulfilment of functional KPIs;
- functioning of the hotline as a tool for timely detection and efficient prevention of different fraud types.

The main tools of the Internal Control Service are audits and analysis of the data received as a result of such audits. The results obtained by the Internal Control Service are reported to the President of Sistema and the Ethics and Internal Control Committee to ensure that decisions are taken to eliminate the identified deficiencies.

The Internal Audit Service reports to the Audit and Finance Committee of the Sistema Board of Directors. The Internal Audit Service is responsible for:

- assessing the efficiency of the risk management system and preparing recommendations on improving it;
- auditing the quality of the management business processes;
- assessing the efficiency of the internal control system.

The main tools of the Internal Audit Service include obtaining information on the above processes, analysing the received information and preparing recommendations and assessments for Sistema's management. The results obtained by the Internal Audit Service are reported to the Audit and Finance Committee and the Board of Directors for taking decisions on building the internal control system, and for increasing the quality of risk management and corporate governance.

The Internal Audit Service submits to the Audit and Finance Committee of the Sistema Board of Directors a quarterly report on the work carried out.

Following the decision of the Audit and Finance Committee the following procedures have been developed at Sistema for purchasing external audit services for the purposes of audit of the financial and accounting reports of Sistema JSFC: The Audit and Finance Committee performs an annual assessment of the quality of audit services. If the quality of services provided by the current auditor is recognised as insufficient, the Audit and Finance Committee arranges a tender to select a new auditor. If the quality of services of the current auditor is recognised as satisfactory, negotiations are conducted on the price of audit services for the next period. In the meantime, to ensure impartiality and objectivity of the auditor, the Audit Committee of Sistema JSFC decided that a tender for the audit of the RAS and US GAAP financial statements shall be conducted at least once every five years.

4. Social responsibility

The philosophy of corporate social responsibility (CSR) of Sistema JSFC is based on the aspiration to the long-term and sustainable development of the Corporation that would allow for a harmonic combination of successful business with basic human values and national development priorities.

Corporate social responsibility of Sistema JSFC is a comprehensive system that comprises all of its activities. While adhering to the fundamental documents and standards in CSR, like the GRI, the UN Global Compact and the Social Charter of the Russian Business, the Corporation also focuses on the following four key areas:

1. **Responsibility of a corporate citizen** as contribution to the development of the society and the state in general.
2. **Responsibility of an employer** towards employees and their families, ensuring good working conditions necessary for building a high quality of life.
3. **Responsibility of a business partner** implying adherence to business ethics, application of best practices in corporate governance and information disclosure, which makes it possible to provide sufficient protection and respect for the rights of partners and shareholders, including minority shareholders.
4. **Responsibility of a party to social relations** which allocates funding for science and education, culture and sports, as well as for support of social initiatives and projects.

Corporate social responsibility matters are annually reviewed by the Board of Directors of the Corporation and the Corporate Governance and Ethics Committee. Importantly, the core CSR principles approved at the Corporation's level are being implemented and applied at all of its subsidiaries and affiliates. The Corporation has designed a system for cascading the CSR functions that includes forming standards, building the management structure, training personnel, and controlling implementation via a system of indicators.

Below there is a brief description of the last year's CSR performance results and achievements of Sistema JSFC:

Responsibility of a corporate citizen

Sistema JSFC is one of the largest national taxpayers, and its portfolio companies are often notable contributors to the budgets of the regions of their presence.

Companies of Sistema JSFC produce material influence on the development of the national intellectual potential and growth in areas related to innovations and state-of-the-art technologies. For instance, in 2011 SITRONICS alone invested ca US\$ 55 million in advanced research and development and almost US\$ 69 million more in the development of knowledge-intensive manufacturing facilities.

Being a participant to the GLONASS target program, the E-Government and the Multi-Service Information Educational Environment projects and other large-scale federal programs, the Corporation plays a key role in developing the high-tech industry, as it creates high quality jobs, develops the entrepreneurial environment, and participates in forming the national intellectual elite.

The Corporation rigorously abides by the ecology principles, and participation in environmental programs is set out in the Ethics Code of Sistema JSFC. Being participants of the hydrocarbon market, the Corporation's companies invest substantial funds in environmental measures. For instance, in 2011 Bashneft alone spent RUB 2.1 billion on these purposes. In the reporting period the company adopted a strategy in the area of health, safety and environment (HSE). Besides other matters, it provides for the construction of a unit for oil sludge processing, upgrade of the waste treatment facilities and other actions aimed at minimizing the technological environmental impact.

Responsibility of an employer

Sistema JSFC, together with its subsidiaries and affiliates, is also one of the largest employers in Russia. In 2011, the headcount of the subsidiaries and affiliates of the Corporation exceeded 143 thousand people. With the family members of the employees taken into account, the Corporation is responsible for the welfare of about half a million

citizens of the Russian Federation. Provision of good working conditions necessary for building a high quality of life is an unquestionable priority and the corner stone of the Company's CSR policy.

We believe that the quality of a workplace comprises a number of components, such as the compensation level, the motivation system, conditions of labor, social guarantees, professional development and growth opportunities.

For instance, employees' salaries are differentiated according to a grade system designed by Hay Group, a leading international consultancy, on the basis of monitoring salaries across various reference groups in the labor market. Total annual compensation of the employees is aligned with the advanced motivation system adopted in the Corporation.

Besides the social guarantees stipulated in the Labor Code of the Russian Federation, each of the Corporation's companies offers additional guarantees and benefits to its employees in line with its Social Policy fixed in the bylaws. In particular, the employees of Sistema JSFC and its subsidiaries can use the services of one of the best private healthcare networks, CJSC Medsi, at a discount or free of charge.

The Corporation is the founder of the Sistema non-state pension fund that offers a range of pension programs to portfolio companies. Such programs make it possible for their participants to accumulate pensions on much better terms than those offered by the governmental pension system.

The Corporation pays special attention to the development of each employee's intellectual potential. The Group cooperates with major national higher educational establishments and finances its own Corporate University. Around 90 thousand employees of Sistema JSFC companies are trained annually. The Corporation also creates all the necessary conditions for professional and career development. Managers of Sistema JSFC and its portfolio companies are regularly included in the Russia's Top-1000 Best Managers annual rating of the Association of Managers of Russia and the Kommersant newspaper.

Responsibility of a business partner

In its Corporate Ethics Code the Corporation has set a number of principles that reflect responsibility in business relations, and follows them rigorously.

These principles include: sound business practice, adherence to professional, legal and ethical standards of doing business, adherence to corporate governance standards, and respect for the rights of minority shareholders, transparency and high quality of disclosure.

Sistema JSFC was one of the first companies in Russia to join the UN Global Compact, and it has recently confirmed its membership as it submitted a report that was approved by a special UN commission. Today Sistema JSFC is a member of the Steering Committee of the Global Compact Network Russia.

The Corporation and its subsidiaries have adopted an Ethics Code and a Corporate Conduct Code.

Sistema JSFC plays an active role in fighting corruption, which is reflected in its procedures and bylaws. In 2011 the Board of Directors of Sistema JSFC adopted the Anti-corruption Policy which sets rules and restrictions in the following areas: getting presents and business entertainment expenses, participation in charitable and sponsorship activities, participation in political activities, and interaction with civil servants.

Sistema JSFC and its subsidiaries use transparent mechanisms and procedures for purchasing and tenders. In 2011 the company designed and enacted the Tender Procedures and Purchasing Code in order to improve efficiency of procurement procedures. Besides, in the reporting period Sistema JSFC aggressively increased the share of purchasing from electronic trading floors.

Business relations practices of Sistema JSFC are highly appreciated by the market. In 2011 the Expert Rating Agency rated the corporate governance of Sistema JSFC as 7+ ("Developed corporate governance practice") on the national scale. Besides, the Corporation was the 2011 winner in the nomination "Best level of disclosure on the corporate governance practice (RID nomination)" among non-financial sector companies. In 2011 MTS was granted the GAMMA-7 rating in "Analysis and assessment of efficiency in corporate governance, accountability and management". This is the highest rating among companies of Russia and the CIS.

Responsibility of a party to social relations

The Corporation is one of the major philanthropists and investors in the Russian social sphere. Such investments totaled RUB 2,000 million in 2011. Social investments were mostly made in the following areas:

- Science and education;
- Culture;
- Sport;
- Direct support to social initiatives and projects.

Sistema JSFC considers it important to render substantial and consistent support to talented, intellectually gifted and proactive young people. In 2011 the Corporation started the all-Russian program for forming and developing the

national talent pool entitled "Lift to the Future". The project will be implemented as an organized Russian national social network for the young whose purpose is to search for, support and develop talented young people.

Being aware of the importance of supporting education and science, the Corporation is a patron of the Higher School of Management of the Saint-Petersburg State University, the European University, the Russian Geographical Society, and many other educational and scientific institutions and projects. The most gifted students of a number of technical higher educational establishments are covered by a scholarship program.

Sistema JSFC is a major sponsor of numerous Russian cultural events. Since 2003 the Corporation has been the main sponsor of the State Russian Museum, a sponsor of the Mariinsky Theatre festivals, the annual Musical Kremlin concerts, and the international ballet contest Benois de la Danse. Sistema JSFC also sponsors the Sovremennik Theater.

The Corporation traditionally provides support to Russian sports: the Russian Olympians Foundation, the Russian Rugby Union, the Federation of Cycling Sport of Russia, the Sports Federation of the Russian Ministry of the Interior, and a number of junior sport schools.

Projects in the social sphere are an important component of our charitable activities: Sistema JSFC finances a number of orphanages and shelters, and is in close cooperation with several charitable foundations that support the disabled and veterans.

Social projects are implemented via the Sistema Charitable Foundation that was established in 2003 to ensure effective management of the Corporation and its subsidiaries' social investments.

In 2011 the Corporation became a laureate of the Corporate Social Responsibility Leaders contest run by PricewaterhouseCoopers and the Vedomosti.

5. Audited financial statements in
accordance with the US GAAP for the full
year ended December 31, 2011

SISTEMA JSFC AND SUBSIDIARIES

Consolidated Financial Statements
As of December 31, 2011 and 2010 and
For the Years Then Ended

SISTEMA JSFC AND SUBSIDIARIES

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INDEPENDENT AUDITORS' REPORT

To the Board of Directors and Shareholders of Sistema Joint Stock Financial Corporation:

We have audited the accompanying consolidated statements of financial position of Sistema Joint Stock Financial Corporation and its subsidiaries (the "Group") as of December 31, 2011 and 2010, and the related consolidated statements of operations, cash flows, and changes in shareholders' equity for the years 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, 2011 and 2010, 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.



Moscow, Russia
April 20, 2012

SISTEMA JSFC AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF FINANCIAL POSITION AS OF DECEMBER 31, 2011 AND 2010

(Amounts in thousands of U.S. dollars, except share and per share amounts)

	Notes	2011	2010
ASSETS			
CURRENT ASSETS:			
Cash and cash equivalents		\$ 2,923,957	\$ 2,245,884
Assets from banking activities, current portion (including cash and cash equivalents of \$1,315,075 and \$2,308,488)	6	4,204,961	5,502,729
Short-term investments	7	763,631	879,680
Accounts receivable, net	8	1,756,278	1,780,423
VAT receivable		709,099	531,127
Inventories and spare parts	10	1,659,653	1,455,897
Deferred tax assets, current portion	21	311,891	357,821
Disposal group held for sale	4	1,409,064	1,370,142
Other current assets	9	1,722,844	1,685,336
Total current assets		15,461,378	15,809,039
NON-CURRENT ASSETS:			
Property, plant and equipment, net	12	18,360,826	18,022,199
Advance payments for non-current assets		264,709	1,312,053
Goodwill	13	1,601,260	1,872,520
Other intangible assets, net	14	2,251,166	3,021,918
Investments in affiliates	15	1,382,651	1,147,694
Assets from banking activities, net of current portion	6	2,303,120	1,799,620
Debt issuance costs, net		171,951	159,803
Deferred tax assets, net of current portion	21	348,589	304,761
Long-term investments	16	1,294,687	469,742
Other non-current assets		461,684	246,699
Total non-current assets		28,440,643	28,357,009
TOTAL ASSETS		\$ 43,902,021	\$ 44,166,048

See notes to consolidated financial statements.

SISTEMA JSFC AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF FINANCIAL POSITION (CONTINUED) AS OF DECEMBER 31, 2011 AND 2010

(Amounts in thousands of U.S. dollars, except share and per share amounts)

	Notes	2011	2010
LIABILITIES AND SHAREHOLDERS' EQUITY			
CURRENT LIABILITIES:			
Accounts payable		\$ 2,189,019	\$ 1,741,712
Liabilities from banking activities, current portion	17	3,152,989	4,191,836
Taxes payable		794,117	649,194
Deferred tax liabilities, current portion	21	168,545	168,982
Subscriber prepayments, current portion		605,545	579,952
Accrued expenses and other current liabilities	18	2,362,768	3,277,693
Short-term loans payable	19	299,610	1,074,081
Current portion of long-term debt	20	4,097,076	2,103,405
Disposal group held for sale	4	248,317	295,805
Total current liabilities		<u>13,917,986</u>	<u>14,082,660</u>
LONG-TERM LIABILITIES:			
Long-term debt, net of current portion	20	12,013,197	12,206,515
Subscriber prepayments, net of current portion		106,586	129,515
Liabilities from banking activities, net of current portion	17	1,644,478	1,444,783
Deferred tax liabilities, net of current portion	21	1,412,199	1,580,518
Asset retirement obligation	2	214,121	258,382
Postretirement benefits obligation		77,591	58,732
Property, plant and equipment contributions		86,081	89,067
Total long-term liabilities		<u>15,554,253</u>	<u>15,767,512</u>
TOTAL LIABILITIES		<u>29,472,239</u>	<u>29,850,172</u>
Commitments and contingencies	27		
Redeemable noncontrolling interests	2	723,819	107,343
SHAREHOLDERS' EQUITY:			
Share capital (9,650,000,000 shares issued; 9,267,985,025 and 9,281,827,594 shares outstanding with par value of 0.09 Russian Rubles, respectively)	23	30,057	30,057
Treasury stock (382,014,975 and 368,172,406 shares with par value of 0.09 Russian Rubles, respectively)		(467,198)	(463,733)
Additional paid-in capital		2,575,601	2,553,563
Retained earnings		6,418,649	6,471,327
Accumulated other comprehensive loss		(518,354)	(171,149)
Total Sistema JSFC shareholders' equity		<u>8,038,755</u>	<u>8,420,065</u>
Non-redeemable noncontrolling interests		<u>5,667,208</u>	<u>5,788,468</u>
TOTAL EQUITY		<u>13,705,963</u>	<u>14,208,533</u>
TOTAL LIABILITIES AND EQUITY		<u>\$ 43,902,021</u>	<u>\$ 44,166,048</u>

See notes to consolidated financial statements.

SISTEMA JSFC AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS FOR THE YEARS ENDED DECEMBER 31, 2011 AND 2010

(Amounts in thousands of U.S. dollars, except share and per share amounts)

	Notes	2011	2010
Sales		\$ 32,452,236	\$ 26,222,373
Revenue from banking activities		529,012	588,946
TOTAL REVENUES		32,981,248	26,811,319
Cost of sales, exclusive of depreciation, depletion and amortization shown separately below		(13,021,173)	(10,716,816)
Cost related to banking activities, exclusive of depreciation and amortization shown separately below		(310,332)	(374,036)
Selling, general and administrative expenses		(3,936,588)	(3,747,805)
Depreciation, depletion and amortization		(3,281,629)	(2,862,754)
Transportation costs		(789,785)	(535,391)
Provision for doubtful accounts		(135,967)	(161,519)
Loss from impairment and provisions of other assets	11	(1,031,262)	(313,381)
Taxes other than income tax		(6,257,642)	(4,106,338)
Other operating expenses, net		(458,852)	(260,271)
Equity in results of affiliates		120,929	92,235
Gain upon adoption of equity method	15	-	477,400
Gain on disposal of interests in subsidiaries and affiliates		62,514	-
OPERATING INCOME		3,941,461	4,302,643
Interest income		176,584	131,534
Change in fair value of derivative instruments		(2,268)	(2,062)
Interest expense		(1,742,690)	(1,597,244)
Foreign currency transactions (losses)/ gains		(326,415)	26,151
Income from continuing operations before income tax		2,046,672	2,861,022
Income tax expense	21	(1,088,546)	(1,065,480)
Income from continuing operations		\$ 958,126	\$ 1,795,542
Income/(loss) from discontinued operations, net of income tax effect of \$26,184 and \$23,483		71,233	(2,999)
Gain on disposal of discontinued operations, net of income tax effect of \$39,547 and \$nil	4	161,817	324,656
NET INCOME		\$ 1,191,176	\$ 2,117,199
Noncontrolling interest		(973,174)	(1,198,502)
NET INCOME ATTRIBUTABLE TO SISTEMA JSFC		\$ 218,002	\$ 918,697
Amounts attributable to Sistema JSFC:			
Income from continuing operations		\$ 118,087	\$ 621,663
Income from discontinued operations		99,915	297,034
Weighted average number of common shares outstanding – basic and diluted		9,276,977,916	9,280,322,906
Income per share, basic and diluted, U.S. cent			
Income from continuing operations		1.27	6.7
Income from discontinued operations		1.08	3.2
Net income attributable to Sistema JSFC shareholders		2.35	9.90

See notes to consolidated financial statements.

SISTEMA JSFC AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS FOR THE YEARS ENDED DECEMBER 31, 2011 AND 2010 (Amounts in thousands of U.S. dollars)

	2011	2010
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	\$ 1,191,176	\$ 2,117,199
Gain on disposal of discontinued operations	(161,817)	(324,656)
(Income)/loss from discontinued operations	<u>(71,233)</u>	<u>2,999</u>
Income from continuing operations	958,126	1,795,542
Adjustments to reconcile net income to net cash provided by operations:		
Depreciation, depletion and amortization	3,281,629	2,862,754
Equity in results of affiliates	(120,929)	(92,235)
Deferred income tax benefit	(14,934)	(24,097)
Change in fair value of derivative financial instruments	2,268	2,062
Foreign currency transactions losses/(gains)	326,415	(26,151)
Debt issuance cost amortization	49,179	89,244
Non-cash compensation to employees of subsidiaries	51,037	70,978
Accretion expense associated with the asset retirement obligation	29,475	8,925
Loss from impairment and provisions of other assets	1,031,262	313,381
Loss on disposal of property, plant and equipment	24,160	32,124
Gain on disposal of interests in subsidiaries and affiliates	(62,514)	-
Gain upon adoption of equity method	-	(477,400)
Amortization of connection fees	(96,676)	(95,706)
Provision for doubtful accounts	135,967	161,519
Allowance for loan losses	10,563	29,052
Dividends received from affiliates	42,328	34,937
Changes in operating assets and liabilities, net of effects from purchase of businesses:		
Trading securities	(121,253)	120,236
Accounts receivable	(186,070)	(417,639)
VAT receivable	(167,414)	(464,537)
Other current assets	(144,852)	(298,271)
Inventories and spare parts	(190,841)	(395,067)
Accounts payable	574,602	226,193
Subscriber prepayments	99,340	132,105
Taxes payable	97,105	(54,119)
Accrued expenses and other liabilities	(198,047)	406,003
Postretirement benefits obligation	<u>(5,650)</u>	<u>55,331</u>
Net cash provided by operating activities of continuing operations	5,404,276	3,995,164
Net cash provided by operating activities of discontinued operations	<u>167,132</u>	<u>61,588</u>
Net cash provided by operating activities	<u>\$ 5,571,408</u>	<u>\$ 4,056,752</u>

SISTEMA JSFC AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS (CONTINUED) FOR THE YEARS ENDED DECEMBER 31, 2011 AND 2010 (Amounts in thousands of U.S. dollars)

	2011	2010
CASH FLOWS FROM INVESTING ACTIVITIES:		
Payments for purchases of property, plant and equipment	(3,680,939)	(3,486,468)
Payments for purchases of intangible assets	(451,151)	(693,106)
Payments for purchases of businesses, net of cash acquired	(375,245)	(364,532)
Payments for purchases of long-term investments	(929,097)	(478,530)
Payments for purchases of short-term investments	(893,682)	(851,325)
Payments for purchases of other non-current assets	(173,816)	(78,286)
Increase in restricted cash	(45,299)	(16,445)
Proceeds from sale of subsidiaries, net of cash disposed	184,596	307,358
Proceeds from sale of property, plant and equipment	170,178	18,782
Proceeds from sale of long-term investments	165,629	140,979
Proceeds from sale of other non-current assets	-	92,430
Proceeds from sale of short-term investments	1,184,068	461,882
Net (decrease)/ increase in loans to customers and banks	(341,126)	107,917
Net cash used in investing activities	\$ (5,185,884)	\$ (4,839,344)
CASH FLOWS FROM FINANCING ACTIVITIES:		
(Principal payments on)/proceeds from short-term borrowings, net	(276,885)	460,617
Net (decrease)/increase in deposits from customers of the banking division	(651,101)	597,888
Net (decrease) in debt securities issued and other liabilities	(457,867)	(225,504)
Advance received for shares of SSTL	-	602,276
Proceeds from long-term borrowings, net of debt issuance costs	6,421,015	5,459,359
Debt issuance costs	(69,860)	(86,522)
Principal payments on long-term borrowings	(4,331,488)	(5,302,634)
Principal payments on capital lease obligations	(19,122)	(10,420)
Acquisition of noncontrolling interests in existing subsidiaries	(261,295)	(787,434)
Dividends paid	(960,486)	(823,616)
Proceeds from capital transactions of subsidiaries	153,710	109,112
Purchases of treasury shares	(28,559)	-
Net cash used in financing activities	\$ (481,938)	\$ (6,878)
Effect of foreign currency translation on cash and cash equivalents	\$ (154,384)	\$ (10,110)
Net decrease in cash and cash equivalents	\$ (250,798)	\$ (799,580)
Cash and cash equivalents at the beginning of the period (including cash of discontinued operations)	4,573,556	5,373,136
Cash and cash equivalents at the end of the period (including cash of discontinued operations)	4,322,758	4,573,556
Cash and cash equivalents of discontinued operations at the end of the period	(83,726)	(19,184)
Cash and cash equivalents of continuing operations at end of the period *	\$ 4,239,032	\$ 4,554,372
CASH PAID DURING THE PERIOD FOR:		
Interest paid, net of amounts capitalized	\$ (1,802,826)	\$ (1,643,973)
Income taxes paid	(1,069,790)	(987,696)
NON-CASH INVESTING AND FINANCING ACTIVITIES:		
Property, plant and equipment contributed free of charge	\$ 6,110	\$ 2,814
Equipment acquired through vendor financing	152,489	36,064
Equipment acquired under capital leases	2,708	2,567
Amounts owed for capital expenditures	322,867	220,790
Payable related to business acquisitions	6,857	23,281
Advances for purchase of long-lived assets	118,192	675,548
* Cash and cash equivalents at the end of the period comprised of the following:		
Non-banking activities	\$ 2,923,957	\$ 2,245,884
Banking activity	1,315,075	2,308,488
	\$ 4,239,032	\$ 4,554,372

See notes to consolidated financial statements.

SISTEMA JSFC AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY FOR THE YEARS ENDED DECEMBER 31, 2011 AND 2010 (Amounts in thousands of U.S. dollars, except share and per share amounts)

	Share capital		Treasury stock		Additional paid-in capital	Retained earnings	Accumulated other compre- hensive loss	Sistema JSFC shareholders' equity	Non- redeemable non- controlling interests	Total equity	Redeemable non- controlling interests
	Shares	Amount	Shares	Amount							
Balances at January 1, 2010	9,650,000,000	30,057	(371,018,060)	(466,345)	2,088,319	5,577,759	(93,647)	7,136,143	6,873,852	14,009,995	82,261
Issue of shares to employees	-	-	2,845,654	2,612	-	-	-	2,612	-	2,612	-
Accrued compensation costs	-	-	-	-	60,629	336	-	60,965	757	61,722	-
Change in fair value of noncontrolling interests	-	-	-	-	-	(6,639)	-	(6,639)	(5,479)	(12,118)	12,118
Dividends declared by subsidiaries	-	-	-	-	-	-	-	-	(838,158)	(838,158)	(14,973)
Dividends declared by Sistema JSFC	-	-	-	-	-	(17,455)	-	(17,455)	-	(17,455)	-
Acquisition of noncontrolling interests	-	-	-	-	(77,699)	-	-	(77,699)	(695,950)	(773,649)	-
Disposals and capital transactions of subsidiaries	-	-	-	-	482,314	(1,371)	-	480,943	(687,050)	(206,107)	-
Acquisition of subsidiaries	-	-	-	-	-	-	-	-	-	-	19,216
Comprehensive income:											
Change in fair value of interest rate swaps,	-	-	-	-	-	-	13,932	13,932	11,496	25,428	-
net of income tax effect of \$(6,357)	-	-	-	-	-	-	-	-	-	-	-
Unrealized losses on available-for-sale securities,	-	-	-	-	-	-	3,628	3,628	-	3,628	-
net of income tax effect of nil	-	-	-	-	-	-	(2,291)	(2,291)	(5,232)	(7,523)	-
Unrecognized actuarial loss, net of income tax effect of \$nil	-	-	-	-	-	-	(92,771)	(92,771)	(56,487)	(149,258)	938
Translation adjustment, net of income tax effect of \$7,528	-	-	-	-	-	918,697	-	918,697	1,190,719	2,109,416	7,783
Net income	-	-	-	-	-	-	-	841,195	1,140,496	1,981,691	8,721
Total comprehensive income								841,195	1,140,496	1,981,691	8,721
Balances at December 31, 2010	9,650,000,000	30,057	(368,172,406)	(463,733)	2,553,563	6,471,327	(171,149)	8,420,065	5,788,468	14,208,533	107,343
Purchase of treasury shares	-	-	(34,078,140)	(28,585)	-	-	-	(28,585)	-	(28,585)	-
Disposal of treasury shares	-	-	20,235,571	25,120	-	-	-	25,120	-	25,120	-
Accrued compensation cost	-	-	-	-	24,334	-	-	24,334	-	24,334	-
Change in fair and redemption value of noncontrolling interests	-	-	-	-	-	(183,532)	-	(183,532)	-	(183,532)	177,477
Dividends declared by subsidiaries	-	-	-	-	-	-	-	-	(838,089)	(838,089)	(5,741)
Dividends declared by Sistema JSFC	-	-	-	-	-	(87,148)	-	(87,148)	-	(87,148)	-
Disposals and capital transactions of subsidiaries	-	-	-	-	(2,296)	-	-	(2,296)	(140,945)	(143,241)	600,000
Comprehensive income:											
Change in fair value of interest rate swaps,	-	-	-	-	-	-	3,903	3,903	3,461	7,364	-
net of income tax effect of \$(1,841)	-	-	-	-	-	-	3,148	3,148	3,256	6,404	-
Unrecognized actuarial gains, net of income tax effect of \$nil	-	-	-	-	-	-	(354,256)	(354,256)	(274,405)	(628,661)	(2,972)
Translation adjustment, net of income tax effect of \$nil	-	-	-	-	-	218,002	-	218,002	1,125,462	1,343,462	(152,288)
Net income	-	-	-	-	-	-	-	(129,203)	857,774	728,571	(155,260)
Total comprehensive income								(129,203)	857,774	728,571	(155,260)
Balances at December 31, 2011	9,650,000,000	30,057	(382,014,975)	(467,198)	2,575,601	6,418,649	(518,354)	8,038,755	5,667,208	13,705,963	723,819

See notes to consolidated financial statements.

SISTEMA JSFC AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEARS ENDED DECEMBER 31, 2011 AND 2010

(Amounts in thousands of U.S. dollars, unless otherwise stated)

1. DESCRIPTION OF THE BUSINESS AND OPERATING ENVIRONMENT

Description of the business – Sistema Joint Stock Financial Corporation (the “Company”, together with its subsidiaries, the “Group”) invests in, and manages a range of companies which operate in the telecommunications, oil and energy, high technology, banking and other sectors. The main focus of the Group’s activities is service-based industries. The Company and the majority of the Company’s consolidated subsidiaries are incorporated in the Russian Federation (“RF”).

The controlling shareholder of the Company is Vladimir P. Evtushenkov. Minority holdings are held by certain top executives and directors of the Company. The rest of the shares are listed on the London Stock Exchange in the form of Global Depositary Receipts (“GDRs”) and Russian stock exchanges.

Below are the Group’s significant entities and their principal activities:

Significant entities	Short name	Principal activity	Beneficial ownership as of December 31,	
			2011	2010
Sistema Joint Stock Financial Corporation	Sistema	Investing and financing		
Core Assets:				
Mobile TeleSystems and subsidiaries	MTS	Telecommunications	53%	55%
Bashneft and subsidiaries	Bashneft	Oil and gas production	69% ⁽¹⁾	73% ⁽¹⁾
Bashkirenergo (Note 4)	Bashkirenergo	Energy production	39% ⁽²⁾	31% ⁽²⁾
Developing Assets:				
RTI and subsidiaries (Note 5)	RTI	Technology	85%	-
MTS Bank and subsidiaries ⁽³⁾	MTS Bank	Banking	99%	99%
Sistema Shyam TeleServices Limited	SSTL	Telecommunications	57%	74%
Sistema Mass-media and subsidiaries	SMM	Mass media	75%	75%
Detsky Mir-Center and subsidiaries	Detsky Mir	Retail trading	75%	75%
Intourist and subsidiaries	Intourist	Travel services	66%	66%
Medsia and subsidiaries	Medsia	Healthcare services	100%	100%
Binnopharm and subsidiaries	Binnopharm	Pharmaceuticals	100%	100%
NIS	NIS	Technology	51%	51%

⁽¹⁾ Voting interests as of December 31, 2011 and 2010 – 86%.

⁽²⁾ Voting interests as of December 31, 2011 and 2010 – 50%.

⁽³⁾ Former title of MTS Bank is Moscow Bank for Reconstruction and Development (“MBRD”).

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of presentation – The accompanying consolidated financial statements have been prepared in conformity with the accounting principles generally accepted in the United States of America (“U.S. GAAP”). The Group’s entities maintain accounting records in the local currencies of the countries of their domicile in accordance with the requirements of respective accounting and tax legislation. The accompanying financial statements differ from the financial statements prepared for statutory purposes in that they reflect certain adjustments, appropriate to present the financial position, results of operations and cash flows in accordance with U.S. GAAP, which are not recorded in the accounting books of the Group’s entities.

Principles of consolidation – The consolidated financial statements include the accounts of the Company, as well as entities where the Company has operating and financial control, most often through the direct or indirect ownership of a majority voting interest. Those ventures where the Group exercises significant influence but does not have operating and financial control are accounted for using the equity method. Investments in which the Group does not have the ability to exercise significant influence over operating and financial policies are accounted for under the cost method and included in other investments in the consolidated statements of financial position. The consolidated financial statements also include accounts of variable interest entities (“VIEs”) in which the Group is deemed to be the primary beneficiary. An entity is generally a VIE if it meets any of the following criteria: (i) the entity has insufficient equity to finance its activities without additional subordinated financial support from other parties, (ii) the equity investors cannot make significant decisions about the entity’s operations or (iii) the voting rights of some investors are not proportional to their obligations to absorb the expected losses of the entity or receive the expected returns of the entity and substantially

SISTEMA JSFC AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEARS ENDED DECEMBER 31, 2011 AND 2010

(Amounts in thousands of U.S. dollars, unless otherwise stated)

all of the entity's activities involve or are conducted on behalf of the investor with disproportionately few voting rights.

All significant intercompany transactions, balances and unrealized gains and losses on transactions have been eliminated.

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

Significant estimates for the Group include the allowances for doubtful accounts, customer loans and deferred tax assets, the valuation of goodwill and other long-lived assets, asset retirement obligations, income tax benefits, redeemable noncontrolling interests, derivative instruments, share-based compensation and assets acquired and liabilities assumed in business combinations, the recoverability of investments and the estimates of oil and gas reserves.

Concentration of business risk – The Group's principal business activities are within the Commonwealth of Independent States ("CIS"), primarily in the RF and Ukraine. Laws and regulations affecting businesses operating in the RF and Ukraine are subject to rapid changes, which could impact the Group's assets and operations.

Foreign currency – Management has determined that the functional currencies of most of the Group's subsidiaries are the currencies of the countries of their domicile, with the exception of certain subsidiaries whose functional currency is the U.S. dollar ("USD") due to the pervasive use of the USD in their operations or whose functional currency is the currency of its parent company if the entity is a device or shell company for holding investments or obligations.

In preparing the financial statements of the entities within the Group, transactions in currencies other than the entity's functional currency are recognized at the rates of exchange prevailing on the dates of the transactions. At each balance sheet date, monetary assets and liabilities that are denominated in foreign currencies are retranslated at the rates prevailing at that date. Non-monetary items carried at fair value that are denominated in foreign currencies are translated at the rates prevailing at the date when the fair value was determined. Non-monetary items that are measured in terms of historical cost in a foreign currency, are not restated.

The Group has selected the USD as its reporting currency. The Group's assets and liabilities are translated into USD at exchange rates prevailing on the balance sheet date. Revenues, expenses, gains and losses are translated into USD at average exchange rates prevailing during the reporting period. Equity is translated at the applicable historical rates. The resulting translation gain or loss is recorded as a separate component of other comprehensive income.

On the disposal of a foreign operation, all of the accumulated exchange differences in respect of that operation attributable to the Group are reclassified to profit or loss.

The official rate of exchange, as determined by the Central Bank of the RF, between the Russian ruble ("RUB") and USD as of December 31, 2011 was 32.20 RUB to 1 USD (30.48 RUB to 1 USD as of December 31, 2010).

Revenue recognition – Generally, revenues are recognized when all of the following conditions have been met: (i) there is persuasive evidence of an arrangement; (ii) delivery has occurred; (iii) the fee is fixed and determinable; and (iv) collectability of the fee is reasonably assured. Revenue amounts are presented net of value added taxes.

Revenues under arrangements specific to the respective segments of the Group are recognized as follows:

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MTS

Revenues derived from wireless, local telephone, long distance, data and video services are recognized when services are provided. This is based upon either usage (minutes of traffic processed, volume of data transmitted) or period of time (monthly subscription fees).

The content revenue is presented net of related costs when MTS acts as an agent of the content providers while the gross revenue and related costs are recorded when MTS is a primary obligor in the arrangement.

Upfront fees received for connection of new subscribers, installation and activation of wireless, wireline and data transmission services ("connection fees") are deferred and recognized over the estimated average subscriber life, as follows:

Mobile subscribers	1-5 years
Residential wireline voice phone subscribers	15 years
Residential subscribers of broadband internet service	1 year
Other fixed line subscribers	3-5 years

MTS calculates an average life of mobile subscribers for each region in which it operates and amortizes regional connection fees.

Incentives provided to customers are usually offered on signing a new contract or as part of a promotional offering. Incentives, representing the reduction of the selling price of the service (free minutes and discounts) are recorded in the period to which they relate, when the respective revenue is recognized, as a reduction to both accounts receivable and revenue. However, if the sales incentive is a free product or service delivered at the time of sale, the cost of the free product or service is classified as an expense. In particular, the Group sells handsets at prices below cost to contract subscribers. Such subsidies are recognized in the cost of handsets and accessories when the sale is recorded.

Bashneft

Revenues from the production and sale of crude oil and petroleum products are recognised when title passes to customers at which point the risks and rewards of ownership are assumed by the customer and the price is fixed and determinable. Revenues include excise taxes on petroleum products sales and duties on export sales of crude oil and petroleum products. Excise taxes, which are re-charged to third parties under the terms of processing agreements, are excluded from revenues.

Revenue from a contract to provide services is recognised by reference to the stage of completion of the contract. Revenue from time and material contracts is recognised at the contractual rates as labour hours are delivered and direct expenses are incurred.

Construction contracts revenue includes the initial amount agreed in the contract plus any variations in contract work, claims and incentive payments, to the extent that it is probable that they will result in revenue and can be measured reliably. As soon as the outcome of a construction contract can be estimated reliably, contract revenue is recognised in profit or loss in proportion to the stage of completion of the contract. Contract expenses are recognised as incurred unless they create an asset related to future contract activity. The stage of completion is assessed by reference to surveys of work performed. When the outcome of a construction contract cannot be estimated reliably, contract revenue is recognised only to the extent of contract costs incurred that are likely to be recoverable. An expected loss on a contract is recognised immediately in profit or loss.

RTI

Revenues from the long-term contracts are recognized by reference to the stage of completion of the contract activity at the statement of financial position date when the outcome of a contract can be estimated reliably. This is normally measured by the proportion that contract costs incurred for work performed to date relate to the estimated total contract costs, except where this would not be representative of the stage of completion. Variations in contract work, claims and incentive payments are included to the extent that they have been agreed with the customer. Where the outcome of a contract cannot be estimated reliably, contract revenue is recognized to the extent of contract costs incurred where it is probable that such costs will be recoverable. When it is probable that total contract costs will exceed total contract revenue, the expected loss is recognized immediately.

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The sales of software products and system integration services are generally multiple-element arrangements, involving the provision of related services, including customization, implementation and integration services, as well as ongoing support and maintenance provided to customers. A multiple-element arrangement is separated into more than one unit of accounting if all of the following criteria are met: (a) the delivered items have value to the customer on a standalone basis; (b) there is objective and reliable evidence of the fair value of the undelivered items; and (c) the arrangement includes a general right of return relative to the delivered items, delivery or performance of the undelivered items is considered probable and substantially in the control of the Group.

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

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

When sale agreements provide price protection to the dealer, the revenue is deferred until the dealer sells the merchandise to a third party due to the frequent sales price reductions and rapid technology obsolescence.

Certain products of this segment are generally sold with a limited warranty for product quality. The product return reserves and other post-contract support obligations are accrued at the time of sale. The segment accrues for estimated incurred but unidentified issues based on historical activity.

MTS Bank

Revenues from interest bearing assets are recognized on an accrual basis using the effective interest method. The effective interest method is a method of calculating the amortized cost of a financial asset or a financial liability (or group of financial assets or financial liabilities) and of allocating the interest income or interest expense over the relevant period.

The effective interest rate is the rate that exactly discounts estimated future cash receipts (including all fees on points paid or received that form an integral part of the effective interest rate, transaction costs and other premiums or discounts) through the expected life of the debt instrument, or (where appropriate) a shorter period, to the net carrying amount on initial recognition.

SSTL

Service revenues are recognized as services are rendered, net of discounts and waivers. Processing fees and activation revenues on recharge vouchers and start-up kits are recognized as revenues net of discounts, as and when they get activated.

Revenues from infrastructure services are recognized as services are rendered, in accordance with the terms of the related contracts. Indefeasible right of use contracts are accounted for as operating leases and revenues are recognized over the term of the lease.

Other businesses

The Group's other businesses recognize revenue when products are shipped or when services are rendered to customers. In cases where the Group acts as an agent, only the net agency fee is recognized as revenue.

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Regulated services – Regulated tariff services provided by the Group primarily consist of local telephone services and services rendered to other operators, such as traffic charges, connection fees and line rental services, provided by MTS, and energy provided by Bashkirenergo. Changes in the rate structure for such services are subject to the Federal Tariff Service approval. Revenue from regulated tariff services represented approximately 3.5% and 4.1% of the consolidated revenue for the years ended December 31, 2011 and 2010, respectively. This does not include revenue attributable to Bashkirenergo whose financial results are presented in discontinued operations (Note 4).

Cash and cash equivalents – Cash equivalents include cash on hand, demand deposits and other highly liquid investments with a maturity of three months or less when purchased. Within the cash and cash equivalents balance are cash equivalents of \$1,918.1 million and \$1,321.0 million as of December 31, 2011 and 2010, respectively, which primarily comprise term deposits with banks and bank promissory notes with original maturities of less than 90 days.

Restricted cash – Restricted cash includes cash and cash equivalents restricted by agreements with third parties for special purposes. Restricted cash included in other non-current assets in the consolidated statements of financial position as of December 31, 2011 and 2010 was \$86.3 million and \$48.3 million, respectively, including cash deposited by the Group to guarantee certain loans, and to be in compliance with government regulation of local currency conversion into foreign currencies in Uzbekistan.

Financial instruments – The Group's financial instruments include cash and cash equivalents, short-term investments, accounts receivable, derivative financial instruments, financial assets and liabilities from banking activities, accounts payable and short-term and long term debt.

Hedging activities – The Group uses derivative instruments, including swap, forward and option contracts to manage foreign currency and interest rate risk exposures. The Group reviews its fair value hierarchy classifications quarterly. Changes in significant observable valuation inputs identified during these reviews may trigger reclassification of fair value hierarchy levels of financial assets and liabilities. During the years ended December 31, 2011 and 2010 no reclassifications occurred. The fair value measurement of the Group's hedging agreements is based on the observable yield curves for similar instruments ("Level 2" of the hierarchy established by the U.S. GAAP guidance).

The Group designates derivatives as either fair value hedges or cash flow hedges in case the required criteria are met. Changes in the fair value of derivatives that are designated and qualify as fair value hedges are recorded in the consolidated statement of operations together with any changes in the fair value of the hedged asset or liability that is attributed to the hedged risk.

The effective portion of changes in the fair value of derivatives that are designated and qualify as cash flow hedges are recognized in accumulated other comprehensive income. The gain or loss relating to the ineffective portion is recognized immediately in the consolidated statement of operations. For derivatives that do not meet the conditions for hedge accounting, gains and losses from changes in the fair value are included in the consolidated statement of operations.

Assets and liabilities related to multiple derivative contracts with one counterparty are not offset by the Group.

The Group does not use financial instruments for trading or speculative purposes.

Fair value of financial instruments – The fair market value of certain financial instruments approximates their carrying value due to the short term nature of these amounts, namely cash and cash equivalents, short-term investments, accounts receivable and accounts payable, short-term debt and assets and liabilities from banking activities which are included in current assets and liabilities.

Accounts receivable – Accounts receivable are stated at their net realizable value after deducting a provision for doubtful accounts. Such provision reflects either specific cases of delinquencies or defaults or estimates based on evidence of collectability.

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Assets from banking activities – Assets from banking activities comprise assets (loans, notes and others) involved in operations of the banking division. Impairment losses on loans to customers and banks are included in the allowance for loan losses. Allowance represents management's best estimate of probable credit losses inherent in the lending portfolios as of the balance sheet date. Loans not individually reviewed are evaluated as a group using reserve factor percentages based on historic loss experience qualitative factors. Loans deemed to be uncollectible are charged against the allowance for loan losses. Correspondingly, recoveries of amounts previously charged as uncollectible are credited to the allowance for loan losses. A provision for loan losses is charged to the consolidated statement of operations based on management's evaluation of the estimated losses, after given consideration to the net chargeoffs, that have been incurred in the Group's loan portfolio.

The Group performs detailed reviews of its lending portfolios on a periodic and systematic basis to identify inherent risks and to assess the overall collectability of those portfolios. The allowance on certain homogeneous loan portfolios, which generally consist of consumer and mortgage loans, is based on an evaluation of aggregated portfolios of homogeneous loans, generally by loan type.

Loss forecast models are utilized for portfolios of homogeneous loans which consider a variety of factors including, but not limited to, historical loss experience, anticipated defaults or foreclosures based on portfolio trends, delinquencies and credit scores, and estimated loss factors by loan type. The remaining loan portfolios are reviewed on an individual loan basis.

Loans subject to individual reviews are analyzed and segregated by risk according to the Group's internal risk rating scale. These risk classifications, in conjunction with an analysis of historical loss experience, current economic conditions and performance trends within specific portfolio segments, and any other pertinent information result in the estimation allowances for loan losses. An allowance for loan losses is established for individually impaired loans. A loan is considered impaired when, based on current information and events, it is probable that the Group will be unable to collect all amounts due, including principal and interest, according to the contractual terms of the agreement. Individually impaired loans are measured based on the present value of payments expected to be received, or for loans that are solely dependent on the collateral for repayment, the estimated fair value of the collateral. If the recorded investment in impaired loans exceeds the measure of estimated fair value, an allowance is established as a component of the allowance for loan losses.

Non-accrual loans – In general, the accrual of interest on loans is discontinued at the time the loan is 90 days delinquent unless the credit is well secured and in process of collection. In all cases, loans are placed on non-accrual, or written-off at an earlier date, if collection of principal or interest is considered doubtful. All interest earned but not collected for loans that are placed on non-accrual or written-off is reversed against interest income. Loans are returned to accrual status when all the principal and interest amounts contractually due are reasonably assured of repayment within a reasonable time frame and when the borrower has demonstrated payment performance of cash or equivalents for a minimum of six months.

Inventories and spare parts – Inventories comprise raw materials, work-in-progress, finished goods and goods for resale. Inventory and spare parts are stated at the lower of cost or market value.

The Group's subsidiaries account for inventories using either first-in, first-out or weighted average cost methods.

The cost of raw materials includes the cost of purchase, customs duties, transportation and handling costs. Work in-progress and finished goods are stated at production cost which includes direct production expenses and manufacturing overheads. Costs and estimated earnings in excess of billings on uncompleted contracts include the accumulated costs of projects contracted with third parties, net of related progress billings. The Group periodically assesses its inventories and spare parts for obsolete or slow-moving stock.

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Value-added taxes – Value-added taxes (“VAT”) related to sales are payable to the tax authorities on an accrual basis based on invoices issued to the customer. VAT incurred for purchases may be reclaimed, subject to certain restrictions, against VAT related to sales. VAT related to purchase transactions that will be reclaimed against future sales are recorded as VAT receivable in the accompanying financial statements.

Held for sale – The Group classifies assets and liabilities as held for sale when all the following conditions have been met: (i) management having the authority to approve the action, commits to a plan to sell the asset (disposal group); (ii) the asset (disposal group) is available for immediate sale in its present condition; (iii) an active program to locate a buyer and other actions required to complete the plan to sell have been initiated; (iv) the sale is probable and transfer of the assets (disposal group) is expected to qualify for recognition as a completed sale, within one year; (v) the asset (the disposal group) is being marketed at a reasonable price; and (vi) it is unlikely that the plan will be changed significantly or withdrawn. Held for sale assets are measured at the lower of carrying amount or fair value less cost to sell.

Property, plant and equipment – Property, plant and equipment are stated at historical cost. Cost includes major expenditures for improvements and replacements, which extend useful lives of the assets or increase their revenue generating capacity. Repairs and maintenance, including preventative maintenance, are charged to the consolidated statement of operations as incurred.

The Group recognizes the costs of overhauls and preventive maintenance performed with respect to oil refining assets as expenses when incurred. Cost of major overhauls and replacements, which extend useful lives of the assets or increase their revenue generating capacity are capitalized to the cost of the assets.

Depreciation for property, plant and equipment other than depletion on oil and gas properties is computed under the straight-line method utilizing estimated useful lives of the assets as follows:

Buildings	20-50 years
Leasehold improvements	Lesser of the estimated useful life or the term of the lease
Switches and transmission devices	7-31 years
Network and base station equipment	4-12 years
Refining, marketing, distribution and chemicals	3-40 years
Exploration and production assets	3-19 years
Power and utilities	3-47 years
Other plant, machinery and equipment	3-25 years

Depletion of proved oil and gas properties is calculated using the unit-of-production method based on total proved reserves. Depletion expense of other capitalized costs related to oil and gas production is calculated using the unit-of production method based on proved developed reserves.

Assets held under capital leases are initially recognized as assets of the Group at their fair value at the inception of a lease or, if lower, at the present value of minimum lease payments. The discount rate used in determining the present value of the minimum lease payments is the Group's incremental borrowing rate, unless (1) it is practicable to determine the implicit rate computed by the lessor; and (2) the implicit rate is less than the Group's incremental borrowing rate. If both of those conditions are met, the interest rate implicit in the lease is used.

Items of property, plant and equipment that are retired or otherwise disposed of are eliminated from the consolidated statement of financial position along with the corresponding accumulated depreciation and depletion. Any gain or loss resulting from such retirement or disposal is included in the determination of consolidated net income.

Construction in-progress and telecommunications equipment for installation are not depreciated until an asset is placed into service.

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Transportation expenses – Transportation expenses represent all expenses incurred in the transportation of crude oil and petroleum products via the Transneft pipeline network, as well as by railway and other transportation means. Transportation expenses also include all other shipping and handling costs.

Asset retirement obligation – The Group calculates an asset retirement obligation and an associated asset retirement cost when the Group has a legal or constructive obligation in connection with the retirement of tangible long-lived assets.

As of December 31, 2011 and 2010, the estimated present value of the Group's asset retirement obligations and change in liabilities were as follows:

	2011	2010
Balance, beginning of the year	\$ 273,916	\$ 189,490
Liabilities incurred in the current period	10,105	5,811
Property dispositions	(15,827)	-
Accretion expense	29,475	21,745
Revisions in estimated cash flows	(66,140)	58,734
Currency translation adjustment	(16,805)	(1,864)
Balance, end of the year	\$ 214,724	\$ 273,916
Current portion	603	15,534
Long-term portion	214,121	258,382
Balance, end of the year	\$ 214,724	\$ 273,916

The Group's asset retirement obligation relates primarily to the cost of removing MTS' equipment from sites and decommissioning of Bashneft's wells, dismantling equipment, restoring the sites and performing other related activities. Revisions in estimated cash flows are attributable to changes in economic assumptions, such as inflation rates

The Group recorded the long-term portion of asset retirement obligation as a separate line item in the consolidated statements of financial position, the current portion – as a component of accrued expenses and other current liabilities.

Business combinations – Acquisition of businesses from third parties is accounted for using the purchase method. On acquisition, the assets and liabilities of an acquired entity are measured at their fair values as at the date of acquisition. The noncontrolling interest is stated at the noncontrolling interests' proportion of the fair values of the assets and liabilities recognized.

Acquisitions of entities under common control are accounted for on a carryover basis, which results in the historical book value of assets and liabilities of the acquired entity being combined with that of the Group. Any difference between the purchase price and the net assets acquired is reflected in equity.

Goodwill – Goodwill is determined as the excess of the consideration transferred plus the fair value of any noncontrolling interest in the acquiree at the acquisition date over the fair values of the identifiable net assets acquired. The excess of the fair values of the identifiable net assets acquired over the cost of the business combination plus the fair value of any noncontrolling interest in the acquiree at the acquisition date is credited to income.

Goodwill is not amortized to operations, but instead is reviewed for impairment at least annually. Goodwill is reviewed for impairment by comparing the carrying value of each reporting unit's net assets (including allocated goodwill) to the fair value of the reporting unit. If the reporting unit's carrying amount is greater than its fair value, a second step is performed whereby implied fair value that relates to the reporting unit's goodwill is compared to the carrying value of the reporting unit's goodwill. The Group recognizes a goodwill impairment charge for the amount by which the carrying value of goodwill exceeds the fair value.

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Intangible assets other than goodwill – Other intangible assets include billing, telecommunication and other software, operating licenses, acquired customer bases, radio frequencies, trademarks and telephone numbering capacity. License costs are capitalized as a result of (a) the purchase price allocated to licenses acquired in business combinations; and (b) licenses purchased directly from government organizations which require license payments.

All finite-life intangible assets are being amortized using the straight-line method utilizing estimated useful lives of the assets as follows:

Billing and telecommunication software	1-20 years
Operating licenses	3-15 years
Acquired customer base	1-8 years
Numbering capacity with finite contractual life	2-10 years
Acquired radio frequencies	2-15 years

Trademarks and telephone numbering capacity with unlimited contractual life are not amortized, but are reviewed, at least annually, for impairment. If the fair value of the intangible asset is less than its carrying value, an impairment loss is recognized in an amount equal to the difference. The Group also evaluates the remaining useful life of its intangible assets that are not subject to amortization on an annual basis to determine whether events and circumstances continue to support an indefinite useful life. If an intangible asset that is not being amortized is subsequently determined to have a finite useful life, that asset is tested for impairment.

Investments – The Group's share in the net assets and net income of certain entities, where the Group holds 20% to 50% of voting shares and has the ability to exercise significant influence over their operating and financial policies ("affiliates") is included in the consolidated net assets and operating results using the equity method of accounting. The Group's share in the net income of affiliates where the Group has day-to-day involvement in business activities and which are integral to the Group's business is recorded within operating income. In other cases, the Group's share in net income is shown after the income tax provision. Other-than-temporary decreases in the value of the investment in affiliates are recognized in net income.

All other equity investments, which consist of investments for which the Company does not have the ability to exercise significant influence, are accounted for under the cost method or at fair value. Investments in private companies are carried at cost, less provisions for other-than-temporary impairment in value. For public companies that have readily determinable fair values, the Company classifies its equity investments as available-for-sale or trading. For available for sale securities, the Group records these investments at their fair values with unrealized holding gains and losses included in the consolidated statement of comprehensive income/(loss), net of any related tax effect. For trading securities, the Group records the investment at fair value. Unrealized holding gains and losses for trading securities are included in earnings.

The Group purchases promissory notes for investing purposes. These notes are carried at cost and the discount against the nominal value is accrued over the period to maturity. A provision is made, based on management assessment, for notes that are considered uncollectible. The notes are classified as held-to-maturity.

Investments which are expected to be realized within twelve months after the statement of financial position date are classified as short-term investments. Other investments are classified as long-term investments.

Debt issuance costs – Debt issuance costs are recorded as an asset and amortized using the effective interest method over the terms of the related loans.

Impairment of long-lived assets other than goodwill and indefinite lived intangible assets – The Group periodically evaluates the recoverability of the carrying amount of its long-lived assets. Whenever events or changes in circumstances indicate that the carrying amounts of those assets may not be recoverable, the Group compares the undiscounted net cash flows estimated to be generated by those assets to the carrying amount of those assets. When these undiscounted cash flows are less than the carrying amounts of the assets, the Group records impairment losses to write the asset down to fair value, measured by the estimated discounted net future cash flows expected to be generated from the use of the assets.

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Liabilities from banking activities – Liabilities from banking activities include deposits from banks and customers, promissory notes issued and other liabilities that arise out of operations of MTS Bank.

Property, plant and equipment contributions – Telecommunication equipment and transmission devices, installed at newly constructed properties in Moscow, have been historically transferred to MGTS, a fixed line operator and subsidiary of the Group, by the Moscow City Government free of charge. These assets are capitalized by the Group at their market value at the date of transfer. Simultaneously, deferred revenue is recorded in the same amount and is amortized as a reduction of the depreciation charge in the consolidated statement of operations over the contributed assets' life.

Income taxes – Income taxes of the Group's Russian entities have been computed in accordance with RF laws. The corporate income tax rate in the RF is 20%. The income tax rate on dividends paid within Russia is 9%. The foreign subsidiaries of the Group are paying income taxes in their respective jurisdictions.

Deferred tax assets and liabilities are recognized for differences between the carrying amounts of assets and liabilities in the consolidated financial statements and the tax bases of assets and liabilities that will result in future taxable or deductible amounts. The deferred tax assets and liabilities are measured using the enacted tax laws and rates applicable to the periods in which the differences are expected to affect taxable income. Deferred tax assets are reduced by a valuation allowance when, in the opinion of management, it is more likely than not that some portion or all of the deferred tax assets will not be realized. In making such determination, we consider all available positive and negative evidence, including future reversals of existing taxable temporary differences, projected future taxable income, tax planning strategies and recent financial operations.

Uncertain tax positions are recognized in the consolidated financial statements for positions which are considered more likely than not of being sustained based on the technical merits of the position on audit by the tax authorities. The measurement of the tax benefit recognized in the consolidated financial statements is based upon the largest amount of tax benefit that, in management's judgment, is greater than 50% likely of being realized based on a cumulative probability assessment of the possible outcomes.

The Group recognizes interest and penalties relating to unrecognized tax benefits and penalties within income taxes.

Treasury stock – if the Group reacquires its own equity instruments, those instruments ("treasury shares") are recognized as a deduction of equity at cost, being the consideration paid to reacquire the shares. No gain or loss is recognized in profit or loss on the purchase, sale, issue or cancellation of the Group's own equity instruments. Such treasury shares may be acquired and held by the Company or by other subsidiaries of the Group.

Share-based compensation – The Group calculates and records the fair value of equity instruments, such as stock options or restricted stock, awarded to employees for services received and recognizes such amounts in the consolidated statement of operations. The fair value of the equity instruments is measured on the date they are granted and is recognized over the period during which the employees are required to provide services in exchange for the equity instruments (Note 26). Share-based compensation expense includes the estimated effects of forfeitures. Such estimates are adjusted over the requisite service period to the extent actual forfeitures differ, or are expected to differ from such estimates. Changes in estimated forfeitures are recognized in the period of change and also impact the amount of expense to be recognized in future periods.

For phantom stock awards that include a component that will be settled in cash, and a component that is settled in equity, the Group accounts for the awards separately, based on their substance. For the component that is settled in cash, the awards generally are accounted for as liabilities with compensation cost recognized over the service (vesting) period of the award based on the fair value of the award remeasured at each reporting period. For the component that is settled in equity, compensation cost is measured based on the fair value of the award on the date of grant and the compensation cost is recognized over the service (vesting) period of the award.

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Retirement and post-retirement benefits – Subsidiaries of the Group contribute to local state pension funds and social funds, on behalf of their employees.

In Russia, starting from January 1, 2010, social contributions are calculated by the application of following rates: 26% – for accumulated personal income up to RUB 415,000, 0% – for the personal earnings above the aforementioned amount. Social contributions are allocated to three social funds, including a pension fund, and the rate of contributions to the pension fund is 20%. The contributions are expensed as incurred.

In the Ukraine, subsidiaries of the Group are required to contribute a specified percentage of each employee's payroll up to a fixed limit into a pension fund, an unemployment fund and a social security fund. The contributions are expensed as incurred.

In addition to the above, Intracom Telecom and MGTS have defined benefit plans to provide their employees certain benefits upon and after retirement. The net period cost of the Group's defined benefit plans is measured on an actuarial basis using the projected unit credit method and several actuarial assumptions. The recognition of expense for defined benefit plans is significantly impacted by estimates made by management such as discount rates used to value certain liabilities, expected return on assets, mortality rates, future rates of compensation increase and other related assumptions. Gains and losses occur when actual experience differs from actuarial assumptions. If such gains or losses exceed ten percent of the greater of plan assets or plan liabilities the Company amortizes those gains or losses over the average remaining service period of the employees.

The Group records in the statement of financial position the funded status of its pension plans based on the projected benefit obligation.

Borrowing costs – Borrowing costs are recognized as an expense in the period in which they are incurred. Borrowing costs for assets that require a period of time to get them ready for their intended use are capitalized and amortized over the related assets' estimated useful lives. The capitalized borrowing costs for the years ended December 31, 2011 and 2010 amounted to \$59.6 million and \$46.4 million, respectively.

Advertising costs – Advertising costs are expensed as incurred. Advertising costs for the year ended December 31, 2011 and 2010 were \$427.5 million and \$417.3 million, respectively, and were reflected as a component of selling, general and administrative expenses in the accompanying consolidated statements of operations.

Taxes other than income tax – Taxes other than income tax comprise excises, extraction tax and customs, which relate to the Bashneft, and property tax.

Redeemable noncontrolling interests – From time to time, in order to optimize the structure of business acquisitions and to defer payment of the purchase price the Group enters into put and call option agreements to acquire noncontrolling interests in the existing subsidiaries. These put and call option agreements qualify as redeemable securities and are accounted for at either redemption value or the fair value of redeemable noncontrolling interests as of the reporting date. The fair value of redeemable noncontrolling interests is assessed based on discounted future cash flows of the acquired entity ("Level 3" significant unobservable Inputs of the hierarchy established by the US GAAP guidance). Any changes in redemption value of redeemable noncontrolling interests are accounted for in the Group's retained earnings. Redeemable noncontrolling interests are presented as temporary equity in the consolidated statement of financial position.

Earnings per share – Basic earnings per share ("EPS") is based on net income attributable to the Company divided by the weighted average number of shares outstanding during the year.

Diluted EPS is based on net income attributable to the Company adjusted in certain circumstances, divided by the weighted average number of shares outstanding during the year, adjusted for the dilutive effect of all potential shares that were outstanding during the year. Such potentially dilutive shares are excluded when the effect would be to increase diluted earnings per share or reduce the diluted loss per share.

Diluted EPS reflect the potential dilution related stock options granted to employees. The diluted EPS is not different from basic for the years ended December 31, 2011 and 2010.

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Distributions to shareholders – Distributable retained earnings of the Group are based on amounts extracted from the statutory accounts of the Company (based on the Russian accounting standards) and may significantly differ from amounts calculated on the basis of U.S. GAAP.

Reclassifications and revisions – Certain comparative information presented in the consolidated financial statements for the years ended December 31, 2010 has been revised in order to achieve comparability with the presentation used in the consolidated financial statements for the year ended December 31, 2011. Such reclassifications and revisions were not significant to the Group financial statements, except for presentation of discontinued operations of Bashkirenergo (Note 4).

Recent accounting pronouncements

Adopted during the period

In October 2009, the Financial Accounting Standards Board ("FASB") amended the revenue recognition for multiple deliverable arrangements guidance to remove the non-software components of tangible products and certain software components of tangible products from the scope of existing software revenue guidance, resulting in the recognition of revenue similar to that for other tangible products. The FASB amended the revenue recognition for multiple deliverable arrangements guidance to require the use of the relative selling price method when allocating revenue in these types of arrangements. This method allows a vendor to use its best estimate of selling price if neither vendor specific objective evidence nor third party evidence of selling price exists when evaluating multiple deliverable arrangements. This updated guidance is effective prospectively for revenue arrangements entered into or materially modified in fiscal years beginning on or after June 15, 2010. The adoption of this guidance, effective January 1, 2011, did not have a significant impact on the Group's consolidated financial statements.

To be adopted in future periods

In June 2011, the FASB amended its guidance on the presentation of comprehensive income. Under the amended guidance, an entity has the option to present comprehensive income in either one continuous statement or two consecutive financial statements. A single statement must present the components of net income and total net income, the components of other comprehensive income and total other comprehensive income, and a total for comprehensive income. In a two-statement approach, an entity must present the components of net income and total net income in the first statement. That statement must be immediately followed by a financial statement that presents the components of other comprehensive income, a total for other comprehensive income, and a total for comprehensive income. The option under the current guidance that permits the presentation of components of other comprehensive income as part of the statement of changes in shareholders' equity has been eliminated. The amendment becomes effective for fiscal years, and interim periods within those years, beginning after December 15, 2011. Early adoption is permitted. This guidance will not have an impact on the amounts reported in the Group's consolidated financial statements as it is disclosure-only in nature.

In September 2011, the FASB updated the authoritative guidance on testing goodwill for impairment. The update gives entities carrying out goodwill impairment test an option of performing qualitative assessment before calculating the fair value of a reporting unit. If an entity determines, on the basis of qualitative factors, that the fair value of a reporting unit is more likely than not less than the carrying amount, the two-step impairment test would be required. The guidance is effective for all entities for annual and interim goodwill impairment tests performed for fiscal years beginning after December 15, 2011. The adoption of this guidance is not expected to have a significant impact on the Group's consolidated financial statements.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEARS ENDED DECEMBER 31, 2011 AND 2010

(Amounts in thousands of U.S. dollars, unless otherwise stated)

3. ACQUISITIONS

Business combinations in the year ended December 31, 2011

During the year ended December 31, 2011, the Group had no acquisitions which are considered to be individually material. The following table summarizes the information for business combinations which occurred during the year ended December 31, 2011:

Acquiree	Principal activity	Date of acquisition	Interest acquired	Acquiring segment	Purchase price (in millions)
Inteleca Group	Fixed line operator	April	100%	MTS	\$ 19.2
Infocentr	Fixed line operator	April	100%	MTS	15.4
Orenburgnefteproduct	Wholesale and retail of oil products	April	94%	Bashneft	119.3
Bashneft-Nefteproduct	Wholesale and retail of oil products	July	100%	Bashneft	101.7
Altair	Fixed line and Internet services	August	100%	MTS	25.6
Moskovia	Broadcasting company	September	56%	Other	22.7
TVT	Fixed line operator	October	100%	MTS	162.5
Scon and other	Retail of oil products	December	100%	Bashneft	17.8
Donskoe	Agriculture	December	100%	Other	15.7
Total					\$ 499.9

In July 2010, Bashneft acquired a 49.99% interest in ASPEC, a company engaged in the wholesale and retail of oil products, real estate development and automotive retail business, for a cash consideration of \$123 million. In July 2011, ASPEC was reorganized into two legal entities: ASPEC and Bashneft-Nefteproduct. As a result of the reorganization, Bashneft received 100% of Bashneft-Nefteproduct which accumulated ASPEC's petroleum products trading business, and simultaneously withdrew as shareholder from ASPEC which retained the other remaining businesses. The consideration transferred in this business combination was measured at the acquisition-date fair value of the Group's share in the part of ASPEC's businesses that was disposed of (i.e. the other remaining businesses). No resulting gain or loss has been recognized as a result of this transaction.

The following table summarizes the amounts of the assets acquired and liabilities assumed recognized at the acquisition date, as well as the fair value at the acquisition date of the noncontrolling interest in the acquirees:

	(in millions)
Current assets	\$ 180.5
Property, plant and equipment	273.4
Goodwill	241.7
Customer base	20.1
Other non-current assets	3.5
Current liabilities	(146.3)
Non-current liabilities	(46.7)
Noncontrolling interest	(26.3)
Purchase price	\$ 499.9

The purchase price allocation for TVT is provisional as the Group has not completed the valuation of the company's individual assets as of the date of these consolidated financial statements.

The goodwill arising from the acquisitions consists largely of the synergies which are expected to arise from combining the operations of the Group and acquired companies as well as to the economic potential of the markets in which the acquired companies operate. The goodwill arising on each particular acquisition was assigned to the acquiring segment. None of the goodwill recognized is expected to be deductible for income tax purposes. The customer base assets recognized as a result of the acquisitions are amortized over a period ranging from 8 to 14 years.

Pro forma results of operations have not been presented because the effects of these business combinations, both individually and in aggregate, were not material to the Group's consolidated results of operations.

SISTEMA JSFC AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEARS ENDED DECEMBER 31, 2011 AND 2010 (Amounts in thousands of U.S. dollars, unless otherwise stated)

Business combinations in the year ended December 31, 2010

Sky Link – In November 2009, the Group and Svyazinvest (“the Parties”) signed a non-binding memorandum of understanding, under which the Parties agreed to enter in a series of transactions which would ultimately result in (i) the disposal of the Group’s investment in Svyazinvest to a state-controlled enterprise; (ii) non-cash extinguishment of the Group’s indebtedness to Sberbank; (iii) an increase in the Group’s ownership in Sky Link from 50% to 100% and disposal of this 100% investment to Svyazinvest; and (iv) the disposal of 28% of MGTS’ common stock previously owned by Svyazinvest to the Group.

In April 2010 the Group raised its effective equity interest in Sky Link by 50% to 100%. This 100% interest had previously been agreed to be disposed of as a part of the transaction with Svyazinvest (see above), and was therefore classified as an asset held for sale upon the date of the Group acquiring 100% ownership. The purchase price allocation for the acquisition was as follows:

	(in millions)
Current assets	\$ 47.6
Non-current assets	541.3
Current liabilities	(135.2)
Non-current liabilities	(136.9)
Fair value of the Group’s investments as of the date of acquisition	(148.3)
Purchase price	\$ 168.5

In July 2010, the Group and Svyazinvest signed an exchange agreement where the parties agreed to exchange their interests in MGTS and Sky Link under certain conditions.

According to the share exchange agreement, Svyazinvest agreed to transfer to the Group 28% of ordinary shares in MGTS (23.3% of the share capital of MGTS), in exchange for Group’s 100% interest in Sky Link. Furthermore, the Group was to make an additional cash payment of RUB 450 million to Svyazinvest to cover the difference in value of MGTS and Sky Link shares, and the new shareholders of Sky Link agreed to settle its obligations to the Group in the total amount of approximately \$307.4 million. As a result of the transaction the Group recognized a gain on disposal of discontinued operations amounting to \$324.7 million.

Upon completion of the foregoing deal, the Group’s interest in MGTS increased to 93.3% and the noncontrolling interests attributable to MGTS decreased by \$410.3 million, with corresponding increase in additional paid-in capital of \$86.0 million.

Other – The following table summarizes the information for other business combinations which occurred during the year ended December 31, 2010:

Acquiree	Principal activity	Date of acquisition	Interest acquired	Acquiring segment	Purchase price (in millions)
Tenzor Telecom	Fixed line operator	February	100%	MTS	6.2
Penza Telecom	Fixed line operator	May	100%	MTS	19.3
M2M Telematics	Navigation and telematics	July	51%	Other	20.0
Multiregion	Fixed line operator	July	100%	MTS	123.6
Serebryany Bor	Lease of a building	October	100%	Other	5.9
Lank Telecom	Fixed line operator	December	100%	MTS	17.8
NMSK	Fixed line operator	December	100%	MTS	23.2
Total					\$ 216.0

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEARS ENDED DECEMBER 31, 2011 AND 2010

(Amounts in thousands of U.S. dollars, unless otherwise stated)

The following table summarizes the amounts of the assets acquired and liabilities assumed recognized at the acquisition date, as well as the fair value at the acquisition date of the noncontrolling interest in the acquirees:

		(in millions)
Current assets	\$	53.5
Property, plant and equipment		75.3
Goodwill		181.3
Customer base		115.7
Other non-current assets		38.3
Current liabilities		(153.3)
Non-current liabilities		(51.3)
Noncontrolling interest		(43.5)
Purchase price	\$	216.0

The goodwill arising from the acquisitions consists largely of the synergies expected from combining the operations of the Group and acquired companies as well as to the economic potential of the markets in which the acquired companies operate. The goodwill arising on each particular acquisition was assigned to the acquiring segment. None of the goodwill recognized is expected to be deductible for income tax purposes. The customer base assets recognized as a result of the acquisitions are amortized over a period ranging from 8 to 12 years.

In connection with the business combinations which occurred during the years ended December 31, 2011 and 2010 the Group incurred \$7.1 mln and \$12.7 mln of third-party acquisition related costs included in selling, general and administrative expenses in the consolidated statements of operations.

Acquisitions of noncontrolling interests in existing subsidiaries

From time to time the Group makes the acquisitions of noncontrolling interests in respects of its subsidiaries where it retains control. The Group accounted for these changes in its ownership interest as equity transactions.

In April 2011, a termination record was entered into the Unified State Register thereby legally completing the merger of OJSC Comstar-UTS ("Comstar"), MTS' fixed line subsidiary, into MTS. In accordance with the terms of the merger, qualifying holders of Comstar ordinary shares received ordinary shares of MTS at an exchange ratio of 0.825 MTS ordinary shares for each one Comstar ordinary share. A total of 98,853,996 Comstar shares were converted into existing MTS treasury shares as well as newly issued MTS shares. As a result, MTS' charter capital increased by 73,087,006 ordinary shares to a total of 2,066,413,144 ordinary shares. The transaction was accounted for directly in equity and resulted in the decrease of noncontrolling interest by \$244.2 million and corresponding increase in additional paid-in capital by \$102.4 million.

In September 2010, through voluntary tender offer, MTS acquired 37,614,087 ordinary Comstar shares, or approximately 9.0% of Comstar's issued share capital, for a total cost of RUB 8.28 billion (approximately \$271.89 million as of October 6, 2010). This brings MTS' total ownership interest in Comstar to 70.97% of Comstar's issued share capital (or 73.33% excluding treasury shares). The transaction was accounted for directly in equity.

In April 2010, Bashneft acquired 25% of shares of Sistema-Invest, a subsidiary of the Group, for a cash consideration of \$205 million. As a result of acquisition the Group's interest in Sistema-Invest increased to 90%. In December 2010 the Group's interest in Sistema-Invest increased to 100% for a cash consideration of \$120 million. The transactions in April and December 2010 were accounted for directly in equity and resulted in the decrease in noncontrolling interest by \$245.7 million and by \$35 million, respectively.

In February-April 2010, Bashneft made mandatory offers to acquire noncontrolling interests in Ufimsky Refinery, Ufaorgsintez, Ufaneftekhim, Novoil and Bashkirnefteproduct. As a result of subsequent purchases of noncontrolling interests the Group's ownership in these entities increased by 0.51%, 3.67%, 5.64%, 0.51% and 0.59% respectively for a total cash consideration of \$128.1 million. These transactions were accounted for directly in equity and resulted in the decrease in noncontrolling interest by \$119.1 million.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEARS ENDED DECEMBER 31, 2011 AND 2010 (Amounts in thousands of U.S. dollars, unless otherwise stated)

4. DISPOSALS AND DISCONTINUED OPERATIONS

Discontinued operations

Bashkirenergo – In December 2011, Sistema and INTER RAO UES, a Russian energy holding, signed a non-binding memorandum of understanding summarizing the intention of INTER RAO UES to acquire, and Sistema to sell, energy producing business of Bashkirenergo which now controls both energy producing and distribution power capacities. The results of operations of the generation business of Bashkirenergo are reported in discontinued operations in the consolidated statements of operations for all periods presented, and the assets and related liabilities are included in the consolidated statement of financial position as disposal group held for sale as of December 31, 2011 and 2010. Such assets and liabilities consisted of the following:

	<u>2011</u>	<u>2010</u>
Current assets	\$ 299,807	\$ 170,746
Non-current assets	1,109,257	1,153,606
Total assets of disposal group held for sale	<u>1,409,064</u>	<u>1,324,352</u>
Current liabilities	117,122	177,445
Non-current liabilities	131,195	86,904
Total liabilities of disposal group held for sale	<u>\$ 248,317</u>	<u>\$ 264,349</u>

The results of discontinued operations of Bashkirenergo for the years ended December 31, 2011 and 2010 were as follows:

	<u>2011</u>	<u>2010</u>
Total revenue	\$ 1,535,314	\$ 1,676,021
Total expense	(1,444,205)	(1,617,642)
Income from discontinued operations before income tax	<u>91,109</u>	<u>58,379</u>
Income tax expense	(24,047)	(22,642)
Income from discontinued operations, net of income tax effect	<u>\$ 67,062</u>	<u>\$ 35,737</u>

ESKB – In September 2011, the Group completed the sale of 100% interest in electricity retail company ESKB, a subsidiary of Bashkirenergo, to RusHydro for a total cash consideration of RUB 5.7 billion. As a result of this transaction, the Group recognized gain on disposal of discontinued operations of \$149.5 million.

The results of discontinued operations of ESKB for the years ended December 31, 2011 and 2010 were as follows:

	<u>2011</u>	<u>2010</u>
Total revenue	\$ 973,113	\$ 22,627
Total expense	(962,605)	(19,264)
Income from discontinued operations before income tax	<u>10,508</u>	<u>3,363</u>
Income tax expense	(2,137)	(841)
Income from discontinued operations, net of income tax effect	<u>\$ 8,371</u>	<u>\$ 2,522</u>

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WattDrive – In November 2011, the Group completed the sale of its 74.9% interest in WattDrive, a subsidiary of RTI. As a result of this transaction, the Group recognized gain on disposal of discontinued operations of \$12.3 million. Losses from discontinued operations of WattDrive amounted to \$4.2 million and \$1.0 million for the years ended December 31, 2011 and 2010, respectively.

Sky Link – As discussed in Note 3, during the year ended December 31, 2010, the Group recognized gain on disposal of discontinued operations of Sky Link of \$324.7 million. Loss from discontinued operations of Sky Link amounted to \$39.3 million for the year ended December 31, 2010.

Disposal of interests in subsidiaries and affiliates

Intourist – In July 2011, Intourist sold 50.1% interest in ITC, its wholly-owned subsidiary which managed Intourist's tour operating and retail business to Thomas Cook Group plc for a consideration of \$45 million satisfied by the cash payment of \$10 million and by the issue of \$35 million of the acquirer's shares. As a result of this transaction the Group recognized a gain in the amount of \$47.8 million. Upon disposal of the controlling interest, the Group accounted for its remaining equity interest in ITC in accordance with the equity method (Note 15).

5. CAPITAL TRANSACTIONS OF SUBSIDIARIES

MTS – In December 2011, MTS acquired 29% of the ordinary shares of MGTS from Sistema for RUB 10.56 billion (\$336.3 million as of December 1, 2011). Upon completion of this transaction, MTS' ownership interest in MGTS increased to 99.01% of the ordinary shares and 69.7% of the preferred shares, which overall totals 94.1% of MGTS charter capital. The transaction was accounted for directly in equity and resulted in decrease in noncontrolling interest for \$178.7 million and increase in additional paid-in capital for \$118.6 million.

In December 2010, MTS acquired 100% of Sistema Telecom from Sistema for RUB 11.59 billion (\$379.0 million as of December 27, 2010). Sistema Telecom's key assets consist of property rights in respect of the group of trademarks, including the distinctive "egg" trademarks of MTS, Comstar and MGTS, certain promissory notes previously issued by MTS in the amount of RUB 2.00 billion (\$65.5 million) and a 45% interest in TS-Retail, a 100% subsidiary of Sistema through direct and indirect ownership. The transaction was accounted for directly in equity and resulted in the decrease in noncontrolling interests by \$198.7 million.

SSTL – In March 2011, the Russian Federal Agency for State Property Management acquired a 17.14% interest in SSTL, through the acquisition of shares issued by SSTL for the rupee equivalent of \$600 million. As a result of this transaction the Group's share in SSTL decreased to 57%. In connection with the transaction the Group entered into a put option agreement to acquire this interest in SSTL during a one year period beginning five years after the purchase of shares in SSTL at the higher of \$777 million or their market value at that date determined by an independent appraiser. The Group accounted for the redeemable noncontrolling interest in SSTL at the redemption value and presented this as temporary equity in its consolidated statements of financial position.

RTI – In February 2011, the Group and the Bank of Moscow established RTI. The Group contributed its 97% interest in Concern RTI, a manufacturer of radiotechnical equipment, and RUB 2.88 billion (approximately \$97 million) in cash receiving 84.6% of the share capital of the newly established company. The Bank of Moscow invested RUB 3 billion (approximately \$100 million) of cash in exchange for 15.4% of the company's share capital. Upon completion of the deal, the effective ownership of the Group in Concern RTI decreased to 82.1% which resulted in the increase of noncontrolling interest by \$49.2 million.

In July 2011, Sistema sold its controlling interest in SITRONICS, a provider of telecommunication, IT and microelectronic solutions, to RTI, a fellow subsidiary (see discussion above). Upon completion of the deal, the effective ownership of the Group in SITRONICS decreased to 59.2% and resulted in the increase of noncontrolling interest by \$29.3 million.

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Sistema-Invest – In May 2011, the Group completed the reorganization of Sistema-Invest, its subsidiary holding the Group's investments in the oil and energy companies in the Republic of Bashkortostan, by merging into it Bashkir Integrated Energy Systems, UNKH-EnergolInvest, UNPZ-EnergolInvest and Novoil-EnergolInvest (the "Merged Entities") which were previously owned by a number of other Group subsidiaries including Bashneft, UNPZ, Novoil and Ufaneftekhim. During the merger, shares of the Merged Entities were converted into Sistema-Invest treasury shares and additionally issued ordinary shares. As a result of the reorganization, Sistema-Invest holds 50.17% of the ordinary shares of Bashkirenergo (47.87% of its charter capital) previously held by the Merged Entities. This transaction was accounted for directly in equity and resulted in an increase of noncontrolling interest by \$225.1 million.

Detsky Mir – In December 2010, Detsky Mir, a subsidiary of the Company, increased its share capital through an additional share issue offered to Sberbank in a private placement. Detsky Mir-Center issued 743 shares with a par value of RUB 100 representing 25%+1 share of the company's share capital after the additional issue. Sberbank acquired the interest in Detsky Mir for a total consideration of approximately RUB 3.4 billion (approximately \$111.6 million as of December 31, 2010). The strategic objective of the shareholders was to use the proceeds of the investment to grow the value of the business with the ultimate aim of attracting a strategic investor or achieving a similar event in the next several years. If this is not achieved within three years, and under certain other conditions, Sberbank will have the right to sell its interest in Detsky Mir to Sistema. The parties also agreed to certain pre-emptive and tag-along and drag-along rights in relation to their respective interests in Detsky Mir. The transaction was accounted for directly in equity and resulted in the increase in noncontrolling interests by \$12.7 million and corresponding increase in additional paid-in capital by \$96.5 million.

MTS Bank – In October 2010, MTS Bank issued additional shares, which were all purchased by the Group. As a result of transaction, the Group's share in MTS Bank increased to 99.3%. The transaction was accounted for directly in equity and resulted in a decrease in the noncontrolling interest of \$12.5 million.

Bashneft – In January 2010, as part of its plans to build a vertically integrated oil group, Sistema transferred its interest in Bashkirnefteproduct to Bashneft. This transaction was accounted for directly in equity and resulted in an increase in noncontrolling interests by \$53 million.

6. ASSETS FROM BANKING ACTIVITIES, NET

Assets from banking activities, net of an allowance for loan losses, as of December 31, 2011 and 2010 consisted of the following:

	2011	2010
Cash and cash equivalents	\$ 1,315,075	\$ 2,308,488
Loans to customers	4,146,685	3,326,827
Investments in securities (trading)	650,579	694,753
Loans to banks	243,167	477,108
Investments in securities (available-for-sale)	209,089	554,874
Other investments	197,375	197,351
Less: allowance for loan losses	(253,889)	(257,052)
Assets from banking activities, net	6,508,081	7,302,349
Less: amounts maturing after one year	(2,303,120)	(1,799,620)
Assets from banking activities, current portion	\$ 4,204,961	\$ 5,502,729

Major categories of loans to customers as of December 31, 2011 and 2010 comprise the following:

	2011	2010
Corporate customers	\$ 3,245,105	\$ 2,553,242
Individuals	901,580	773,585
Total	\$ 4,146,685	\$ 3,326,827

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As of December 31, 2011, approximately 73% and 1% of loans to corporate customers and individuals, respectively, were evaluated individually for impairment.

The following table presents the effective average interest rates by categories of loans as of December 31, 2011 and 2010:

	2011			2010		
	RUB	USD	Other	RUB	USD	Other
Loans to customers						
- corporate customers	11.1%	7.6%	11.2%	13.4%	11.6%	10.0%
- individuals	17.5%	10.5%	12.6%	16.5%	10.4%	12.6%
Loans to banks	3.9%	0.2%	0.7%	4.7%	0.4%	0.5%

As of December 31, 2011 and 2010, MTS Bank did not hold any investments classified as held-to-maturity. In May 2010, MTS Bank sold the part of its bank bonds in the amount of \$90.9 million, which were previously classified as held-to-maturity. The remaining portion of these bonds in the amount of \$232.3 million was reclassified to available-for-sale and accounted for at fair value.

The movement in the allowance for loan losses for the years ended December 31, 2011 and 2010 was as follows:

	2011	2010
Allowance for loan losses, beginning of the year	\$ 257,052	\$ 228,000
Additions charged to the results of operations	48,057	38,797
Write-off of allowance for loans	(37,494)	(9,126)
Currency translation adjustment	(13,726)	(619)
Allowance for loan losses, end of the year	\$ 253,889	\$ 257,052

7. SHORT-TERM INVESTMENTS

Short-term investments as of December 31, 2011 and 2010 consisted of the following:

	2011	2010
Bank deposits with original maturities exceeding 90 days	447,134	773,540
Promissory notes and loans	192,236	75,901
Investments in securities (trading)	124,080	2,827
Funds in trust management	-	26,986
Other	181	426
Total	\$ 763,631	\$ 879,680

Promissory notes and loans from third parties, which are primarily denominated in RUB, bear interest rates varying from 5.5% to 14.0% as of December 31, 2011.

The effective interest rates on bank deposits with original maturities exceeding 90 days as of December 31, 2011 are between 2.0% to 9.0% for RUB and USD denominated deposits.

As of December 31, 2010, the effective interest rates on bank deposits with original maturities exceeding 90 days were between 6.5% to 9.0% for RUB and USD denominated deposits.

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8. ACCOUNTS RECEIVABLE, NET

Accounts receivable, net of provision for doubtful accounts, as of December 31, 2011 and 2010 consisted of the following:

	2011	2010
Trade receivables	\$ 1,954,585	\$ 2,008,595
Less: provision for doubtful accounts	(198,307)	(228,172)
Total	\$ 1,756,278	\$ 1,780,423

Management anticipates no losses in respect of receivables from related parties and accordingly no provision has been created in respect thereof.

9. OTHER CURRENT ASSETS

Other current assets as of December 31, 2011 and 2010 consisted of the following:

	2011	2010
Prepaid expenses and other receivables	\$ 955,542	\$ 1,100,730
Tax advances and overpayments	592,605	460,941
Advances paid to third parties	324,791	312,228
	1,872,938	1,873,899
Less: provision for doubtful accounts	(150,094)	(188,563)
Total	\$ 1,722,844	\$ 1,685,336

10. INVENTORIES AND SPARE PARTS

Inventories and spare parts as of December 31, 2011 and 2010 consisted of the following:

	2011	2010
Work-in-progress	\$ 290,837	\$ 212,863
Finished goods and goods for resale	877,864	744,564
Raw materials and spare parts	552,079	505,500
Costs and estimated earnings in excess of billings on uncompleted contracts	15,143	6,686
	1,735,923	1,469,613
Less: long-term portion	(76,270)	(13,716)
Total	\$ 1,659,653	\$ 1,455,897

11. LOSS FROM IMPAIRMENT AND PROVISIONS OF OTHER ASSETS

Impairment losses recognized by the Group for the years ended December 31, 2011 and 2010 comprised of the following:

	2011	2010
Goodwill and licenses in SSTL	\$ 694,651	\$ -
Long-lived assets in MTS Turkmenistan	-	119,580
Other	336,611	193,801
Total	\$ 1,031,262	\$ 313,381

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Suspension of operating licenses in SSTL – On February 2, 2012 the Indian Supreme Court delivered its judgment on a public interest petition seeking cancellation of 122 cellular phone licences granted by the Government of India in 2008, including licenses granted to SSTL in 21 telecom circles (out of 22 existing 2G licenses). In its judgment the Court quashed all 122 licences issued on and after January 10, 2008, including those granted to SSTL. The Court's directions shall come into force after four months from February 2, 2012. Further, the Court directed the Telecom Regulatory Authority of India to make fresh recommendations for the grant of licences and the allocation of spectrum in the 2G band by auction, as was done for the allocation of spectrum in the 3G band.

As a consequence of the above cancellation, the Group reassessed the carrying amount of assets in SSTL as of December 31, 2011. Due to the withdrawal of licences, the total impairment loss of \$694.7 million was recognized, whereof the loss from impairment of operating licenses is \$346.0 million and the loss from impairment of goodwill is \$348.7 million.

Management of the Group has the intent and the ability to continue its operations in India, and has performed an analysis of the recoverability of the carrying amounts of other long-lived assets as of December 31, 2011. This analysis supported the carrying value of the assets as of December 31, 2011 of \$654.0 million and indicated that no impairment is required, based on the assumption of continuous use. Management also considered recent market transactions and current prices of the long-lived assets, and concluded that no impairment of other long-lived assets of SSTL has occurred.

In addition, SSTL's loan agreements contain clauses which allow lenders, under certain circumstances including the termination or alteration of telecom licenses, to declare all or part of the loans to be payable on demand. As a consequence of such clauses, the Group has classified all debt payable by SSTL in the amount of \$1,573.5 million as short-term in the Group's consolidated statement of financial position as of December 31, 2011.

Suspension of operating licenses in MTS Turkmenistan – In December 2010, MTS suspended its operations in Turkmenistan following a notice received from the Ministry of Communications of Turkmenistan informing of a decision to suspend licenses held by BCTI, its wholly-owned subsidiary in Turkmenistan, for a period of one month starting from December 21, 2010. On January 21, 2011, the period of license suspension expired, however, permission to resume operations was not granted. Following the decision to suspend the licenses, the Turkmenistan government authorities took further steps, including unilateral termination of interconnect agreements between BCTI and state-owned telecom operators, to prevent MTS from providing services to its customers. The Group initiated a number of proceedings against the Turkmenistan government authorities and the state-owned telecom operators to defend its legal rights.

On December 21, 2010, BCTI filed three requests for arbitration with the International Court of Arbitration of the International Chamber of Commerce ("ICC") against the Ministry of Communications of Turkmenistan and several state-owned telecom operators requesting specific performance on the respective agreements and compensation of damages. Subsequently, the sovereign state of Turkmenistan was joined as a respondent in the proceedings against the Ministry of Communications of Turkmenistan. An independent appraisal has shown that MTS and BCTI have suffered damages amounting to \$855 million as a result of breaches committed by the respondents. MTS have made a claim for this amount in the ICC proceedings. In March 2012 MTS and BCTI withdrew the demand for specific performance of the 2005 Agreement from its' claim against Ministry of Communications of Turkmenistan and Turkmenistan after negotiations with Turkmen government stopped at the end of 2011 and not resumed to date.

On January 21, 2011, MTS sent a formal notice to the Government of Turkmenistan requesting to resolve the dispute through negotiations and notifying it of its intention to file a claim pursuant to the provisions of the Bilateral Investment Treaty between the Russian Federation and Turkmenistan. The dispute was not resolved by negotiations and, accordingly, on September 1, 2011, MTS filed a claim against Turkmenistan in the International Centre for the Settlement of Investment Disputes ("ICSID"). On October 5, 2011, the claim was registered by the ICSID Secretariat.

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Considering the adverse impact of such circumstances on the Group's ability to conduct operations in Turkmenistan, the Group determined that all of its long-lived assets attributable to Turkmenistan were impaired and recorded an impairment charge of \$119.6 million, whereby the loss from the impairment of intangible assets was \$12.1 million and for property, plant and equipment was \$107.5 million. These impairments were recognized in the consolidated statement of operations for the year ended December 31, 2010. The Group also assessed the recoverability of the subsidiary's current assets and provided for or wrote down those which were considered to be impaired in the total amount of \$18.2 million.

12. PROPERTY, PLANT AND EQUIPMENT, NET

Property, plant and equipment, net of accumulated depreciation, as of December 31, 2011 and 2010 consisted of the following:

	2011	2010
Switches, transmission devices, network and base station equipment	\$ 12,161,261	\$ 11,295,627
Refining, marketing, distribution and chemicals	4,900,081	4,886,962
Exploration and production assets	3,767,298	3,758,454
Other plant, machinery and equipment	2,160,619	2,063,254
Buildings and leasehold improvements	1,658,871	1,782,206
Power and utilities	664,100	610,782
Construction in-progress and equipment for installation	2,415,512	1,678,000
Land	42,014	33,650
	27,769,756	26,108,935
Less: accumulated depreciation and depletion	(9,408,930)	(8,086,736)
Total	\$ 18,360,826	\$ 18,022,199

Depreciation and depletion expenses for the years ended December 31, 2011 and 2010 amounted to \$2,668.2 million and \$2,332.8 million respectively.

13. GOODWILL

The carrying amounts of goodwill attributable to each reportable segment are as follows:

	MTS	SSTL	RTI	MTS Bank	Other	Total
Balance as of January 1, 2010						
Gross amount of goodwill	\$ 1,176,889	\$ 441,393	\$ 124,157	\$ 64,072	\$ 2,508	1,809,019
Accumulated impairment loss	(48,466)	-	-	(63,560)	-	(112,026)
	1,128,423	441,393	124,157	512	2,508	1,696,993
Adjustments to preliminary allocations	(6,004)	-	-	-	-	(6,004)
Purchase price allocations	181,311	-	-	-	-	181,311
Currency translation adjustment	2,255	-	(2,404)	-	369	220
Balance as of December 31, 2010						
Gross amount of goodwill	1,354,081	441,393	121,753	64,072	2,877	1,984,176
Accumulated impairment loss	(48,096)	-	-	(63,560)	-	(111,656)
	1,305,985	441,393	121,753	512	2,877	1,872,520
Adjustments to preliminary allocations	6,945	-	-	-	-	6,945
Purchase price allocations	185,690	-	-	-	56,051	241,741
Impairment (Note 11)	-	(348,679)	-	-	-	(348,679)
Currency translation adjustment	(74,835)	(92,714)	176	-	(3,894)	(171,267)
Balance as of December 31, 2011						
Gross amount of goodwill	1,469,313	348,679	121,929	64,072	55,034	2,059,027
Accumulated impairment loss	(45,528)	(348,679)	-	(63,560)	-	(457,767)
	\$ 1,423,785	\$ -	\$ 121,929	\$ 512	\$ 55,034	\$ 1,601,260

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14. OTHER INTANGIBLE ASSETS, NET

Intangible assets other than goodwill as of December 31, 2011 and 2010 consisted of the following:

	2011			2010		
	Gross carrying value	Accumulated amortization	Net carrying value	Gross carrying value	Accumulated amortization	Net carrying value
Amortized intangible assets:						
Billing and telecommunication software	\$ 1,668,715	(1,042,773)	625,942	\$ 1,682,959	(1,056,324)	626,635
Acquired customer base	544,911	(215,267)	329,644	649,231	(236,326)	412,905
Radio frequencies	353,776	(138,546)	215,230	314,722	(100,496)	214,226
Operating licenses	702,311	(285,955)	416,356	1,410,192	(448,960)	961,232
Numbering capacity with finite contractual life, software and other	408,659	(31,541)	377,118	659,559	(137,739)	521,820
	3,678,372	(1,714,082)	1,964,290	4,716,663	(1,979,845)	2,736,818
Unamortized intangible assets:						
Trademarks	203,952	-	203,952	216,504	-	216,504
Numbering capacity with indefinite contractual life	82,924	-	82,924	68,596	-	68,596
Total intangible assets	\$ 3,965,248	(1,714,082)	2,251,166	\$ 5,001,763	(1,979,845)	3,021,918

Amortization expense recorded on other intangible assets for the years ended December 31, 2011 and 2010 amounted to \$613.4 million and \$530.0 million, respectively. The estimated amortization expense for each of the five following years and thereafter is as follows:

Year ended December 31,	
2012	\$ 602,700
2013	443,375
2014	282,408
2015	180,474
2016	116,992
Thereafter	338,341
	\$ 1,964,290

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

15. INVESTMENTS IN AFFILIATES

Investments in affiliates as of December 31, 2011 and 2010 consisted of the following:

	2011		2010	
	Voting power, %	Carrying value	Voting power, %	Carrying value
Belkamneft	38.5%	\$ 597,060	38.5%	\$ 559,784
Bashneft-Polus	74.9%	341,000	-	-
SITRONICS-Nano	49.8%	235,674	49.8%	243,366
MTS Belarus	49.0%	176,659	49.0%	227,130
ITC (Note 4)	49.9%	10,873	-	-
ASPEC (Note 3)	-	-	49.99%	107,185
RussNeft	49.0%	-	49.0%	-
Other	Various	21,385	Various	10,229
Total		\$ 1,382,651		\$ 1,147,694

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Belkamneft – In April 2009, upon obtaining control over Bashneft in business combination, the Group received a 38.5% interest in Belkamneft, a company engaged in the production of crude oil. Since the Group was unable to exert any influence over the operations of Belkamneft, it accounted for this investment using the cost method. This changed in April 2010 with the acquisition of a 49% interest in RussNeft, the controlling shareholder of Belkamneft; thereafter, while the Group's equity interest was unchanged, the Group was in a position to exert significant influence and consequently, the equity method of accounting was adopted. The excess of the fair value of the investment over its carrying value in the amount of \$477.4 million was recognized as gain in the consolidated statement of operations for the year ended December 31, 2010.

The financial position and results of operations of Belkamneft as of and for the years ended December 31, 2011 and 2010 were as follows:

	(unaudited)	
	2011	2010
Total assets	\$ 2,553,094	\$ 2,589,636
Total liabilities	448,498	462,671
Net income	195,852	87,949

Bashneft-Polus – In December 2011, in connection with the development of two oil fields named after R.Trebs and A.Titov located in the Nenets Autonomous District of Russia, Bashneft entered into an agreement with LUKOIL, to sell a 25.1% interest in Bashneft-Polus, its wholly-owned subsidiary holding the mineral rights for the development of the fields, for \$152.9 million accompanied by a shareholders' agreement.

The Group concluded that, although the Group retained a 74.9% interest in Bashneft-Polus, the shareholders agreement provides LUKOIL with substantive participating rights in the entity. The Group, therefore, deconsolidated Bashneft-Polus and began accounting for the entity under the equity method of accounting prospectively from the date control over the subsidiary was relinquished. The Group recognized a gain of \$34.6 million on this disposal, which was recognized in the Group's consolidated statement of operations for the year ended December 31, 2011. The Group recognized income tax expense in the amount of \$31.0 million associated with this transaction.

The financial position and results of operations of Bashneft-Polus as of and for the year ended December 31, 2011 were as follows:

	(unaudited)
Total assets	\$ 755,545
Total liabilities	300,436
Net income	-

SITRONICS-Nano – In October 2009, SITRONICS, a subsidiary of the Group, entered into an agreement to form SITRONICS-Nano, which is owned 49.75% by SITRONICS, 49.75% – by Russian Corporation of Nanotechnologies ("RUSNANO") and 0.5% – by another party. The primary purpose of SITRONICS-Nano is to acquire equipment and licenses necessary to launch 90 nanometer microchip production and to lease them to SITRONICS, and to provide project financing to SITRONICS. The equipment and licenses purchases are financed through the equity of SITRONICS-Nano and external borrowings.

SITRONICS-Nano is determined to be a variable interest entity where SITRONICS has a variable interest through a lease agreement and is not the primary beneficiary. SITRONICS accounts for the investment under the equity method.

RUSNANO has a put option to sell its shares to Sistema at market price plus 25% not earlier than in nine years and not later than in 10.5 years from the date of financing (December 2009). Sistema has a call option to acquire at any time RUSNANO's shares at RUB 6,480.0 million (\$201.3 million as of December 31, 2011) plus 18% p.a. In addition, during the first nine years of operations of SITRONICS-Nano on non-fulfillment of certain criteria, RUSNANO can put its share in SITRONICS-Nano to Sistema at RUB 6,480.0 million (\$201.3 million as of December 31, 2011) plus 18% p.a., less any net profit attributed and paid to RUSNANO during the period from the date of the put option application.

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The maximum exposure to a loss is determined as the Group's contribution to SITRONICS-Nano adjusted by the Group's share of distributed results of the investee and is equal to \$211.2 million.

The financial position and results of operations of SITRONICS-Nano as of and for the years ended December 31, 2011 and 2010 were as follows:

	(unaudited)	
	2011	2010
Total assets	\$ 500,661	\$ 449,488
Total liabilities	94,918	20,142
Net income/(loss)	919	(2,783)

MTS Belarus – The financial position and results of operations of MTS Belarus as of and for the year ended December 31, 2011 and 2010 were as follows:

	(unaudited)	
	2011	2010
Total assets	\$ 417,555	\$ 527,609
Total liabilities	92,884	72,533
Net income	107,533	145,707

RussNeft – In April 2010, the Group acquired a noncontrolling 49.0% interest in RussNeft, an oil and gas company, for a total cash consideration of \$20 million. The investment is accounted for using the equity method. As a result of the final measurement of the equity interest in RussNeft and the ongoing operational losses, the Group recognized a loss in the amount of \$20 million in the year ended December 31, 2010 bringing the carrying value of the Group's investment to nil in its consolidated statements of financial position. Nothing has been recognized in 2011 for this investment as the entity's net assets were still negative. As of December 31, 2011 the RussNeft's shares were pledged as a guarantee of payment of certain RussNeft debts.

The financial position and results of operations of Russneft as of and for the year ended December 31, 2011 and 2010 were as follows:

	(unaudited)	
	2011	2010
Total assets	\$ 5,307,259	\$ 6,219,259
Total liabilities	6,513,095	7,206,314
Net income	546,193	588,934

16. LONG-TERM INVESTMENTS

Long-term investments as of December 31, 2011 and 2010 consisted of the following:

	2011	2010
Bank deposits	\$ 772,867	\$ 108,025
Loans and notes	450,814	281,712
Other	71,006	80,005
Total	\$ 1,294,687	\$ 469,742

The effective interest rates on bank deposits as of December 31, 2011 are between 4.9% to 10.7% for RUB and USD denominated deposits.

Long-term investments as of December 31, 2011 include loan given to Bashneft-Polus, an affiliate of the Group, in amount of \$166 million.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEARS ENDED DECEMBER 31, 2011 AND 2010 (Amounts in thousands of U.S. dollars, unless otherwise stated)

17. LIABILITIES FROM BANKING ACTIVITIES

Liabilities from banking activities as of December 31, 2011 and 2010 consisted of the following:

	2011	2010
Term deposits	\$ 2,473,950	\$ 3,026,225
Deposits repayable on demand	2,089,509	2,026,740
Promissory notes issued and other liabilities	234,008	583,654
	4,797,467	5,636,619
Less: amounts maturing within one year	(3,152,989)	(4,191,836)
Total liabilities from banking activities, net of current portion	\$ 1,644,478	\$ 1,444,783

Liabilities from banking activities as of December 31, 2011 and 2010 include liabilities with affiliates and other related parties for \$240.1 million and \$153.8 million, respectively. The fair value of liabilities from banking activities approximates their carrying value.

The following table presents the effective average interest rates by categories of bank deposits and notes issued as of December 31, 2011 and 2010:

	2011			2010		
	RUB	USD	Other	RUB	USD	Other
Term deposits:						
- corporate customers	8.1%	4.2%	2.8%	6.9%	4.8%	3.8%
- individuals	7.8%	4.8%	4.4%	11.0%	7.8%	7.5%
Promissory notes issued	8.6%	1.1%	-	8.3%	5.0%	-
Deposits repayable on demand:						
- corporate customers	2.2%	-	-	1.6%	-	-
- individuals	0.4%	0.1%	0.1%	0.4%	0.2%	0.3%

18. ACCRUED EXPENSES AND OTHER CURRENT LIABILITIES

Accrued expenses and other current liabilities as of December 31, 2011 and 2010 consisted of the following:

	2011	2010
Customers' advances	\$ 777,162	\$ 724,518
Payroll and other accrued expenses	389,537	468,187
Accruals for services	308,457	365,447
Bitel liability (Note 27)	213,152	210,760
Accrued interest on loans	163,771	180,878
Tax and legal provisions	101,481	88,605
Financial instruments at fair value	40,917	57,473
Dividends payable	13,069	53,474
Advance for shares of SSTL (Note 5)	-	602,276
Other	355,222	526,075
Total	\$ 2,362,768	\$ 3,277,693

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19. SHORT-TERM LOANS PAYABLE

Short-term loans payable as of December 31, 2011 and 2010 consisted of the following:

	Interest rate (Actual at December 31, 2011)	2011	2010
<i>USD-denominated:</i>			
VTB	-	\$ -	\$ 200,000
Other	Various	18,274	14,890
		<u>18,274</u>	<u>214,890</u>
<i>RUB-denominated:</i>			
Zenit	10.25%-10.50%	28,912	8,844
Bank of Moscow	MOSPRIME+5.0% (12.22 %)	26,394	-
Sberbank	-	-	581,069
Other	Various	60,794	58,717
		<u>116,100</u>	<u>648,630</u>
<i>Other currencies</i>			
ING Bank	13%	128,225	154,171
Other	Various	37,011	41,296
Loans from related parties	Various	-	15,094
Total		\$ <u>299,610</u>	\$ <u>1,074,081</u>

20. LONG-TERM DEBT

Long-term debt as of December 31, 2011 and 2010 consisted of the following:

	2011	2010
Loans from banks and financial Institutions	\$ 10,326,198	\$ 7,229,309
Notes and corporate bonds	5,356,583	6,674,890
Capital leases	227,647	250,876
Loans from related parties	54,931	50,339
Vendor financing	133,705	95,590
Other borrowings	11,209	8,916
	<u>16,110,273</u>	<u>14,309,920</u>
Less: amounts maturing within one year	<u>(4,097,076)</u>	<u>(2,103,405)</u>
Total	\$ <u>12,013,197</u>	\$ <u>12,206,515</u>

The schedule of repayments of long-term debt over the five-year period and thereafter beginning on December 31, 2011 is as follows:

Year ended December 31,	
2012	\$ 4,097,076
2013	2,354,096
2014	1,467,499
2015	2,363,042
2016	2,189,133
Thereafter	<u>3,639,427</u>
Total	\$ <u>16,110,273</u>

SISTEMA JSFC AND SUBSIDIARIES

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Loans from banks and financial institutions – Loans from banks and financial institutions as of December 31, 2011 and 2010 consisted of the following:

	Maturity	Interest rate (Actual at December 31, 2011)	2011	2010
<i>USD-denominated:</i>				
Calyon, ING Bank N.V., Nordea Bank AB, Raiffeisen Zentralbank Osterreich AG	2012-2020	LIBOR + 1.15% (1.96%)	\$ 580,742	\$ -
Deutsche Bank	2012-2014	LIBOR + 1.55% (1.85%)	300,000	-
China Development Bank	2012-2017	LIBOR+1.5% (2.31%)	249,616	157,406
Gazprombank	2012-2014	LIBOR + 4.9% (5.48%)	229,309	-
Skandinaviska Enskilda Banken AB	2012-2017	LIBOR+ 0.23%-1.8% (1.03%-2.61%)	204,507	242,013
Bank of China	2012-2017	LIBOR+1.5%-1.95% (2.31%-2.76%)	139,805	139,960
Bank of Moscow	2014-2018	LIBOR + 6.75%-9.5% (7.33-9.8%)	117,450	-
EBRD	2012-2014	LIBOR+1.51%-3.1% (2.32%-3.91%)	83,333	116,667
HSBC Bank plc and ING BHF Bank AG	2012-2014	LIBOR+0.3% (1.11%)	51,503	71,244
HSBC Bank plc, ING Bank AG and Bayerische Landesbank	2012-2015	LIBOR+0.3% (1.11%)	42,961	59,570
Citibank International plc and ING Bank N.V.	2012-2013	LIBOR+0.43% (1.23%)	40,688	62,486
Commerzbank AG, ING Bank AG and HSBC Bank plc	2012-2014	LIBOR+0.3% (1.11%)	36,495	51,285
Golden Gates (Bank of Moscow)	2012	9.75%	20,000	306,000
Societe Generale	2012-2016	LIBOR+1.25% (2.06%)	18,860	20,768
The Royal Bank of Scotland	2012-2013	LIBOR+0.35% (1.16%)	12,574	61,361
Barclays Bank plc	-	-	-	46,047
Troika Dialog Bank	-	-	-	30,000
Other	Various	Various	6,324	14,128
			2,134,167	1,378,935
<i>EUR-denominated:</i>				
Bank of China	2012-2016	EURIBOR+1.95% (3.57%)	116,812	35,123
Syndicated Loan to Intracom Telecom	2012	EURIBOR+4.5% (5.61%)	116,487	158,808
EBRD	2012	EURIBOR+5.2% (6.49%)	77,658	158,808
BNP Paribas	2012-2018	EURIBOR+1.65% (3.27%)	64,033	52,159
LBWW	2012-2017	EURIBOR+0.75% (2.37%)	36,215	43,201
The Royal Bank of Scotland	2012-2013	EURIBOR+0.35% (1.97%)	8,958	13,740
Other	Various	Various	16,282	18,346
			436,445	480,185
<i>RUB-denominated:</i>				
Sberbank	2013-2017	7.75%-8.90%	4,388,106	2,053,182
Gazprombank	2013-2018	8.75%-9.00%	1,830,699	990,914
Bank of Moscow	2013-2018	Mosprime+7.25% (14.47%)	590,309	459,364
Raiffeisenbank	2014	Mosprime+3% (9.37%-10.22%)	83,861	63,172
Unicredit	2014-2016	Mosprime+4.5%-7.5% (10.87%-13.87%)	69,271	66,927
ING Bank	2014	10.74%	32,613	-
VTB	-	-	-	492,176
VTB-Capital	-	-	-	492,176
Other	Various	Various	6,875	15,118
			7,001,734	4,633,029
<i>Other currencies:</i>				
State Bank of India	2012	13.5%	396,095	535,595
Other	Various	Various	357,757	201,565
			753,852	737,160
Total			\$ 10,326,198	\$ 7,229,309

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Certain loans from banks and financial institutions are subject to restrictive covenants, including, but not limited to compliance with certain financial ratios, limitations on dispositions of assets and transactions within the Group, retention of telecom licenses. As described in Note 11, SSTL's loan agreements contain clauses which allow lenders, under certain circumstances including the termination or alteration of telecom licenses, to declare all or part of the loans to be payable on demand.

As a consequence of such clauses, the Group has reclassified all debt payable by SSTL in the amount of \$1,573.5 million as short-term in the Group's consolidated statement of financial position as of December 31, 2011.

Equipment with carrying value of \$241.9 million has been pledged to collateralize some of the other loan facilities provided to the Group.

Notes and corporate bonds – Notes and corporate bonds as of December 31, 2011 and 2010 consisted of the following:

	Currency	Interest rate (December 31, 2011)	Fair value as of December 31, 2011	Carrying value as of December 31,	
				2011	2010
MTS International Notes due 2020	USD	8.6%	\$ 804,975	\$ 750,000	\$ 750,000
MTS Notes due 2016	RUB	14.3%	482,667	465,895	492,176
MTS Notes due 2020	RUB	8.2%	443,732	457,928	492,176
MTS Notes due 2014	RUB	7.6%	412,625	422,988	492,176
MTS Finance Notes due 2012	USD	8.0%	402,000	400,000	400,000
Bashneft Bonds due 2016	RUB	12.5%	371,950	357,301	1,640,587
Sistema JSFC Bonds due 2014	RUB	14.8%	366,747	352,641	648,155
Sistema JSFC Bonds due 2016	RUB	7.7%	344,691	349,940	-
Bashneft Bonds due 2014	RUB	9.4%	310,752	310,597	-
MTS Notes due 2018	RUB	8.0%	302,976	298,499	315,337
MTS Notes due 2017	RUB	8.7%	298,639	310,597	328,117
Sistema JSFC Bonds due 2016	RUB	12.5%	256,484	247,333	623,423
MTS Notes due 2015	RUB	7.8%	228,838	234,706	39,823
Sistema JSFC Bonds due 2013	RUB	9.8%	159,520	154,829	196,870
SITRONICS Bonds due 2013	RUB	10.8%	90,384	93,179	98,435
Intourist Bonds due 2013	RUB	14.0%	61,498	62,119	65,623
SITRONICS Bonds due 2013	RUB	11.8%	39,070	39,011	41,212
DM-Center Bonds due 2015	RUB	8.5%	33,576	35,719	37,733
MTS Notes due 2013	RUB	7.0%	12,652	13,318	13,250
			5,423,776	5,356,600	6,675,093
Less: unamortized discount			-	(17)	(203)
Total			\$ 5,423,776	\$ 5,356,583	\$ 6,674,890

All Group's RUB-denominated notes and corporate bonds are traded on MICEX-RTS, a Russian exchange. MTS International Notes due 2020 are traded on Irish stock exchange. MTS Finance Notes due 2012 redeemed in January 2012 were traded on Luxembourg stock exchange. The fair values of notes and corporate bonds are based on the market quotes as of December 31, 2011 at the exchanges where they are traded.

In certain instances the Group has an unconditional obligation to repurchase notes at par value if claimed by the noteholders, where a subsequent sequential coupon is announced. The notes therefore can be defined as callable obligations under the FASB authoritative guidance on debt, as the holders have the unilateral right to demand repurchase of the notes at par value upon announcement of new coupons. The FASB authoritative guidance on debt requires callable obligations to be disclosed as maturing in the reporting period, when the demand for repurchase could be submitted disregarding the expectations of the Group about the intentions of the noteholders. The Group discloses such notes in the aggregated maturities schedule as these are the reporting periods when the noteholders will have the unilateral right to demand repurchase.

Notes and corporate bonds are subject to certain financial and non-financial restrictive covenants, including, but not limited to, limitations on dispositions of assets, limitations on transactions with affiliates, compliance with certain financial ratios. Management believes that the Group is in compliance with all restrictive financial covenants relating to notes and corporate bonds as of December 31, 2011.

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21. INCOME TAX

The Group's income tax expense for the years ended December 31, 2011 and 2010 was as follows:

	<u>2011</u>	<u>2010</u>
Current provision	\$ 1,103,480	\$ 1,089,577
Deferred income tax benefit	<u>(14,934)</u>	<u>(24,097)</u>
Total	\$ <u>1,088,546</u>	\$ <u>1,065,480</u>

Income tax expenses is different from that which would be obtained by applying the statutory income tax rate to income from continuing operations before income tax expense and equity in net income of Energy companies in the Republic of Bashkortostan. The items causing this difference are as follows:

	<u>2011</u>	<u>2010</u>
Income tax provision computed on income from continuing operations before taxes at the statutory rate of 20%	\$ 409,334	\$ 572,204
Adjustments due to:		
Change in valuation allowance	281,221	105,129
Non-deductible expenses	279,166	240,116
Earnings distribution from subsidiaries	103,806	80,530
Effect of Group restructuring	3,543	75,400
Impairment of goodwill	69,740	-
Impairment of long-lived assets in Turkmenistan	-	27,565
(Reductions)/additions to unrecognized tax benefits	(4,034)	766
Settlements with tax authorities on prior period income tax	(10,497)	(27,252)
Foreign rates differential	(41,002)	(6,587)
Currency exchange and translation differences	<u>(2,731)</u>	<u>(2,391)</u>
Income tax expense	\$ <u>1,088,546</u>	\$ <u>1,065,480</u>

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The tax effects of temporary differences that give rise to the deferred tax assets and liabilities are presented below:

	2011	2010
Deferred tax assets:		
Property, plant and equipment	\$ 330,904	\$ 392,279
Tax losses carried forward	669,271	475,523
Accrued expenses	146,672	172,593
Inventory obsolescence	52,399	61,762
Allowance for doubtful accounts and loans receivable	26,994	38,904
Intangible assets	165,092	37,517
Deferred connection fees	42,818	31,522
Deferred revenues	16,755	20,832
Other	57,970	77,570
	1,508,875	1,308,502
Less: valuation allowance	(743,160)	(460,660)
Total deferred tax assets	765,715	847,842
Deferred tax liabilities		
Property, plant and equipment	(1,181,266)	(1,362,833)
Intangible assets	(235,117)	(257,604)
Undistributed earnings of subsidiaries and affiliates	(229,840)	(242,367)
Debt issuance costs	(20,975)	(34,966)
Other	(18,781)	(36,990)
Total deferred tax liabilities	\$ (1,685,979)	\$ (1,934,760)
Net deferred tax assets, current portion	\$ 311,891	\$ 357,821
Net deferred tax assets, net of current portion	348,589	304,761
Net deferred tax liabilities, current portion	(168,545)	(168,982)
Net deferred tax liabilities, net of current portion	(1,412,199)	(1,580,518)

The Group has the following significant balances for income tax losses carried forward as of December 31, 2011 and 2010:

Jurisdiction	Period for carry-forward	2011	2010
India	2012-2019	\$ 381,320	\$ 241,330
Luxembourg	Unlimited	125,124	124,464
Russia	2012-2021	160,189	94,164
Other	2012-2013	2,638	15,565
Total		\$ 669,271	\$ 475,523

Management has established the valuation allowances against certain deferred tax assets (see the table below), that are not more likely than not to be realized in future periods. In evaluating the Group's ability to realize its deferred tax assets, the Company considers all available positive and negative evidence, including operating results, ongoing tax planning, and forecasts of future taxable income on a jurisdiction by jurisdiction basis. The valuation allowance as of December 31, 2011 and 2010 relates to the following deferred tax assets:

	2011	2010
Tax losses carried forward	\$ 478,482	\$ 335,362
Impairment of licenses in SSTL	87,743	-
Sale of investment in Svyazinvest	66,596	66,887
Other	110,339	58,411
Total	\$ 743,160	\$ 460,660

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22. FAIR VALUE MEASUREMENTS AND DERIVATIVE FINANCIAL INSTRUMENTS

The following fair value hierarchy table presents information regarding Group's assets and liabilities measured at fair value on a recurring basis as of December 31, 2011 and 2010:

	Fair value measurements using			
	Quoted prices in active markets for identical assets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)	Total fair value
<i>December 31, 2011</i>				
Assets at fair value:				
Trading securities	774,659 \$	- \$	- \$	774,659
Available-for-sale securities	97,625	111,464	-	209,089
Interest rate swaps	-	2,341	-	2,341
Currency option agreements	-	894	-	894
Total assets	872,284	114,699	-	986,983
Liabilities at fair value:				
Interest rate swaps	-	(15,959)	-	(15,959)
Put options	-	-	(24,958)	(24,958)
Redeemable noncontrolling interests	-	-	(99,819)	(99,819)
Total liabilities	-	(15,959)	(124,777)	(140,736)
<i>December 31, 2010</i>				
Assets at fair value:				
Trading securities	697,580	-	-	697,580
Available-for-sale securities	328,502	226,372	-	434,098
Interest rate swaps	-	3,322	-	3,322
Currency option agreements	-	247	-	247
Total assets	1,026,082	229,941	-	1,135,247
Liabilities at fair value:				
Interest rate swaps	-	(31,315)	-	(31,315)
Put options	-	(11,636)	(22,689)	(34,325)
Cross-currency interest rate swaps	-	(3,469)	-	(3,469)
Currency option agreements	-	(2,612)	-	(2,612)
Redeemable noncontrolling interests	-	-	(107,343)	(107,343)
Total liabilities	- \$	(49,032)\$	(130,032)\$	(179,064)

23. SHARE CAPITAL

As of December 31, 2011 and 2010, the Company had 9,650,000,000 voting common shares with a par value of RUB 0.09 issued, of which 9,267,985,025 and 9,281,827,594 shares were outstanding, respectively.

Dividends declared by the Company in the years ended December 31, 2011 and 2010 are as follows:

	2011	2010
Dividends declared, million Rubles	2,509	530.8
Dividends declared, equivalent in million USD	87.1	17.5

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24. SEGMENT INFORMATION

The Group defines operating segments as components of an enterprise engaging in business activities about which separate financial information is available that is evaluated regularly by the chief operating decision maker or group in deciding how to allocate resources and in assessing performance. The Group's management evaluates the performance of the segments based on operating income.

In April 2011, the Group's Board of Directors approved a new organizational and management structure which established two business units based on the level of maturity of the various assets under management, namely "Core Assets" and "Developing Assets". This change of the structure caused the composition of the Group's reportable segments to change. The Group identified six reportable segments namely MTS and Bashneft, which form part of the Core Assets, and SSTL, MTS Bank and RTI, which form part of the Developing Assets, and Corporate division (Note 1). Information about operating segments that are not reportable due to their materiality have been combined and disclosed in the "Other" category. Prior period segment data has been restated to reflect these changes.

Intercompany eliminations presented below consist primarily of the following items: intercompany sales transactions, elimination of gross margin in inventory and other intercompany transactions conducted under the normal course of operations.

Financial information by reportable segment is presented below:

For the year ended December 31, 2011	Core Assets		Developing Assets			Other	Corporate	Total
	MTS	Bashneft	SSTL	MTS Bank	RTI			
Net sales to external customers ^(a)	12,312,501	16,537,117	262,264	529,012	1,355,363	1,947,440	37,551	32,981,248
Intersegment sales	6,187	11,969	-	31,894	737,676	27,537	26,998	842,261
Equity in results of affiliates	49,443	75,245	-	-	-	(3,759)	-	120,929
Net interest expense ^(b)	-	-	-	(1,912)	-	-	-	(1,912)
Depreciation, depletion and amortization	2,293,021	611,876	99,424	17,339	104,010	146,560	9,399	3,281,629
Operating income/(loss)	2,893,938	2,778,789	(1,196,084)	(23,510)	50,382	(129,373)	(228,712)	4,145,430
Interest income	62,559	74,021	34,152	-	13,028	74,310	102,685	360,755
Interest expense	656,898	559,806	162,442	-	83,403	110,684	274,569	1,847,802
Income tax expense/(benefit)	613,681	527,117	(6,747)	(5,118)	28,854	12,984	(82,225)	1,088,546
Investments in affiliates	176,659	937,601	-	-	214,625	16,527	37,239	1,382,651
Segment assets	15,919,243	13,530,524	1,113,191	6,978,934	2,629,665	4,079,014	3,135,691	47,386,262
Indebtedness ^(c)	8,700,407	3,393,314	1,573,523	-	1,126,471	369,382	1,246,786	16,409,883
Capital expenditures ^(d)	2,584,467	877,442	178,156	34,360	127,166	321,702	8,797	4,132,090

For the year ended December 31, 2010	Core Assets		Developing Assets			Other	Corporate	Total
	MTS	Bashneft	SSTL	MTS Bank	RTI			
Net sales to external customers ^(a)	11,295,251	11,705,968	114,615	588,946	1,169,343	1,898,620	38,576	26,811,319
Intersegment sales	3,805	772	-	24,779	462,473	3,926	24,736	520,511
Equity in results of affiliates	70,649	36,074	-	-	1,389	(15,877)	17,883	110,118
Net interest revenue ^(b)	-	-	-	24,444	-	-	-	24,444
Depreciation, depletion and amortization	2,000,495	591,477	81,822	18,571	97,950	64,895	7,544	2,862,754
Operating income/(loss)	2,744,107	2,301,342	(410,789)	21,329	82,604	84,251	(288,791)	4,534,053
Interest income	84,396	74,511	4,971	-	7,774	4,145	90,494	266,291
Interest expense	777,288	327,852	91,982	-	87,923	120,654	335,484	1,741,183
Income tax expense/(benefit)	566,339	417,154	-	11,727	29,327	42,218	(1,285)	1,065,480
Investments in affiliates	230,130	666,969	-	-	220,755	-	29,840	1,147,694
Segment assets	14,388,217	12,354,042	1,788,876	7,849,704	2,378,495	5,773,667	3,466,480	47,999,481
Indebtedness ^(c)	7,160,611	3,927,161	1,245,856	-	917,435	383,411	1,749,527	15,384,001
Capital expenditures ^(d)	2,647,117	1,088,772	169,000	19,151	91,236	105,344	58,954	4,179,574

(a) Interest income and expenses of the MTS Bank are presented as revenues from financial services and cost of financial services, correspondingly, in the Group's consolidated financial statements.

(b) Represents the net interest result of banking activities. In reviewing the performance of MTS Bank, the chief operating decision maker reviews the net interest result, rather than the gross interest amounts.

(c) Represents the sum of short-term and long-term debt.

(d) Represents purchases of property, plant and equipment and intangible assets.

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The following table summarizes dividends declared to Corporate division during the years ended December 31, 2011 and 2010:

	2011	2010
Bashneft, including		
OJSC Bashneft	\$ 495,938	\$ 738,525
OJSC Sistema-Invest	145,634	197,410
MTS, including		
OJSC MTS	543,863	535,439
OJSC MGTS	157,216	-

The reconciliation of segment operating income to the consolidated income from continuing operations before income tax expense and a reconciliation of segment assets to the consolidated segment assets are as follows:

	2011	2010
Total segment operating income	\$ 4,145,430	\$ 4,534,053
Intersegment eliminations	(203,969)	(231,410)
Operating income	3,941,461	4,302,643
Interest income	176,584	131,534
Change in fair value of derivative financial instruments	(2,268)	(2,062)
Interest expense	(1,742,690)	(1,597,244)
Foreign currency transactions (losses)/gains	(326,415)	26,151
Income from continuing operations before income tax	\$ 2,046,672	\$ 2,861,022

	December 31	
	2011	2010
Total segment assets	\$ 47,386,262	\$ 47,999,481
Intersegment eliminations	(3,484,241)	(3,833,433)
Total assets	\$ 43,902,021	\$ 44,166,048

For the years ended December 31, 2011 and 2010, the Group did not have revenues from transactions with a single external customer amounting to 10% or more of the Group's consolidated revenues. For the years ended December 31, 2011 and 2010 the Group's revenues outside of the RF were as follows:

	2011	2010
Ukraine	\$ 1,212,826	\$ 1,148,663
Uzbekistan	440,988	447,971
India	262,264	114,615
Armenia	200,450	207,281
Central and Eastern Europe	147,325	150,755
Greece	77,264	231,461
Turkmenistan	-	207,586
Other	170,585	433,802
Total	\$ 2,511,702	\$ 2,942,134

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As of December 31, 2011 and 2010, the Group's long-lived assets located outside of the RF were as follows:

	<u>2011</u>	<u>2010</u>
Ukraine	\$ 1,045,663	\$ 1,281,135
Uzbekistan	950,200	966,668
India	702,651	1,085,337
Armenia	430,653	485,007
Greece	98,938	110,045
Central and Eastern Europe	72,251	81,272
Other	73,086	88,043
Total	\$ <u>3,373,442</u>	\$ <u>4,097,507</u>

25. RELATED PARTY TRANSACTIONS

The Group provides services to and purchases services from affiliates. During the years ended December 31, 2011 and 2010, the Group entered into transactions with related parties as follows:

	<u>2011</u>	<u>2010</u>
Sales of goods and services	\$ (750,027)	\$ (864,187)
Revenue from banking activities	(13,926)	(11,554)
Cost of sales	249,197	8,097
Cost related to banking activities	550	14,043
Selling, general and administrative expenses	12,850	72,164

The Group enters into transactions to purchase and sell goods and services from and to its related parties in the normal course of business.

As of December 31, 2011 and 2010, the related party balances were as follows:

	<u>2011</u>	<u>2010</u>
Assets:	\$	
Cash and cash equivalents	1,038	1,457
Short-term investments	3,323	29,475
Accounts receivable, net	136,201	94,688
Other current assets	7,166	6,261
Long-term investments	188,043	144,144
Liabilities:		
Accounts payable	(46,225)	(63,781)
Accrued expenses and other current liabilities	(53,898)	(81,535)

Other related party balances as of December 31, 2011 and 2010 are disclosed in the corresponding notes to the financial statements.

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26. SHARE-BASED COMPENSATION

The Company, and several of its subsidiaries, operate share-based compensation plans in order to compensate their employees. This is done through either "equity" plans, in which employees may exercise their options for shares, or "phantom" plans, which generally allow employees to receive cash compensation which varies depending on the share price that the options are linked to.

Sistema JSFC Share-based Long-Term Motivation Program – In 2010, the Company's Board of Directors established a three-year motivational program for senior management ("Sistema JSFC Share-based Long-Term Motivation Program"). According to the program, participants were granted phantom shares of the Company upon their continued employment with the Group. Participants had right to convert up to two-thirds of phantom shares granted before December 31, 2010 into cash and the rest, including shares granted during 2011, were converted into ordinary shares of the Company in January 2012.

The grant-date fair value of an equity portion of the award was measured at the fair value of the Company's ordinary shares at grant-date and equated to \$83.8 million and \$54.3 million as of December 31, 2011 and 2010, respectively. The Group recognized \$31.7 million and \$75.5 million of compensation expense for the Company's Share-based Long-Term Motivation Program for the years ended December 31, 2011 and 2010, respectively.

In addition to the plans disclosed above, the Group has a number of share-based compensation plans in its subsidiaries, including MTS and Bashneft, not disclosed here on the basis of their lack of significance to the Group.

27. COMMITMENTS AND CONTINGENCIES

Operating leases – The Group leases land, buildings and office space mainly from municipal organizations through contracts which expire in various years through 2060.

Rental expenses under operating leases amounting to \$527.2 million and \$495.7 million for the years ended December 31, 2011 and 2010, respectively, and are included in selling, general and administrative expenses and operating expenses. Rental expenses under the operating leases amounting to \$232.0 million and \$182.4 million for the years ended December 31, 2011 and 2010 respectively, are included in cost of sales.

Future minimum rental payments under operating leases in effect as of December 31, 2011, are as follows:

Year ended December 31,	
2012	\$ 387,384
2013	186,023
2014	172,452
2015	171,873
2016	172,020
Thereafter	<u>568,870</u>
Total	\$ <u>1,658,622</u>

Agreement with Apple – In August 2008, MTS entered into an unconditional purchase agreement with Apple Sales International to buy 1.5 million iPhone handsets at the list price on the purchase date over a three year period. Pursuant to the agreement MTS is also required to incur certain iPhone promotion costs. As of December 31, 2011 MTS made 28.6% of its total purchase installment contemplated by the agreement. The total amount paid for handsets purchased under the agreement for the years ended December 31, 2011 and 2010 amounted to \$140.8 million and \$79.4 million, respectively.

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Capital commitments – As of December 31, 2011, the Group had executed purchase agreements of approximately \$764.1 million to acquire property, plant and equipment, intangible assets and costs related thereto.

Guarantees – As of December 31, 2011, MTS Bank and its subsidiaries guaranteed loans for several companies, including related parties, which totaled \$304.3 million. These guarantees would require payment by the Group only in the event of default on payment by the respective debtor. As of December 31, 2011, no event of default has occurred under any of the guarantees issued by the Group.

Commitments on loans and unused credit lines – As of December 31, 2011, MTS Bank and its subsidiaries had \$528.6 million of commitments on loans and unused credit lines available to its customers.

Taxation – Russia and the CIS countries currently have a number of laws related to various taxes imposed by both federal and regional governmental authorities. Applicable taxes include VAT, corporate income tax (profits tax), a number of turnover-based taxes, and payroll (social) taxes. Laws related to these taxes have not been in force for significant periods, in contrast to more developed market economies; therefore, the government's implementation of these regulations is often inconsistent or nonexistent. Accordingly, few precedents with regard to tax rulings have been established. Tax declarations, together with other legal compliance areas (for example, customs and currency control matters), are subject to review and investigation by a number of authorities, which are enabled by law to impose extremely severe fines, penalties and interest charges. These facts create tax risks in Russia and the CIS countries that are more significant than those typically found in countries with more developed tax systems.

Generally, according to Russian tax legislation, tax declarations remain open and subject to inspection for a period of three years following the tax year. As of December 31, 2011, tax declarations of the Company and its subsidiaries in Russia for the preceding one-three fiscal years are open for further review.

During 2011 and 2010 the Russian tax authorities completed the tax audits of the number of Group's subsidiaries. Based on the results of this audits, the Russian tax authorities assessed that \$61.8 million and \$17.4 million in additional taxes, penalties and fines were payable by the Group as of December 31, 2011 and 2010, respectively. The Group partially appealed in courts of original jurisdictions.

Management believes that it has adequately provided for tax and customs liabilities in the accompanying consolidated financial statements. As of December 31, 2011 and 2010, the provision accrued amounted to \$7.1 million and \$10.0 million, respectively. In addition, the accrual for unrecognized income tax benefits, potential penalties and interest recorded in accordance with the authoritative guidance on income taxes totaled \$22.4 million and \$17.8 million as of December 31, 2011 and 2010, respectively. However, the risk remains that the relevant authorities could take differing positions with regard to interpretive issues and the effect could be significant.

With regard to matters where practice concerning payment of taxes is unclear, management estimated possible tax exposure to be approximately \$550 million and \$184 million as of December 31, 2011 and 2010, respectively.

Pricing of revenue and expenses between each of the Group's subsidiaries in the course of its activities might be subject to transfer pricing rules. The Group's management believes that taxes payable are calculated in compliance with the applicable tax regulations relating to transfer pricing. However there is a risk that the tax authorities may take a different view and impose additional tax liabilities. As of December 31, 2011 and 2010, no provision was recorded in the consolidated financial statements in respect of such additional claims.

Bitel – In December 2005, MTS Finance, a subsidiary of MTS, acquired a 51.0% interest in Tarino Limited ("Tarino"), from Nomihold Securities Inc. ("Nomihold"), for \$150.0 million in cash based on the belief that Tarino was at that time the indirect owner, through its wholly owned subsidiaries, of Bitel LLC ("Bitel"), a Kyrgyz company holding a GSM 900/1800 license for the entire territory of Kyrgyzstan.

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Following the purchase of the 51.0% interest, MTS Finance entered into a put and call option agreement with Nomihold for "Option Shares," representing the remaining 49.0% interest in Tarino shares and a proportional interest in Bitel shares. The call option was exercisable by MTS Finance from November 22, 2005 to November 17, 2006, and the put option was exercisable by Nomihold from November 18, 2006 to December 8, 2006. The call and put option price was \$170.0 million.

Following a decision of the Kyrgyz Supreme Court on December 15, 2005, Bitel's corporate offices were seized by a third party. As the Group did not regain operational control over Bitel's operations in 2005, it accounted for its 51.0% investment in Bitel at cost as at December 31, 2005. The Group appealed the decision of the Kyrgyz Supreme Court in 2006, but the court did not act within the time period permitted for appeal. The Group subsequently sought the review of this dispute over the ownership of Bitel by the Prosecutor General of Kyrgyzstan to determine whether further investigation could be undertaken by the Kyrgyz authorities.

In January 2007, the Prosecutor General of Kyrgyzstan informed the Group that there were no grounds for involvement by the Prosecutor General's office in the dispute and that no legal basis existed for the Group to appeal the decision of the Kyrgyz Supreme Court. Consequently, the Group decided to write off the costs relating to the purchase of the 51.0% interest in Bitel, which was reflected in its consolidated financial statements for the year ended December 31, 2006. Furthermore, with the impairment of the underlying asset, a liability of \$170.0 million was recorded with an associated charge to earnings.

In November 2006, MTS Finance received a letter from Nomihold purporting to exercise the put option and sell the Option Shares for \$170.0 million to MTS Finance. In January 2007, Nomihold commenced an arbitration proceeding against MTS Finance in the London Court of International Arbitration in order to compel MTS Finance to purchase the Option Shares. Nomihold sought specific performance of the put option, unspecified monetary damages, interest, and costs. In January 2011 the London Court of International Arbitration made an award in favor of Nomihold satisfying Nomihold's specific performance request and ordered MTS Finance to pay to Nomihold \$170.0 million for the Option Shares, \$5.9 million in damages and \$34.9 million in interest and other costs – all representing in total approximately \$210.8 million ("Award"). An amount of the Award is bearing an interest until Award is satisfied. In addition to the \$170.0 million liability related to this case and accrued in the year ended December 31, 2006, the Group recorded an additional loss in amount of \$40.8 million and \$3.2 million in the consolidated financial statements for the year ended December 31, 2010 and 2011, respectively, representing interest accrued on the awarded sums.

On January 26, 2011, Nomihold obtained a freezing order in respect of the Award from the English High Court of Justice which, in part, restricts MTS Finance from dissipating its assets. Additionally, MTS Finance has been granted permission to appeal the Award, but the Court has imposed conditions upon the appeal. MTS Finance is currently seeking to have the conditions lifted.

Further on February 1, 2011, Nomihold obtained an order of the Luxemburg District Court enforcing the Award in Luxembourg. This order is in the process of being appealed.

As an issuer of US \$400,000,000 2012 Notes pursuant to an Indenture dated January 28, 2005 (as amended) ("the Notes"), MTS Finance was due to redeem the principal of the Notes and pay the final coupon payment on January 30, 2012. However as a result of the freezing order, MTS applied to and obtained from the English Court an order authorizing both payments to be made by MTS on behalf of MTS Finance ("the Direct Payments"). The Direct Payments to noteholders by the trustee under the Indenture were made on or around January 28, 2012.

The Direct Payments were made despite an obligation under an intercompany loan agreement dated January 28, 2005 between MTS and MTS Finance ("the Intercompany Loan Agreement") to process the payments through MTS Finance. However because MTS Finance was subject to a freezing order and not capable of transferring out the money to the trustee for distribution, and because MTS owed obligations to the noteholders as guarantor under the Indenture, MTS decided to make the Direct Payments to the noteholders pursuant to an order of the English Court.

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In relation to the obligations under the Intercompany Loan Agreement, MTS and MTS Finance have agreed to refer to arbitration the question of whether under the Intercompany Loan Agreement itself there remains an obligation to make any further payments to MTS Finance in light of the Direct Payment. On February 9, 2012, MTS received a request for arbitration from MTS Finance. The process is underway and will clarify the rights between the parties under the Intercompany Loan Agreement. MTS denies that any further payments are due under the Intercompany Loan Agreement. The arbitration will be conducted under the Rules of the London Court of International Arbitration and it is expected to last between 6 and 12 months.

In addition, three Isle of Man companies affiliated with the Group (the "KFG Companies"), have been named defendants in lawsuits filed by Bitel in the Isle of Man seeking the return of dividends received by these three companies in the first quarter of 2005 from Bitel in the amount of approximately \$25.2 million plus compensatory damages, and to recover approximately \$3.7 million in losses and accrued interest. In the event that the defendants do not prevail in these lawsuits, the Group may be liable to Bitel for such claims. Bitel's Isle of Man advocates have recently withdrawn from their representation of Bitel, and Bitel does not appear to be pursuing these claims.

In January 2007, the KFG Companies asserted counterclaims against Bitel, and claims against other defendants, including Altimo LLC ("Altimo"), Altimo Holdings & Investments Limited ("Altimo Holdings"), CP-Crédit Privé SA and Fellowes International Holdings Limited, for the wrongful misappropriation and seizure of Bitel. The defendants sought to challenge the jurisdiction of the Isle of Man courts to try the counterclaims asserted by the KFG Companies.

On March 10, 2011, the Judicial Committee of the UK Privy Council ruled in favor of the KFG Companies and confirmed the jurisdiction of the Isle of Man courts to try the counterclaims asserted by the KFG Companies against various defendants, including Sky Mobile, Altimo and Altimo Holdings, for the wrongful misappropriation and seizure of Kyrgyz telecom operator Bitel and its assets.

On June 30, 2011, the KFG Companies obtained from the Isle of Man court a general asset freezing injunction over the assets of Altimo and Altimo Holdings. The general freezing injunction against Altimo Holdings was replaced on November 30, 2011 by a specific freezing injunction over (i) Altimo Holding's interest in its Dutch subsidiary, Altimo Coöperatief U.A., and (ii) VimpelCom common shares worth \$500 million that Altimo Coöperatief U.A. has lodged with the Isle of Man court. The KFG Companies are proceeding with their counterclaims in the Isle of Man. A trial has been set to commence in May 2013.

In a separate arbitration proceeding initiated against the KFG Companies by Kyrgyzstan Mobitel Investment Company Limited ("KMIC"), under the rules of the London Court of International Arbitration, the arbitration tribunal in its award found that the KFG Companies breached a transfer agreement dated May 31, 2003 (the "Transfer Agreement"), concerning the shares of Bitel. The Transfer Agreement was made between the KFG Companies and IPOC International Growth Fund Limited ("IPOC"), although IPOC subsequently assigned its interest to KMIC, and KMIC was the claimant in the arbitration. The tribunal ruled that the KFG Companies breached the Transfer Agreement when they failed to establish a date on which the equity interests in Bitel were to be transferred to KMIC and by failing to take other steps to transfer the Bitel interests. This breach occurred prior to MTS Finance's acquisition of the KFG Companies. The arbitration tribunal ruled that KMIC is entitled only to damages in an amount to be determined in future proceedings. The tribunal is currently deciding whether to stay the damages phase of the LCIA proceedings pending conclusion of the Isle of Man proceedings. The Group is not able to predict the outcome of these proceedings or the amount of damages to be paid, if any.

3G license – In May 2007, the Federal Service for Supervision in the Area of Communications and Mass Media awarded MTS a license to provide 3G services in the RF. The 3G license was granted subject to certain capital and other commitments. The major conditions are that the Group will have to build a certain number of base stations that support 3G standards and will have to start providing services in the RF by a certain date, and will have to build a certain number of base stations by the end of the third, fourth and fifth years from the date of granting the license. Management believes that as of December 31, 2011 the Group is in compliance with these conditions.

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Other – In the ordinary course of business, the Group is a party to various legal proceedings, and subject to claims, certain of which relate to the developing markets and evolving fiscal and regulatory environments in which the Group operates. In the opinion of management, the Group's liability, if any, in all pending litigation, other legal proceedings or other matters will not have a material effect upon the financial condition, results of operations or liquidity of the Group.

28. SUBSEQUENT EVENTS

For the purpose of the accompanying consolidated financial statements, subsequent events have been evaluated through April 20, 2012.

Acquisition of noncontrolling interest in NIS – In February 2012, the Group increased its interest in NIS, a federal GPS network operator, from 51% to 70% through an acquisition of an additional issue of NIS' shares paid by contributing its 51% interest in M2M Telematics, acquired in 2010 (Note 3), to the charter capital of NIS.

Voluntary tender offer for noncontrolling interest in SITRONICS – In March 2012, RTI, a subsidiary of the Group, made a voluntary tender offer to acquire up to 36.9% of SITRONICS' common shares, representing all noncontrolling interest in the company including the shares underlying SITRONICS GDRs. The offer period remains open until May 22, 2012.

Motivation program – In January 2012, Sistema JSFC granted approximately 1% of the Company's charter capital to certain members of management and Board of Directors within the framework of Sistema JSFC Share-based Long-Term Motivation Program (Note 26).

29. SUPPLEMENTARY INFORMATION ON OIL AND GAS EXPLORATION AND PRODUCTION ACTIVITIES (UNAUDITED)

This section provides unaudited supplemental information on oil and gas exploration and production activities in accordance with ASC No. 932 Extractive Activities – Oil and Gas, subtopic 235, Notes to Financial Statements (ASC No. 932) in six separate tables:

- I. Capitalized costs relating to oil and gas producing activities;
- II. Costs incurred in oil and gas property acquisition, exploration, and development activities;
- III. Results of operations for oil and gas producing activities;
- IV. Reserve quantity information;
- V. Standardized measure of discounted future net cash flows;
- VI. Principal sources of changes in the standardized measure of discounted future net cash flows.

Amounts shown for equity companies represent the Group's share in its exploration and production affiliates, which are accounted for using the equity method of accounting.

I. Capitalized costs relating to oil and gas producing and exploration activities

As of December 31, 2011

	Consolidated subsidiaries	Group's share in equity investees
Unproved oil and gas properties	\$ -	\$ 358,659
Proved oil and gas properties	3,699,741	2,111,775
Accumulated depreciation, depletion and amortization	(475,813)	(554,230)
Net capitalized costs	<u>\$ 3,223,928</u>	<u>\$ 1,916,204</u>

As of December 31, 2010

	Consolidated subsidiaries	Group's share in equity investees
Unproved oil and gas properties	\$ 48,799	\$ -
Proved oil and gas properties	3,693,491	2,020,998
Accumulated depreciation, depletion and amortization	(315,900)	(414,135)
Net capitalized costs	<u>\$ 3,426,390</u>	<u>\$ 1,606,863</u>

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(Amounts in thousands of U.S. dollars, unless otherwise stated)

II. Costs incurred in oil and gas property acquisition, exploration, and development activities

Year ended December 31, 2011	Consolidated subsidiaries	Group's share in equity investees
Acquisition of proved properties	\$ -	\$ -
Acquisition of unproved properties	-	358,659
Exploration costs	15,948	11,029
Development costs	471,955	174,516
Total costs incurred	<u>\$ 487,903</u>	<u>\$ 544,204</u>

Year ended December 31, 2010	Consolidated subsidiaries	Group's share in equity investees
Acquisition of proved properties	\$ -	\$ 13,028
Acquisition of unproved properties	48,799	-
Exploration costs	8,004	3,775
Development costs	240,321	66,370
Total costs incurred	<u>\$ 297,124</u>	<u>\$ 83,173</u>

III. Results of operations for oil and gas producing activities

The Group's results of operations for oil and gas producing activities are presented below. In accordance with ASC No. 932, transfers to Group companies are based on market prices estimated by management. Income taxes are based on statutory rates. The results of operations exclude corporate overhead and interest costs.

Year ended December 31, 2011	Consolidated subsidiaries	Group's share in equity investees
Sales	\$ 1,499,992	\$ 1,227,109
Transfers	3,350,651	141,961
Total revenues	<u>4,850,643</u>	<u>1,369,070</u>
Production costs (excluding production taxes)	(759,000)	(248,474)
Exploration expenses	(15,948)	(11,029)
Depreciation, depletion and amortization	(219,897)	(154,920)
Accretion expense	(23,237)	(2,271)
Taxes other than income taxes	(1,937,304)	(545,930)
Related income tax	(379,051)	(93,848)
Total results of operation of producing activities	<u>\$ 1,516,206</u>	<u>\$ 312,598</u>

Year ended December 31, 2010	Consolidated subsidiaries	Group's share in equity investees
Sales	\$ 984,403	\$ 471,682
Transfers	2,343,576	188,737
Total revenues	<u>3,327,979</u>	<u>660,419</u>
Production costs (excluding production taxes)	(623,800)	(129,909)
Exploration expenses	(8,004)	(2,516)
Depreciation, depletion and amortization	(170,612)	(57,313)
Accretion expense	(11,969)	(839)
Taxes other than income tax	(1,257,987)	(254,785)
Related income taxes	(251,121)	(47,642)
Total results of operation of producing activities	<u>\$ 1,004,486</u>	<u>\$ 167,415</u>

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IV. Reserve quantity information

Proved reserves are the estimated quantities of oil and gas reserves for which geological and engineering data demonstrate their recoverability with reasonable certainty in future years from known reservoirs under existing economic and operating conditions. In accordance with ASC No. 932 existing economic and operating conditions are based on the 12-months average price. Proved reserves do not include additional quantities of oil and gas reserves that may result from applying secondary or tertiary recovery techniques not yet tested and determined to be economic.

Proved developed reserves are the quantities of proved reserves expected to be recovered through existing wells with existing equipment and operating methods.

Due to the inherent uncertainties and the necessarily limited nature of reservoir data, estimates of reserves are inherently imprecise, require the application of judgment and are subject to change as additional information becomes available.

Management has included within proved reserves significant quantities which the Group expects to produce after the expiry dates of certain of its current production licenses in the Russian Federation. The Subsoil Law of the Russian Federation states that, upon expiration, a license is subject to renewal at the initiative of the license holder provided that further exploration, appraisal, production or remediation activities are necessary and provided that the license holder has not violated the terms of the license. The law applies both to newly issued and old licenses and the management believes that licenses will be renewed upon their expiration for the remainder of the economic life of each respective field.

Estimated net proved oil and gas reserves and changes for the year ended December 31, 2011 and December 31, 2010 are shown in the tables set out below.

Thousands of barrels (proved developed and undeveloped reserves)	Consolidated subsidiaries	Group's share in equity investees
Crude oil		
January 1, 2010	1,795,100	-
Acquisition of equity interest in RussNeft	-	462,458
Revisions of previous estimates	181,512	36,298
Purchase of hydrocarbons in place	-	3,903
Extensions and discoveries	-	-
Production	(100,712)	(20,886)
Sales of reserves	-	-
December 31, 2010	1,875,900	481,773
Revisions of previous estimates	198,295	83,116
Extensions and discoveries	-	-
Production	(107,554)	(32,121)
Sales of reserves	-	-
December 31, 2011	1,966,641	532,768
Proved developed reserves		
December 31, 2010	1,763,800	323,945
December 31, 2011	1,799,986	328,915
Proved undeveloped reserves		
December 31, 2010	112,100	157,828
December 31, 2011	166,655	203,853

The noncontrolling interest included in the above total proved reserves was 609,487 thousand barrels and 506,493 thousand barrels as of December 31, 2011 and 2010, respectively. The noncontrolling interest included in the above proved developed reserves was 557,839 thousand barrels and 476,199 thousand barrels as of December 31, 2011 and 2010, respectively.

The Company's proved oil reserves are located entirely in the Russian Federation.

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V. Standardized measure of discounted future net cash flows

The standardized measure of discounted future net cash flows, related to oil and gas reserves in the Group's most significant oil fields, is calculated in accordance with the requirements of ASC No. 932. Estimated future cash inflows from production are computed by applying the 12-months average price for oil and gas to year-end quantities of estimated net proved reserves. Adjustment in this calculation for future price changes is limited to those required by contractual arrangements in existence at the end of each reporting year. Future development and production costs are those estimated future expenditures necessary to develop and produce year-end estimated proved reserves based on year-end cost indices, assuming continuation of year-end economic conditions. Estimated future income taxes are calculated by applying appropriate year-end statutory tax rates. These rates reflect allowable deductions and tax credits and are applied to estimated future pre-tax net cash flows, less the tax bases of related assets. Discounted future net cash flows have been calculated using a ten percent discount factor. Discounting requires a year-by-year estimate of when future expenditures will be incurred and when reserves will be produced.

The information provided in the tables set out below does not represent management's estimate of the Group's expected future cash flows or of the value of the Group's proved oil and gas reserves. Estimates of proved reserve quantities are imprecise and change over time as new information becomes available. Moreover, probable and possible reserves, which may become proved in the future, are excluded from the calculations. The arbitrary valuation prescribed under ASC No. 932 requires assumptions as to the timing and amount of future development and production costs. The calculations should not be relied upon as an indication of the Group's future cash flows or of the value of its oil and gas reserves.

	Consolidated subsidiaries	Group's share in equity investees
As of December 31, 2011		
Future cash inflows	\$ 89,617,864	\$ 24,725,444
Future production and development costs	(48,995,633)	(15,045,873)
Future income tax expenses	<u>(8,124,446)</u>	<u>(1,935,914)</u>
Future net cash flows	<u>32,497,785</u>	<u>7,743,657</u>
Discount for estimated timing of cash flows (10% p.a)	<u>(20,619,374)</u>	<u>(4,368,914)</u>
Discounted future net cash flows	\$ 11,878,411	\$ 3,374,743
Noncontrolling interest in discounted future net cash flows	3,682,307	

	Consolidated subsidiaries	Group's share in equity investees
As of December 31, 2010		
Future cash inflows	\$ 66,653,165	\$ 15,166,680
Future production and development costs	(36,263,017)	(9,669,078)
Future income tax expenses	<u>(6,078,030)</u>	<u>(1,099,520)</u>
Future net cash flows	<u>24,312,118</u>	<u>4,398,082</u>
Discount for estimated timing of cash flows (10% p.a)	<u>(15,216,083)</u>	<u>(2,439,139)</u>
Discounted future net cash flows	\$ 9,096,035	\$ 1,958,943
Noncontrolling interest in discounted future net cash flows	2,455,929	

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VI. Principal sources of changes in the standardized measure of discounted future net cash flows

Consolidated subsidiaries	2011	2010
Discounted present value as at January 1	\$ 9,096,035	\$ 4,017,552
Sales and transfers of oil and gas produced, net of production costs and taxes other than income tax	(2,138,391)	(1,438,187)
Net changes in prices and production costs estimates	6,558,516	4,235,993
Net changes in mineral extraction taxes	(3,700,969)	(1,442,021)
Development costs incurred during the period	471,955	240,321
Changes in estimated future development costs	(236,136)	(419,299)
Revisions of previous quantity estimates	1,307,855	2,180,360
Net changes in income taxes	(644,395)	(758,859)
Accretion of discount	959,147	437,130
Other changes	204,794	2,043,045
Discounted present value at December 31	\$ 11,878,411	\$ 9,096,035

Group's share in equity investees	2011	2010
Discounted present value as at January 1	\$ 1,958,943	\$ 2,220,905
Net changes due to purchases of minerals in place	-	19,392
Sales and transfers of oil and gas produced, net of production costs	(563,637)	(273,208)
Net changes in prices and production costs estimates	2,869,933	38,964
Net changes in mineral extraction taxes	(1,195,214)	(434,834)
Extensions and discoveries, less related costs	-	-
Development costs incurred during the period	174,269	58,047
Changes in estimated future development costs	(177,524)	47,719
Revisions of previous quantity estimates	364,093	49,463
Net changes in income taxes	(322,407)	75,606
Accretion of discount	204,399	168,691
Other changes	61,888	(11,802)
Discounted present value at December 31	\$ 3,374,743	\$ 1,958,943

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