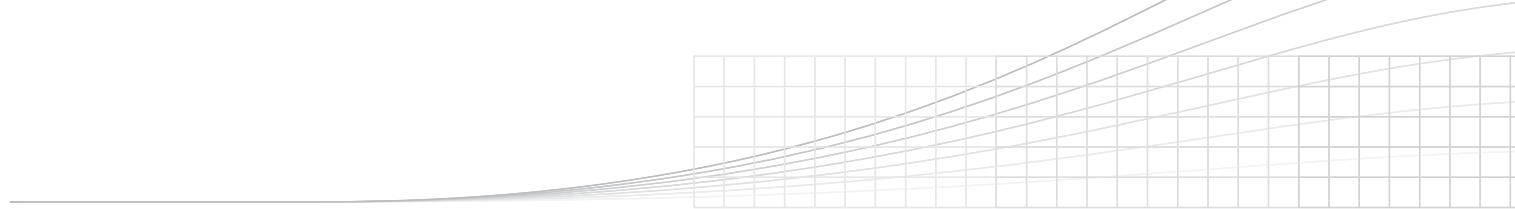




JOINT-STOCK FINANCIAL CORPORATION
SISTEMA

annual report 2006 **new shoots of growth**





annual report 2006

New shoots of growth
New Value for the Business

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About the Company

In the Business of Building Businesses

Sistema is the largest private sector consumer services company in Russia and the CIS. Founded in 1993, the corporation develops and manages a portfolio of market-leading businesses in selected service-based industries. In total, companies controlled by Sistema serve more than 65 million consumers in Russia, the CIS and Eastern and Western Europe. The corporation is focused on the development of advanced technologies not only to maximize its long-term return for shareholders, but also because it believes this represents its primary contribution to the economic development of Russia as well as the other markets where it operates.

Following an IPO in February 2005, 19% of Sistema's shares were traded on the London Stock Exchange in the form of global depositary receipts (GDRs) under the symbol 'SSA'. Sistema is also listed on the Moscow Stock Exchange under the ticker 'SIST' and on the Russian Trading System under the ticker 'AFKS'.

Sistema's primary business can be divided into two key areas: its core foundation business, where its companies are established market leaders, and high potential businesses, where the corporation's operating subsidiaries have the opportunity to establish long-term market leadership in developing consumer market segments. The corporation's foundation businesses are: Telecommunications, High Technology and Real Estate. Sistema's high potential businesses are: Retail, Finance, Mass Media and Venture Capital.

In addition, Sistema maintains a portfolio of other businesses, including: Tourism, Radio and Aerospace Technology, Medicine and Biotechnology. The corporation also has financial investments in the Petroleum sector.

Key business areas

TELECOMMUNICATIONS

MTS, COMSTAR-UTS, MTT, SKYLINK

TECHNOLOGY

SITRONICS

REAL ESTATE

SISTEMA-HALS

RETAIL

DETSKY MIR

FINANCE

MBRD

MASS MEDIA

SISTEMA MASS MEDIA

TOURISM

INTOURIST

RADIO & AEROSPACE TECHNOLOGY

RTI SYSTEMS

Other business areas

INSURANCE

ROSNO

MEDICINE & BIOTECHNOLOGY

MEDSI, BINNOFARM

PETROLEUM

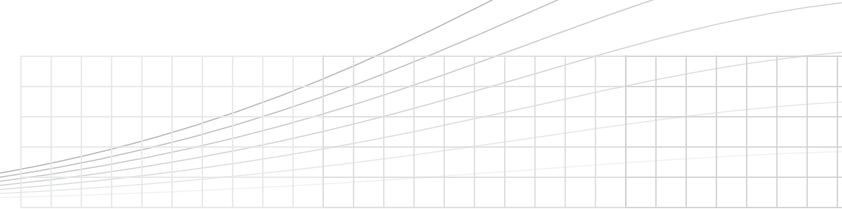
BASHNEFT, NOVOIL, UFANEFTEKHIM,
UFIMSKIY NPZ, BASHKIRNEFTEPRODUKT,
UFAORGSINTEZ

Financial highlights

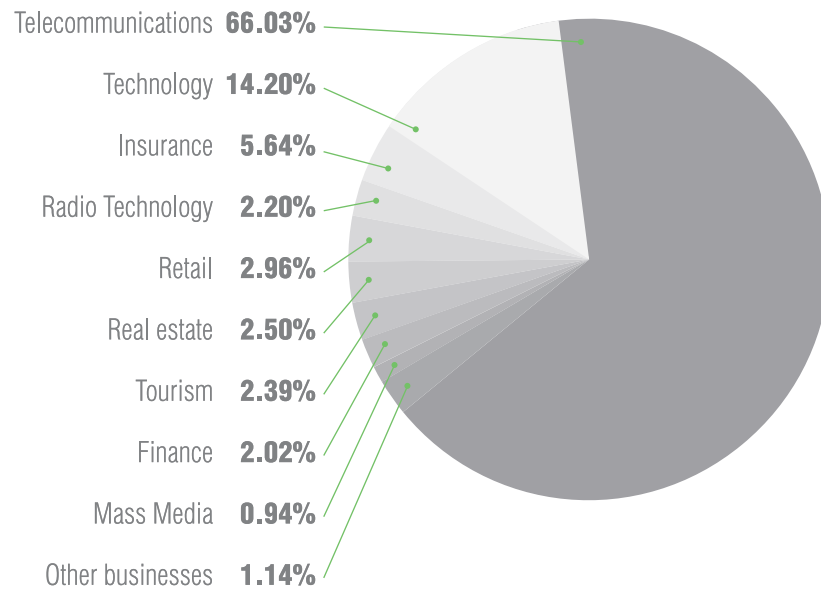
	Revenue (\$, million)	OIBDA ¹ (\$, million)	Net income (\$, million)
2006	10,862.8	4,023.5	903.3
2005	7,593.5	2,982.0	534.4
2004	5,733.9	2,462.0	411.2

	Assets (\$, million)	Shareholders' equity (\$, million)	Earnings per share (\$)
2006	20,131.5	4,611.0	94.4
2005	13,090.9	3,233.6	56.4
2004	8,823.3	1,442.2	50.8

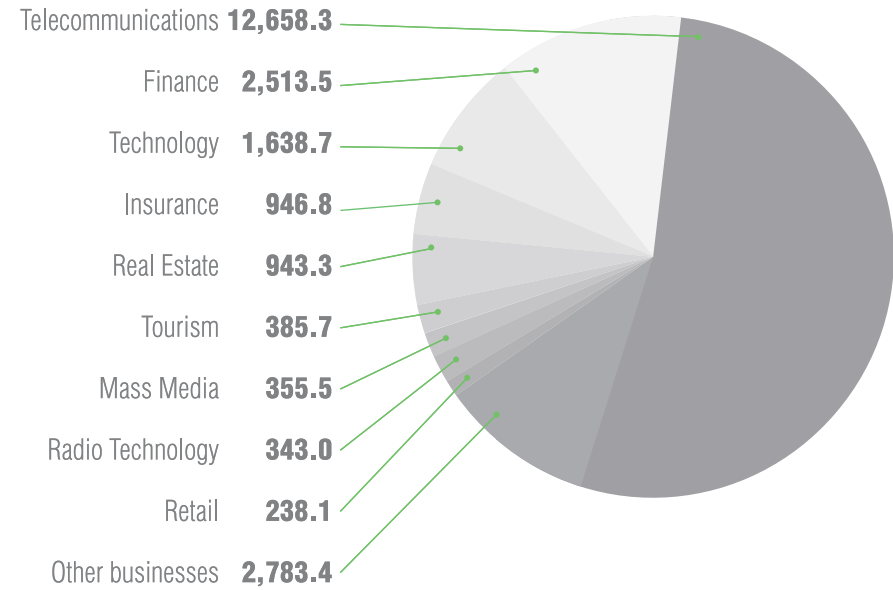
¹ OIBDA is defined as operating income before depreciation and amortization. Please see the MD&A for the whole definition of OIBDA and a reconciliation of OIBDA to operating income.



Revenue by segments²



Assets by segments³



² Before eliminations of intersegment revenue.
³ Before intersegment eliminations.



Sistema



Five questions for the Chairman of the Board of Directors¹

Vladimir
Evtushenkov

The Chairman of the Board
of Directors



New shoots of growth

New Value for the Business

Last year brought significant changes in Sistema's business activities and listed company because the lion's share of assets belonging to the group also became public. This means that you are offering investors the opportunity to choose: they can focus on any one of your subsidiaries or invest directly in the holding company. How are these changes reflected in your strategy?

The configuration of our business today is in some sense unique. We have four publicly listed companies within a public parent company. As a result, this presents us with tasks of new performance and complexity.

On one hand, we need to invest maximum efforts in growing the capitalization of our public subsidiary in order to meet the expectations of our investors. On the other hand, we need to maintain the exceptional growth rates of our non-listed companies as their rapid development will change the balance of our portfolio in the near future. This means we are providing the opportunity for investors to gain access to these promising assets through the parent company.

If you plan to grow the share of non-listed assets in the corporation due to their strong rates of growth, does this mean that you are not preparing for the IPO of any of your companies in the near future?

We have never seen public listings as priority goals in themselves. Rather, they serve as instruments for gaining access to capital for further development. Of course, it is a complex and expensive instrument. At this stage in the life of the corporation we have the opportunity to maintain the aggressive growth of our businesses and build their value. We are making use of the widest range of methods for raising capital without resorting to IPOs. We have not dismissed the idea of bringing our non-public companies to the stock markets. But at near time, we do not see any pressing need for doing this.

In your view, what should be the scenarios for the growth in value of the public and non-public companies? Are there fundamental differences between these scenarios?

I would propose a somewhat different classification of our 'points of growth': maturing markets, fast-growing markets and markets with significant future potential. Sistema's businesses are present in all of these types of markets. Our telecommunications companies work in maturing markets. Nearly all of our non-public companies are present in fast-growing markets - and this includes the entire consumer sector. These companies are Detsky Mir, Sistema Mass-Media and Intourist. I would also add Moscow Bank for Reconstruction and Development and the listed Sistema Hals to this category.

Markets with strong, but not yet fully realized potential, are in the high-technology industry. Sitronics and RTI Systems are exploiting this difficult, highly competitive but extremely promising marketplace.

It appears obvious that the 'points of growth' of an established business, such as, for example, mobile telephony, and a business that is only emerging, such as Pay-TV, should be quite different. Both quantitatively and qualitatively. How do you view these points of growth? How does one go about increasing the capitalization of such different companies?

In maturing markets this is done first and foremost by increasing the EFFICIENCY of the business. For example, the new management team at MTS succeeded in doubling the capital of the company during the year. This resource has not yet been exhausted. We believe that Mobile TeleSystems is still undervalued.

CONVERGENT PROJECTS, the basis for which was also established last year, not only provide the opportunity to continue to improve efficiency, but also establish new consumer market opportunities

and therefore new sources of revenue. In addition, we see enormous potential SYNERGIES in telecommunications with the purchase of a minority shareholding in Svyazinvest by our fixed-line operator, Comstar. Joint and multi-faceted work on this very promising project is already underway.

Entering NEW GEOGRAPHIES and markets also remains a focus of our attention, although our internal criteria for analyzing potential opportunities have become far more considered and strict. The most important of these considerations remains the same: return on invested capital.

The points of growth in growing markets are, of course, the markets themselves. The rapid growth of consumer industries, which has been driven by increases in welfare of Russian households, presents us with a superb base for development. But our goal is TO GROW FASTER THAN THE MARKET. Detsky Mir, for example, saw revenues increase at twice the rate of the overall market. Sistema Hals grew at nearly two times faster than the market.

REGIONAL EXPANSION is still another driver of growth in these markets. Since all of our consumer businesses have a networked character, entry into regional markets is the basis for development today. Detsky Mir opened children's goods superstores in 33 Russian cities. Our Pay-TV network under the unified Stream-TV brand now offers services to more than 1.5 million users covering 37 Russian cities.

The right combination of organic growth and the effect of MERGERS AND ACQUISITIONS is a third means for building value in fast-growing markets.

In markets with significant growth potential, we will focus ourselves on new projects and scientific research and development that should produce UNIQUE PRODUCT OFFERINGS and services. Last year, we launched a new development strategy for our Intellect Telecom scientific research division. We are actively advancing our work in the venture capital sphere. And we expect short-term results from this activity, which has acquired the moniker 'technological radar' within the corporation.

Since technical breakthroughs cannot be achieved without the legislative and infrastructural support of the government, PRIVATE-PUBLIC PARTNERSHIPS are becoming still another driver in this market. The GLONASS navigation system, the development of which has been conducted on the platform of the Radio-Technical Institute, is an example of this kind of cooperation.

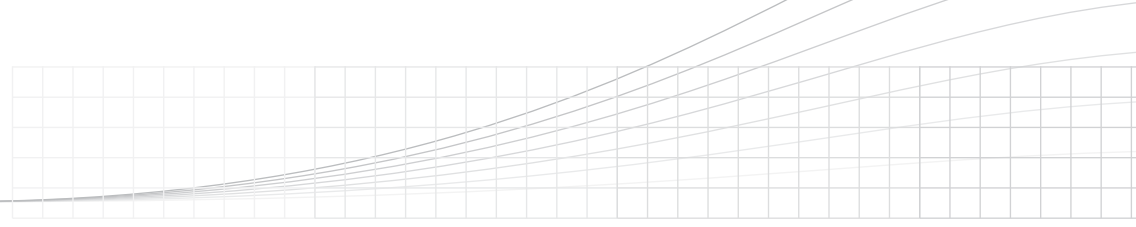
Does this signify that, as a result of the search for new areas of growth, Sistema may enter new industries or purchase new assets?

We do not have the goal of further diversifying our portfolio. But we are certainly working to make it more balanced. We are also striving to open new markets within our existing business areas and areas where they intersect with other markets. For example, does mobile television represent a new market for us or not? Is it telecommunications or media? Also, there is our medicines division, which has existed as part of the corporation for a number of years but which is today, from our point of view, on the threshold of explosive growth, again on the back of growing consumer demand.

Therefore, we are not conducting a deliberate and focused search for opportunities in markets which are totally new for us. But we are prepared for the development of promising growth points within the corporation and contiguous areas of business.

The year 2006 clearly demonstrated that the potential of the industries and markets where Sistema is already present provide us with a full range of challenges. And we are ready to meet these challenges.

¹ Questions for the Chairman of the Board of Directors were drawn from the top-10 questions most often asked of the management of the corporation by representatives of the investment community and media within the survey of Sistema's business reputation.



New shoots of growth

New Value for the Business



Five questions for the President¹

Alexander
Goncharuk

The President



New shoots of growth

New Value for the Business

Sistema is well known to the marketplace as an 'incubator' for growing businesses. Three IPOs over the course of year, each with a capitalization of more than US\$2 billion, provide an accurate tally of this work. Is the corporation changing its approach to managing these listed companies now that they've grown up?

The potential and quality of our public companies were reflected by the high valuations made by the investment community. The capitalization of Sistema Hals and Sitronics during their placements exceeded US\$2 billion and Comstar exceeded US\$3 billion. The market value of MTS during the last year grew from US\$13 to US\$20 billion.

It is clear, given the present scale of activity of our listed businesses, that they no longer require the previous level of external control and deep involvement in their operational activities. However, strategic issues require attention. Previously, the efficiency indicators for these enterprises were numerous and detailed, now we have only a relatively small number of KPIs for our listed businesses. But these are fundamental ones. The main indicator of interest to us as a management company is the growth of capitalization.

Is the corporation prepared to grow the next generation of market leading companies, given its successful track record thus far?

Sistema's strategy has always been based on leadership in the markets where it operates. Certain conditions need to be met in order to maintain this leadership in addition to the dint of our own efforts: a favorable market situation, sources of financing, a thorough action plan and strong management team. Today, our non-public companies have all of the necessary COMPONENTS OF LEADERSHIP. Forecasts for consumer market growth remain extremely optimistic

and these are the markets where Detsky Mir, Sistema Mass Media and Moscow Bank for Reconstruction and Development operate. All of our business areas have carefully worked-out M&A plans and defined strategies for organic growth. Sistema is ready to invest significant funds in these businesses. Out of US\$3 billion in investments detailed in our 2007 budget, no less than half are earmarked to support the rapid growth of our non-listed companies. The management teams have proved themselves to be very effective in meeting the goals set out for them by the shareholders. Therefore, we have no doubts about the great promise of these companies.

In 2006, there were significant changes in the top management team of Sistema, both on the level of the operational companies and in the corporate center. Are you satisfied with the work of these new managers? And, moving forward, how does the corporation plan to shape the effectiveness of their work?

For a corporation such as Sistema, which is concentrated primarily in high-technology service industries, the effectiveness of management is a critical success factor. At every stage of development of the company it requires specialists with different profiles and qualifications. Entering global capital markets, developing current strategy, a toughening competitive environment, the consolidation of whole industries and functioning in an environment of transparency - these are all parts of the reality today. We are aware of the fact that the growth in capitalization of the corporation and its operating companies depends directly on the actions of management.

Therefore we are constantly working on both the management structure of the corporation and the INCENTIVES we provide for our people. We worked the entire year on optimizing the division of responsibilities between the businesses and the corporate center, developed and introduced option and bonus programs at our com-

panies and calculated the parameters we used to evaluate the personal effectiveness of our managers. We also strengthened our team. The main result of this work can be found in our financial results.

Two significant deals for the Russian market have become strong financial indicators of the results of last year: the purchase of a blocking stake in Svayzinvest and the sale of shares in ROSNO. The first deal underscored the consistency of the corporation's strategy in the telecommunications market. The second, with its unprecedented price, demonstrated the ability of Sistema not only to profitably buy into assets but also exit profitably. How do you evaluate the long-term impact of these circumstances for the development of the corporation?

Both deals required an unbelievable concentration of effort and the highest level of professionalism from the management of Sistema.

The consolidation of all types of modern communications within Sistema Telecom allowed us to build a unique level of INDUSTRY EXPERIENCE. And we see very clearly the kind of opportunities for synergies and convergent services that joint work with Szyavinvest opens up: technical, organizational and financial. We are convinced that this cooperation provides an opportunity for a breakthrough, not just for our two companies, but for the industry as a whole.

Regarding ROSNO, we were satisfied by the results of our joint work with our reliable partner of many years, the German insurance group Allianz. Through our jointly coordinated efforts we created not just a successful company but one of the best brands in Russia. This is really valuable experience, because in the global economy, the key to entering highly competitive markets will not only be strong products but also strong brands.

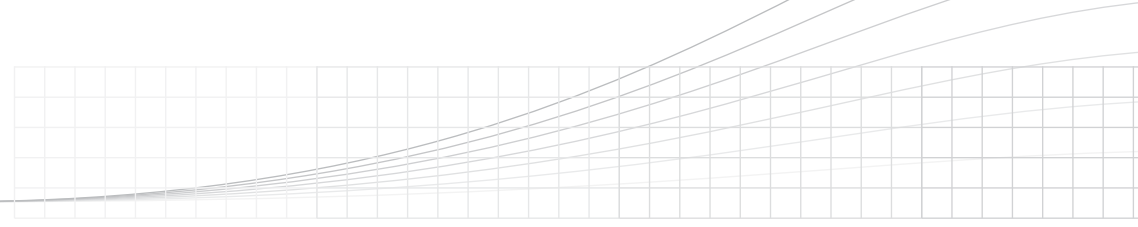
So, the creation of an umbrella brand for Sistema Telecom, a unique project for the Russian market, was brought about for these reasons? How are you planning to use this newly acquired experience in the future?

For a corporation whose business is primarily concentrated on consumer markets, it is difficult to overstate the significance of this step. It is not so much the technology but the client, his requirements and his satisfaction that is the key element in the strategies of the operating companies. The main instrument for establishing communications with the client is BRAND BUILDING. We continue to develop actively the Sitronics high technology brand. The year 2007 marks

the beginning of the promotion of Stream-TV as a national Pay-TV brand. Our most venerable brands, Detsky Mir and Intourist also should acquire new attributes.

The search for new points of growth, through the effectiveness of management, human resources policy and formulating strategy are the goals today. And we hope that our investors and shareholders will find that our efforts measure up to their expectations.

1 Questions for the President were drawn from the top-10 questions most often asked of the management of the corporation by representatives of the investment community and media within the survey of Sistema's business reputation.



New shoots of growth

New Value for the Business

Strategy

Strategic goals:

Strengthening leading positions in key markets:

Sistema remains concentrated on businesses that enjoy leading positions in their sectors or that have clear potential to become market leaders in fast-growing market segments. Market leadership in consumer-focused, technology driven industries allows the corporation to leverage the equity of its brands to enter new market segments and geographic markets and launch new, value-added services that increase profitability and enhance return to investors.

Diversification of the corporation's portfolio of businesses:

Diversification across business lines has allowed Sistema to maximize its exposure to a range of growing consumer markets. Today, the corporation is focused on the balance of businesses within its portfolio. Non-telecommunications share of revenues has grown in recent years. The corporation aims to continue to shift this balance further through growth in existing businesses operating in emerging sectors.

Maintaining solid cash flows from businesses under management:

Sistema's restructuring of its businesses in recent years has allowed it to consolidate its assets and establish more transparent and efficient holding companies in each major business area. This process continues as the corporation seeks to enhance long-term revenue and profit growth of its operating companies.

Preserving strong and solid financial position:

A combined approach of financial transparency, careful management of debt levels of the group and subsidiary level and a long-term approach to financial planning, help ensure that Sistema maintains a robust financial position. The corporation maintains strict debt level criteria to ensure an optimal structure of consolidated borrowing and enhance long-term financial stability.

Maintaining the highest standards of corporate governance:

Long before Sistema's own IPO in February 2005, the company has exceeded the requirements and expectations of corporate transparency. It continues to work to ensure the highest standards of corporate governance and disclosure on the corporate and subsidiary level, to ensure efficiency in running the company, add to the liquidity of its shares and those of its listed subsidiaries and to obtain the most attractive terms available for borrowing.

Strategic principles:

Creating or acquiring promising companies:

While Sistema is concentrated on the growth of its existing businesses, it is always reviewing opportunities to acquire companies that can strengthen existing business areas or create new markets where the corporation has strong potential synergies with existing businesses.

Active participation in the development and management of companies at an early stage:

Sistema's primary ability to add value to a business is its ability to contribute considerable financial and management resources to a company. The corporation has a clearly established track record of building value across a range of businesses and creating sustainable, market-leading companies.

Attracting financial resources for investment in the growth of companies:

The corporation has a long-established presence in the global capital markets and the ability to raise capital through a range of instruments. Sistema plays an important role in attracting international investment to build Russia's high-technology, service-based industries.

Defining clear exit scenarios for investment:

When Sistema invests in a business, it defines a clear exit strategy for its investment directed at increasing value for its shareholders while moving its companies to their next stage of development. These scenarios include the sale of Sistema's stake to a strategic investor, an IPO or integration into existing businesses.



Survey of Operational and Financial Results

A full discussion of Sistema's financial results during 2006, including a management discussion of results, balance sheet and other important information on methodology, including full definitions of certain terminology and ratios used in the results report, is contained in the Management Discussion and Analysis included in this Annual Report.

The following section presents a brief overview of the company's financial and operational results, according to US GAAP, for the year 2006. The operational and financial performance of each business area is discussed in Section 2 of this annual report.

Highlights of the Year:

- Consolidated revenues up 43% year-on-year to US\$10.9 billion
- OIBDA increased 35% year-on-year to US\$4.0 billion
- Operating income rose 40% year-on-year to US\$2.7 billion
- Net income increased 69% year-on-year to US\$903 million
- Total consolidated assets increased 54% year on year to US\$20.1 billion
- Earnings per share rose 67% year on year to US\$94.4

Group Operating Review

Sistema's consolidated revenues increased 43% to US\$10,862 million in 2006, as a result of a robust performance by the corporation's Telecommunications segment and rapid growth in revenues at the Group's non-telecommunications operations. The non-telecommunications businesses accounted for 31% of the Group's consolidated revenues in 2006, compared to 22% in 2005. Organic year-on-year and like-for-like growth was 35% in 2006, and amounted to US\$10.8 billion, excluding businesses acquired or divested since the end of the fourth quarter of 2005.

The corporation's OIBDA increased by 35% year on year from US\$2.982 billion to US\$4.023 billion in 2006. The OIBDA margin in 2006 declined slightly from 39.3% to 37.0% as a result of slightly lower margins in the Telecommunications, Technology, Insurance and Retail segments. Sistema's operating income was up 40% from

US\$2.0 billion to US\$2.7 billion in 2006. The operating margin was 25% in 2006, compared to 26% in 2005.

Consolidated depreciation and amortization expenses were up by 26% in 2006, following growth in the Group's depreciable asset base and the previously announced revision of the estimated remaining useful life of MGTS analogue equipment. Selling, General and Administrative (SG&A) expenses rose by 43% in 2006, from US\$1.414 billion to US\$2.016 billion. A total of US\$153.0 million in 2006, included in SG&A expense, reflects the fair value of non-cash compensation received by employees.

The Group's effective tax rate increased from 29% to 33% in 2006, as a result of foreign gains on the exchange of non-ruble denominated long-term debt and the effect of the stock bonus and stock option awards at Comstar, and the option revaluation charge, which are not tax-deductible.

The increase in minority interest reflects changes both in the net income of the Group and ownership's share in the Group's companies.

In 2006, net income grew 69% from US\$534 million to US\$903 million. One-time, non-recurring items include the write-off of US\$150 million investment in Bitel, Kyrgyzstan, by MTS, and a non-cash charge of US\$60 million in connection with the issued Svyazinvest put and call option.

The weighted average number of shares outstanding increased from 9,475,980 in 2005 to 9,570,050 in 2006, Sistema reported an 67% year on year increase in basic and diluted earnings per share from US\$56.4 to US\$94.4 in 2006.

Financial Highlights

Net cash provided by operating activities was up 19% to US\$2.097 billion year-on-year during 2006.

Net cash used in investing activities in 2006 was US\$5.3 billion and included capital expenditures of US\$2.4 million in 2006, compared to US\$2.5 billion in 2005. The Group spent US\$631 million on acquisitions of businesses.

Cash flow from financing activities amounted to US\$3.4 billion in 2006, which primarily reflected proceeds of the initial public offering of Comstar, which took place in February 2006, and the initial public offering of Sistema-Hals, which took place in November 2006, and additional debt raised by the Group.

The Group's net debt amounted to US\$6.3 billion as at December 31, 2006, compared to US\$3.9 billion as at December 31, 2005.

Credit Ratings

Independent ratings agencies consider a number of key factors in determining the financial stability of the corporation and its subsidiaries, including total debt, current obligations, existing and future liquidity needs and cash flow. Ratings can also be seen as an outside evaluation of the corporation's overall strategy and its position versus its rivals in core business areas. Ratings take into account corporate governance structures in place and protection for minority shareholders. In addition, ratings reflect overall market conditions, in particular the ratings assigned to Russia's sovereign borrowing, may be seen as a benchmark of overall country risk.

Sistema's Ratings

Agency	Date Assigned	Rating	Outlook
S&P	March 24, 2005	BB-	Stable
Fitch Ratings	April 28, 2006	B+	Positive
Moody's	November 19, 2003	B1	Stable

Ratings of Operating Companies

MTS			
S&P	24/03/2005	BB-	Stable
Moody's	10/12/2001	Ba3	Stable
MGTS			
S&P	24/03/2005	BB-	Stable
Moody's	19/01/2006	Ba3	Stable
Sitronics			
Fitch	14/02/2006	B-	Stable
Moody's	16/02/2006	B3	Stable
MBRD			
Fitch	14/04/2006	B	Stable
Moody's	14/12/2004	B1	Stable

Calendar of Events

January

In January, Comstar announced that its fixed-line telecommunications provider, subsidiary Comstar UTS, has acquired a 100% stake in CTK Contrast-Telecom, a leading alternative fixed-line operator in Sergiev Posad, one of the largest districts in Moscow region.

Also in January, ROSNO acquired a 51% stake in Medexpress, a provider of voluntary supplementary medical insurance in the North-Western region of Russia, for US\$6.6 million.

During the month, Sistema Mass Media acquired GK Sendi, an internet provider in Nizhny Novgorod, and Informservis, a cable television operator in the same region, for US\$6.3 million in January 2006. Sistema intends to use these operations for further development its digital TV and broadband networks in Russia's regional markets.

February

Comstar undertook a successful IPO on the LSE in February 2006, raising US\$1 billion for the further development of the company. Following the transaction, around 35% of its shares are in free-float and the transaction marked the successful completion of the first stage of restructuring at the company following the consolidation of Sistema's fixed-line assets in Comstar in late 2005.

On February 25, Sistema's Board of Directors approved previously proposed changes to the corporation's Board and senior management. The changes included the appointment of Vladimir Evtushenkov as Chairman of the Board of Directors and the appointment of Alexander Goncharuk as President. It was also announced that Evgeny Novitsky, the former Chairman of the Board of Directors, would continue to serve as a member of Sistema's Board of Directors.

Also in February, Sistema Mass Media and ECU GEST acquired 90% and 10%, respectively, of JIR Broadcast and JIR Inc., the owners of 100% of United Cable Networks (UCN), for a total cash consideration of US\$145.9 million. UCN is a Pay-TV and broadband service

provider with 724,000 subscribers in 17 metropolitan areas across Russia.

March

Comstar announced the acquisition of a 100% stake in Unitel for a total cash consideration of US\$4.8 million in March. Unitel is an alternative wireless fixed-line telecommunications company serving customers in Moscow region.

Also in March, Sistema completed the previously announced acquisition of 44,564 Sistema common shares, equivalent to 0.46% of the total outstanding shares, for a total cash consideration of \$50.892 million. The acquisition was executed through Sistema Finance, a fully owned subsidiary of Sistema.

Intourist purchased a 20% equity interest in Cosmos Hotel in Moscow for approximately US\$20.8 million, bringing its controlling interest in Cosmos Hotel to 63.4% as part of the development of the Tourist business area's hotel management group.

During March, Concern RTI acquired a 50% plus one share interest in UralEleketro, and a 100% stake in UralElektro-K, for a total cash consideration of US\$5.4 million. Both companies manufacture electronic equipment.

Detsky Mir completed the acquisition of 99% of Tireks Development, the owner of 30% stake in Sistema's subsidiary Dom Igrushki (House of Toys), for a cash consideration of US\$2.4 million as part of the corporation's broader strategy of buying out minority shares in order to streamline its businesses.

June

In June, Sitronics acquired a 51% voting stake of Intracom Telecom, a provider of telecommunications solutions and services in Eastern Europe and the Middle East. The total cash consideration for the deal was US\$150.6 million, including US\$43.9 million payable upon the completion of the due diligence process. In addition, Sitronics

entered into a put option agreement to acquire the remaining 49% of Intracom Telecom stock.

Comstar acquired 100% of Astelit, an alternative fixed-line telecommunications company, for US\$7.8 million in June. Astelit holds licenses for provision of integrated fixed-line services across 51 Russian regions to large corporate customers and has over 200km of its own fiber optic infrastructure in city centers. Astelit was subsequently re-branded as M-Telecom.

Sistema Mass Media sold its ownership in Gazeta Metro in June for US\$1.9 million as part of its overall strategy of selling assets outside of its core business segments of Pay-TV, content and advertising.

July

In July, the Group disposed of Glorely, a subsidiary holding 35% interest in Sistema-Invest, the owner of the Group's energy companies in the Republic of Bashkortostan, for a total cash consideration of US\$201.0 million.

Also in July, MTS acquired a 75% controlling stake in Dagtelecom from Glaxen Corp. for US\$14.7 million. Dagtelecom is a GSM-900 mobile services provider with 1.7 million subscribers in the Republic of Dagestan, in Southern Russia, with a population of 2.6 million people.

In July, Intourist Overseas Limited purchased a 51% stake in Tatilya Turizm Seyahat Insaat, a Turkish travel operator, for US\$0.3 million.

August

In August, Sistema acquired an 81.25% stake in ZAO Sahles, the owner of controlling stakes in the entities comprising Perm Motors Group, for US\$122.5 million. Perm Motors is one of Russia's largest manufacturers of jet aircraft engines and industrial turbines and substantially strengthens the capacity and product offerings available to the corporation's Radar and Aerospace business area.

Also in August, the Group sold an 8% stake in MTK (KOMKOR) together with an additional 3% acquired from a related party after June 30, 2006, for US\$20.0 million.

October

In October, Sistema acquired a 66% controlling stake through directed new share issue in WaveCrest Group Enterprises Ltd. (WaveCrest) for a cash consideration equivalent to GBP 20.0 million. WaveCrest is a global communications service provider offering wholesale (operator) and retail (residential) telephony services, using conventional circuit-switched and Internet protocol (IP) telephony. The deal represents a major cross-border acquisition for Sistema, strengthening the global reach and technological base of its Telecommunications business area.

During the same month, Comstar announced the acquisition of 100% stake in two telecom operators in Kiev, Ukraine - DG Tel and Technologic Systems - through its local subsidiary Comstar- Ukraine, for a total cash consideration of US\$4.7 million, marking a major expansion of Comstar's business in the fast-growing Ukrainian fixed-line market.

Also in October, Comstar announced the purchase of a 75% stake plus one share in Callnet, a transit operator, and Cornet, an Internet Services Provider, which together represent the second largest alternative telecommunications group in the Republic of Armenia. The transaction is part of Comstar's strategy of expanding its presence in fast-growing CIS telecommunications markets.

Comstar also announced the acquisition of 1,605,500 ordinary shares in MGTS. The acquired shares represented 2.01% of the MGTS' ordinary shares, or 1.68% of the MGTS' total shares. Upon completion of this transaction, Comstar-UTS interest in MGTS amounted to 66.88% of MGTS' ordinary shares, or 55.73% of MGTS' total shares.

During the month, Sistema completed the purchase of 2% of its stock for an amount of approximately US\$239 million. The purchase was completed through one of Sistema subsidiaries, Sistema Finance.

Sistema subscribed to a total of 167,131 ordinary shares at the offer price, which constitute 1.73% of the stock, offered by certain directors of the Company. The total subscription was in the amount of approximately US\$207 million. The offer was conducted as part of Sistema's plans to establish a share option program for the top management of the corporation. The acquired shares are intended for the funding of this program, and may also be used in connection with certain future acquisitions.

November

In November 2006, Sistema Hals listed its GDRs on London Stock Exchange to raise funds for its further development. The IPO raised US\$409 million in the first such international listing by a Russian property developer. Following the IPO, around 20% of the company's shares were in free-float. With the transaction, Sistema Hals achieved the highest-ever valuation for a Central and Eastern European real-estate company at time of IPO.

December

In December 2006, Comstar announced the acquisition of a blocking stake 25% plus one share in Telecommunication Investment Joint Stock Company (Svyazinvest) from Mustcom Limited for a total cash consideration of US\$1.3 billion. The company arranged a US\$675 million six month loan facility with ABN AMRO Bank N.V. in connection with this transaction. Svyazinvest is the holding company for Russia's regional fixed-line incumbent operators. The transaction, in line with Comstar's announced intentions at the time of its IPO, provides the company and Sistema with the ability to play a key role in the development of Svyazinvest and the future of the country's regional fixed-line network, Russia's 'last mile'.

In December 2006, Comstar UTS announced that it has reached an agreement with Intracom Holdings (ASE:INTRK) to subscribe to a 51% stake in Hellas On Line SA (HoL) for a cash consideration of euro 47.9 million.

In December 2006, Intourist purchased 51% stake in a number of companies comprising Riviera Holding, a tourist operator in Saint Petersburg. Riviera Holding serves approximately 120,000 tourists annually and operates in more than 20 countries of the world.

Throughout the third quarter, Sistema Mass Media acquired several cable television operators in a number of Russian regions. These purchases included a 74% stake in Smolensk-based Teleradiotekhnika for US\$1.2 million, 100% of Voronezh-based Elecom-service for US\$1.0 million, 100% of Telesat in Nizhny Tagil for \$0.4 million, a 74% share in a group of operators based in Ivanovo for US\$7.1 million, a 55% stake in Electronica in Balakovo for \$0.8 million and 90% of Krasnodar-based Sallak for US\$0.2 million. These acquisitions were in line with Sistema's strategy of growing its regional presence in Russia's cable television market.

Events Following the End of the 2006 Reporting Period

January 2007

In January 2007, Comstar obtained licenses for IP Voice and Data transmission, including WiMAX services, in the twenty largest regions in Russia. The licenses are valid until November 17, 2011 and provide a base for the development of a new generation of corporate and residential services in Russia's regions.

Sistema-Hals announced signing of a US\$187 million credit agreement with Eurohypo AG in January 2007 to finance the development of a shopping centre on the Pulkovskoe highway, St Petersburg.

February 2007

In February 2007, Sistema announced the purchase of an additional 0.48% of its own stock, bringing the total amount of shares purchased by Sistema from March 2006 to date to 284,243 (2.95%) for a total of US\$347.3 million. The acquired shares are intended for the funding of the corporation's share options program for its top management and may also be used in connection with certain future acquisition activity.

The IPO of Sitronics through the offering of GDRs on the LSE in February valued the company at US\$2.35 billion and was the biggest international capital markets technology debut in five years and first by an Eastern European technology company.

Also in February, Standard & Poors Ratings Services upgraded its outlook on Sistema to «positive». Also it assigned a BB- long-term corporate credit rating to Comstar, with a «positive» outlook. Standard & Poors also assigned its ruAA Russia national scale rating to the Group. At the same time the BB-long-term corporate credit rating on the company was affirmed.

In February Sistema sold 46.19% of ROSNO shared to Allianz. Sistema holding in ROSNO was reduced to 3%, while Allianz stake increased to 97%.

March 2007

Sistema-Hals announced the results of an independent valuation of its real estate property and projects. According to the valuation carried out by Cushman and Wakefield Stules & Riabokobylko (C&WS&R), the value of the Sistema-Hals stake in the property and projects increased by 35% in the period from June 30, 2006 to January 1, 2007.

Sistema-Hals was also included in the RUXX (Russian Industrial Leaders Index) database, used as an indicator of Russian economy for international investors.

Also in March, Comstar announced that it had been awarded licenses to provide data transmission in the Kemerovo, Chelyabinsk, Novosibirsk, Sverdlovsk and Tumen regions, as well as in the Stavropol and Primorsky territories, and in the Republic of Tatarstan. The licenses are valid until February 9, 2012 and further expand the company's reach in high-growth Russian regions.

During the month, Comstar sold its 45% equity stake in ZAO Metrocom, an alternative fixed-line telecommunications operator based in St. Petersburg, to MST CJSC. The shares were sold for a total cash consideration of US\$20.0. Comstar acquired the stake in September 2005 for US\$12.2 million in cash. The sale was in line with Comstar's intention to have controlling stakes in all of its operations. Comstar is evaluating other means of expanding its operations in the St. Petersburg area.

In March, Sitronics and ZTE Corporation signed a Memorandum of Understanding concerning development of cooperation in Russian, Chinese and international telecommunication markets. Sitronics and ZTE Corporation will focus their efforts on setting up a joint strategic R&D center for developing communication facilities and consumer electronics.

Also in March, MTS announced its decision to write off costs associated with the acquisition of a 51% stake in Tarino Limited, the indirect owner of Bitel LLP (Bitel), a Kyrgyzstan-based GSM mobile telephone operator, at the end of 2005. The write-off amounted to US\$150 million.

April 2007

In April 2007, an Extraordinary General Meeting of Svyazinvest shareholders elected Sergei Shchebetov (Chairman of the Board of Directors of Comstar) and Anton Abugov (First Vice President and

Head of Strategy and Development at Sistema) to the Svyazinvest Board of Directors.

Also in April, Comstar announced the acquisition of a 100% stake in Golden Line, a wholly owned subsidiary of Comstar Direct, for a total cash consideration of US\$10.2 million from Comstar Direct.

During the same month, Sistema acquired an additional 9.75% stake in Sitronics. As a result of the transaction, Sistema now owns 60% of Sitronics's issued share capital. The acquisition was made in accordance with an ongoing restructuring process and the planned consolidation of assets of the corporation aimed at optimizing the ownership structure.

Comstar announced in April that it had been awarded 10 licenses to provide data transmission in the Krasnoyarsk, Krasnodar and Khabarovsk territories, and the Volgograd, Vladimir, Irkutsk, Leningrad, Tver, Saratov and Ulyanovsk regions in line with its strategy of expanding its presence in Russia's regional markets.

May 2007

In May the Russian Ministry of Information and Communications announced the results of a tender for the 3G license. MTS was one of three companies that received a federal license allowing it to provide 3G services in Russia. In accordance with the conditions set forth in the tender documentation, the winning companies are required to begin commercial exploitation of a 3G network in the period of two years from the time they receive the license. The 3G network in Russia will compliment the existing GSM network. MTS is planning to launch 3G services in the largest cities in Russia starting from the second half of this year.



Risks

The consumer sectors of Russia and the CIS, where the corporation conducts its core business, have grown impressively in recent years. Nonetheless, the sector carries with it substantial risks that may effect the pace of development at the corporation's subsidiaries. Therefore, the evaluation and management of these risks is an important element in the strategy of Sistema. This approach allowed Sistema to endure the 1998 Russian financial crisis with minimal losses.

The risks which could affect the corporation's business are diverse. These risks reflect the emergence of processes and factors beyond the control of Sistema.

Country Outlook

The past year has demonstrated another success of managed democracy over the seven years Mr. Putin has been in power. However, there is a risk that the well established course of political stability and reforms will be upset getting closer to the election cycle, or the smooth transition of power will fail. The neighboring CIS countries have shown more political instability, which results, for better or worse, in the influence of various political forces on their national economies and especially the private companies.

Economic Performance

The strong performance of investments and consumer demand has been sustained. Inflation has declined substantially and industry has posted a remarkable recovery, and the steady growth of the stabilization fund is a strong indication that a prudent fiscal policy will prevail. On the other hand, monetary and fiscal loosening continued, and inflation in general and rising costs for consumer industry are the two biggest macroeconomic risks, fueled by rising budgetary spending, intact balance of payments pressures, and growth in regulated tariffs. In the CIS countries there is a risk that positive economic trends can stall or reverse based on political instability. The trend of Russian and the CIS countries' economic dependency on oil and gas prices continued.

Exchange Rate

Sistema faces exchange rate risks linked to changes in the value of the ruble as well as the grivna and the euro, to the US dollar. As a result of inflation in Russia and other markets where it operates, the corporation links its monetary assets and transactions to the US dollar. Also, a significant share of the corporation's capital expenditures and operating and borrowing costs are dominated in US dollars. In Russia and Ukraine, many of the corporation's services are priced in US dollar equivalents. There is also a risk that nominal exchange rate will not be controlled by the Central Bank of Russia in order to protect domestic corporations from losing competitiveness.

Capital Markets

Sistema sees the risk of Russian equities underperforming average emerging markets. The two principal reasons for the possible weakness appear to be the relative outperformance and the relative liquidity of Russian equity. There is a risk that capital inflows will be smaller - on the back of tighter global liquidity, political risks, high market valuations, etc.

Interest Rate and Other Borrowings

Future changes in interest rates in Russia could substantially change the cost of loans and raising additional capital. Sistema has a number of capital intensive businesses, therefore changes in the cost of borrowing could have a negative impact on the corporation. Also, if Russia's sovereign debt rating were lowered, the corporate debt ratings of Sistema could be affected, making borrowing in international debt markets more costly.

Investors, partners and other interested persons should consult detailed risk summaries for Sistema contained in the Management's Discussion and Analysis of Financial Condition and Results of Operations.

Vladimir Evtushenkov
Chairman of the Board
of Directors



Alexander Goncharuk
President and Chief Executive
Officer of Sistema



Corporate governance Board of Directors

Evgeny Novitsky
Director



Alexander Leiviman
Director



Stephan Newhouse
Independent
Director



Alexander Gorbatovsky
Independent
Director



Vyacheslav Kopiev
Deputy Chairman of the
Board of Directors



Dmitry Zubov
Deputy Chairman of the
Board of Directors



Sergey Drozdov
Director,
Senior Vice President,
Head of the Property
Group of Sistema



Nikolai Mikhailov
Independent
Director



Ron Sommer
Independent
Director



Board of Directors

The Board of Directors, which reports to the General Meeting of Shareholders, is the key corporate governance body at Sistema. It carries out six primary functions: the definition of the corporation's development strategy, establishing clear qualitative and quantitative targets for the executive management and following through on their execution; the efficient management of assets; the appointment of key managers; continued improvement of the corporate governance system and oversight of financial reporting audit and internal control.

The current composition of Sistema's Board of Directors was approved at the Annual General Meeting held on June 30, 2006. In the interests of transparency and clear corporate governance procedures, of the 11 directors on the current Board, four are independent directors and further four are non-executive directors.

Vladimir Evtushenkov
Chairman of the Board of Directors

Vladimir Evtushenkov was born in 1948 in the Smolensk region. He graduated from the D. Mendeleev Moscow Chemical Engineering Institute in 1973, and in 1980 from the School of Economics of the Moscow State University where he earned a Doctorate in Economics.

From 1975 to 1982, Mr. Evtushenkov worked as Deputy Director and Chief Engineer at the Karacharovo Plastics Works. From 1982 until 1987 he was Chief Engineer and subsequently first Deputy General Director of the Polymerbyt Scientific and Production Association. He was appointed head of the Technical Administration of the Moscow City Executive Committee in 1987 and in 1988 became head of the Central Administration on Science and Engineering of the Moscow City Executive Committee. In 1990 Mr. Evtushenkov moved to chair the Moscow City Committee on Science and Engineering.

In 1993, together with a group of like-minded people, he founded Sistema. From the company's inception until 1995, he served as its President and from January 1994 to January 2005, he also served as

Chairman of the Board. Before Sistema's IPO on LSE, Mr. Evtushenkov became President of Sistema. In February 2006, he was again appointed the Chairman of the Board. He is the majority shareholder of Sistema.

He has been a member of the Bureau of the Board of Directors of the Russian Union of Industrialists and Entrepreneurs since 2000. In 2001, he became head of the Union's Committee on industrial policy. He has been a member of the Board of Directors of the Russian Chamber of Commerce and Industry since 2002. Mr. Evtushenkov is also a member of the Government Commission on Science and Innovation Policy and a member of the Russian President's Council on Science and High Technology and the National Council on Corporate Management. In March 2004, he was elected Chairman of the Council of Trustees of the Development Fund for the State Russian Museum.

Alexander Goncharuk
President and Chief Executive Officer of Sistema

Alexander Goncharuk was born in 1956, in Sevastopol. He graduated with honors from both the Sevastopol Naval Engineering Academy in 1978 and the A. Grechko Naval Academy in 1987. From 1987 to 1991 Mr. Goncharuk served as a senior officer at the Main Headquarters of the Navy. He later became General Director of the company ACO Leader.

Mr. Goncharuk became Member of the Board of Directors of Sistema in 1996. From 1995 to 1998, he served as Vice President of Sistema. His group company positions included the post of Chairman of the Board of MTS (in 1998 and from 2002 to 2003), having also served as Deputy Chairman of the Board in 1997 and for the first half of 1999. Mr. Goncharuk was President of Sistema Telecom from 1998 to 2003. Between 2003 and 2006, he was General Director of Concern Sitronics (CSC). In addition to serving on the Sistema Board, he has also been elected to the boards of Sistema Telecom, MTS and Concern Sitronics. Since February 2006, Mr. Goncharuk has been the President of Sistema.

Evgeny Novitsky
Director

Evgeny Novitsky was born on November 19, 1957, in the Tomsk region. He received a degree in Engineering from the C. Bauman Moscow School of Engineering in 1985, and from 1989 to 1990

studied management at the Moscow State Institute of International Relations and at Manchester Business School, University of Manchester (UK).

Mr. Novitsky was an engineer-mathematician at the C. Bauman Moscow School of Engineering from 1985 to 1987 and continued his studies there as a postgraduate until 1990, working on scientific and engineering projects in the defense industry. From 1991 to 1995, he headed the development and production of computers as well as assembly of IBM computers at the Kvant plant in Zelenograd. He also participated in a project to convert a missile launch vehicle based on the SS-20 missile platform for peaceful uses. He was also Chairman of the Board of IVK, a Russian information technology company. In addition, he is the author of a number of publications and a monograph and is a Member of the Board of Trustees of the C. Bauman Moscow School of Engineering.

Mr. Novitsky joined Sistema in 1995 as Director and President and continued in these roles until January 2005, when he became Chairman of the Board, a post he held until February 2006. Since then he has remained on the board as a non-executive director. He also serves as Chairman of the Board of two Sistema group companies, CSC and Concern RTI-Systems and is a member of the management board of a fourth, ECU GEST Holding.

Dmitry Zubov

Deputy Chairman of the Board of Directors

Dmitry Zubov was born in 1954 in the Gorky region. He graduated from the S. Ordzhonikidze Moscow Aircraft Institute in 1977 and is a Doctor of Economics.

In 1978 and 1979, Mr. Zubov worked as a foreman at the Lukhovitsky Engineering Plant and subsequently served as secretary of the Komsomol Committee until 1983. He headed the All-Union School for training team leaders of Komsomol Youth brigades from 1983 to 1986. He then served in the department for working with youth at the Central Committee of the Leninist Young Communist League of the Soviet Union from 1986 to 1988. From 1992 Mr. Zubov was General Director of AOZT Alon until 1996, when he became Deputy Chairman of the Board of Moseximbank. In 1998 he became a Director on the boards of ABN-Sistema and PromKhimInvest.

Mr. Zubov has been working at Sistema since 1999 and has been Deputy Chairman of the Board of Directors since 2000. He holds a number of senior positions in group companies including Chairman of the Board of Sistema Hals and Project Construction Union Sistema-Hals.

Vyacheslav Kopiev

Deputy Chairman of the Board of Directors

Vyacheslav Kopiev was born in 1954 in Moscow. He holds degrees in Engineering and Law and graduated from the Cybernetics Department of the Moscow Institute of Engineering and Physics (MIPHI) in 1977 and from the Law Science Department of the Russian Academy of Management in 1993. Mr. Kopiev also graduated with honors from the Economy Department of the International Marketing and Management Academy in 1994. He is the author of over 70 scientific works.

As a senior engineer at MIPHI, in 1977, Mr. Kopiev was appointed to work in the Krasnogvardeisky District Komsomol Committee. From 1980 to 1989, he was Deputy Chairman of the Moscow City Council of Young Scientists and Specialists as well as the Moscow City Council for the Development of the Scientific and Technical Abilities of Youth. In 1989, he was elected First Secretary of the Moscow City Committee of the Komsomol and in 1990, became Second Secretary of the Komsomol Central Committee. From 1989 onwards, Mr. Kopiev occupied leading positions in the Administrative Board of the Union of Engineering Societies and between 1992 and 1997 was Director for International Relations and Innovation. From 1990 to 1997, he served Chairman of the Board of Directors of JSC Sputnik. In 1995, Mr. Kopiev became Deputy Chairman of the Executive Committee of the Russo-British Chamber of Commerce.

Mr. Kopiev joined Sistema as Vice President in 1997. He served as Senior Vice President and Chief of the External Business Relations Group from 2000 to 2003. He has been a Director since 2001. Since 2003 he has served as Deputy Chairman of the Board. He holds a number of other senior corporate positions, mostly within group companies, including Chairman of the Board of Sistema Mass Media, Intourist, Rosbalt Information Agency and Literaturnaya Gazeta (Literary Gazette).

Alexander Leiviman

Director

Alexander Leiviman was born in 1949 in Chernovtsy. From 1972 to 1973, Mr. Leiviman worked as deputy shop foreman at MosBytKhim. From 1975 to 1977, he was senior staff scientist at the Institute NIPIOTSTROM in Novorossiisk. Mr. Leiviman occupied a number of leading positions at the chemicals plant in Chernovtsy from 1978 to 1992 when he became Deputy General Director of the Innovation Fund of the Moscow Mayor's Office.

Mr. Leiviman has been a Director of Sistema since 1993, joining as Deputy Chairman of the Board, a post he held until 1998. From 1993 until 1996, he served as Vice President and from 1999 to 2002, as First Vice President and Chief of the Finance and Investment Group. Other corporate roles include: President of Sistema-Invest (1996-1997), President of Intourist (1997-1999) and Director of MTS (1998-2002). Mr. Leiviman has been General Director of Sistema Mass Media since September 2003 and is also Chairman of the Board of Concern Radio-Centre, Maxima Advertising Agency, Gazeta Metro, Zolotoy Vek Film Studio and Sistema-International IG. His current Board appointments include: Sistema Telecom, Sistema Mass Media, Intourist, Narodnoye Kino, New Line of Stars Studio, TV Project and TV Stolitsa. He is also on the management board of ECU GEST Holding.

Nikolai Mikhailov Independent Director

Nikolai Mikhailov was born in 1937 in the Bryansk region. He graduated in 1961 from the N. Bauman Moscow School of Engineering and subsequently worked at several defense and scientific and production enterprises. From 1979 to 1987, he headed the Scientific Research Institute for Wireless Radio Set Construction. From 1987 to 1992, he managed international JSC Vympel. Between 1996 and 1997, Mr. Mikhailov was Deputy Secretary of the Russian Security Council and from 1997-2001 First Deputy Minister of Defense of the Russian Federation.

Mr. Mikhailov is a Doctor of Economics (1967), Professor (1992), Grand Doctor of Philosophy (1997) and author of over 100 scientific publications dealing with major radio-electronic systems. He is a full member of a number of industry-related and international academies and chaired one of the departments at the Moscow Physics and Technologies Institute for over 10 years. He has received numerous honors, including Laureate of the USSR State Prize (1984), State Prize of the Russian Federation (1997), Order of the Red Banner of Labor, Badge of Honor, 4th-Degree Merit to Motherland and a number of medals.

Mr. Mikhailov has been a Member of the Board of Sistema since 2000 and from 2001 serve as Advisor to the Chairman. He is on the Board of the following companies: Concern RTI Systems, Business Informatization System, Kamov, NII Stali and Sistema Venture.

Sergei Drozdov

Director, Senior Vice President, Head of the Property Group of Sistema

Sergei Drozdov was born in 1970 in Archangelsk. He graduated in 1993 from the S. Ordzhonikidze State Academy of Management in Economics. Mr. Drozdov was head of the Administration for Financial Innovation and Marketing at the Moscow Property Fund from 1994 to 1995.

Mr. Drozdov has been working at Sistema since 1995. He managed the Department of Development and Investments from 1995 to 1998 and from 1998 and 2002, served as Vice President, Acting President and First Vice President of Sistema-Invest. He became Acting First Vice President and Head of the Department for Corporate Property in May 2002. In September 2002, he was appointed Director and First Vice President of Sistema and Chief of the Property Complex. He holds a number of other senior corporate positions, mainly among group companies, including Chairman of the Boards of Detsky Mir, Reestr, Detsky Mir Center and NII Stali. Mr. Drozdov also serves on the Boards of Sistema Telecom, MGTS, CSC, Sistema-International, Medical Technology MTH, Olimpiyskaya Sistema, Intourist Hotel Group and M-Consult.

Alexander Gorbatovsky Independent Director

Mr. Gorbatovsky has been a Director at Sistema since August 2004. He also serves as Chairman of the Board of MMZ No.3. From 1993 until 1997, he was General Director of Kedr-M and from 1997 until 2002, was President of Sistema-Neft.

Ron Sommer Independent Director

Ron Sommer was born in 1949 in Israel. He studied mathematics at the University of Vienna, where he earned his doctorate in 1971. Mr. Sommer began his professional career with the Nixdorf Group in New York, Paderborn and Paris. In 1980, he was appointed Managing Director of the German subsidiary of the Sony Group. In 1986, he became Chairman of the Management Board of Sony Deutschland, and was subsequently appointed President and Chief Operating Officer of Sony Corporation of America in 1990. In 1993, Mr. Sommer served at Sony Europe in the same function. From May 1995 to July 2002, he served as Chairman of the Management Board of Deutsche Telekom AG. Mr. Sommer is a member of the Board of

Directors of Motorola, a member of the Supervisory Board at Munchener Ruckversicherung (Munich Re) and Celanese. He is also a member of the International Advisory Board of The Blackstone Group. Since May 2003, he has been serving as Chairman of the International Advisory Council of Sistema. Mr. Sommer was elected as a non-executive independent member of the Board of Directors of Sistema in June 2005.

Stephan Newhouse Independent Director

Stephan Newhouse was born in 1947. He attended Yale University where he earned a Bachelor of Arts degree cum laude in 1969. After serving as an officer in the United States Navy from 1969 to 1972, he went on to attend the Harvard Business School where he earned his MBA with Distinction in 1975.

From 1975 to 1979, he worked in the investment banking division of the First Boston Corporation. He is a Director of Harbor Point Limited, a Bermuda based re-insurance company and Shanghai AJ Trust Company, a Chinese financial services group.

Stephan F. Newhouse is the former President of Morgan Stanley and also former Chairman of Morgan Stanley International Inc, the holding company for all of Morgan Stanley's non-North American subsidiaries.

Mr. Newhouse joined Morgan Stanley in 1979, became a Managing Director in 1988, Vice Chairman in 1997, Chairman of Morgan Stanley International in 2000, and President of Morgan Stanley in December of 2003 in which capacity he served until April of 2005.

For the three years prior to being named President of Morgan Stanley, he was also Co-President and Chief Operating Officer of Morgan Stanley's Institutional Securities and Investment Banking Group, which includes the global institutional equities, institutional fixed income and investment banking operations of Morgan Stanley. He was appointed to the Management Committee of Morgan Stanley, the parent company, in 1998.

Committees of the Board of Directors

Five committees exist on the Board of Director level to provide oversight, on behalf of all shareholders, of key issues affecting the corporation's development. These committees are: Strategy; Audit; Nomination and Compensation; Sustainable Development and Corporate Governance, and Investor Relations.

The Strategy Committee analyzes strategic issues affecting the development of Sistema and its operating subsidiaries. The committee reviews financial strategy and the work of financial divisions, the strategy and projects of business areas and the activity of the divisions within the corporation's central management structure.

The Audit Committee oversees the preparation of financial reports, the meeting of financial targets and the audit of the financial reporting of Sistema and its subsidiary companies. In addition, the committee supervises the work of all external auditors and provides guidance over the appointment and compensation of auditors.

The Nomination and Compensation Committee provides the Board of Directors with recommendations for management appointments, selects candidates for election to the boards of affiliate and subsidiary companies. In addition, the committee develops policies for the corporation for developing incentive programs, including recommendations for salary and compensation of senior managers.

The Committee for Sustainable Development and Corporate Governance develops proposals for further improving the corporate conduct of Sistema and its affiliate companies as well as recommendations regarding issues of sustainable development, corporate responsibility and information disclosure. The committee also reviews issues of corporate governance at subsidiary companies and develops respective standard internal documentation.

The Committee for Investor Relations develops policies for developing communications with the investment community. It also strengthens Sistema's IR function with respective documentation and develops recommendations regarding specific investor relations issues.

Corporate governance Key Management

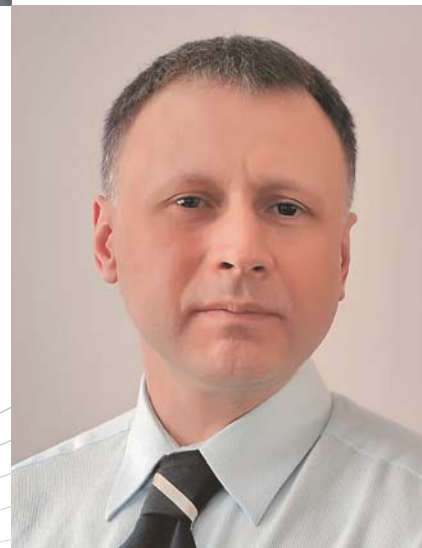
Alexander Goncharuk
President



Anton Abugov
First Vice President,
Head of Strategy and
Development



Ruslan Almakaev
Vice President
Head of Economic
and Information
Security



Alexey Buyanov
Senior Vice President
Head of Finance and
Investment



Sergey Drozdov
Senior Vice President,
Head of the Property



Sergey Cheremin
Vice President Head of
External Relations



Denis Muratov
Vice President
Head of Innovations and
Science



Key Management

The Management Board reports to the Board of Directors and is responsible for both the day-to-day management of Sistema and executing the strategies defined by the Board.

Alexander Goncharuk

President and Chief Executive Officer, Sistema

Alexander Goncharuk was born in 1956, in Sevastopol. He graduated with honors from both the Sevastopol Naval Engineering Academy in 1978 and the A. Grechko Naval Academy in 1987. From 1987 to 1991 Mr. Goncharuk served as a senior officer at the Main Headquarters of the Navy. He later became General Director of the company ACO Leader.

Mr. Goncharuk became Member of the Board of Directors of Sistema in 1996. From 1995 to 1998, he served as Vice President of Sistema. His group company positions included the post of Chairman of the Board of MTS (in 1998 and from 2002 to 2003), also served as Deputy Chairman of the Board in 1997 and for the first half of 1999. Mr. Goncharuk was President of Sistema Telecom from 1998 to 2003. Between 2003 and 2006, he was General Director of Concern Sitronics (CSC). In addition to serving on the Sistema Board, he was also elected to the boards of Sistema Telecom, MTS and Concern Sitronics. Since February 2006, Mr. Goncharuk has been the President of Sistema.

Anton Abugov

First Vice President, Head of Strategy and Development

Anton Abugov was born in 1976. He graduated from the National Economics Academy under the Government of the Russian Federation. In 1995, Mr. Abugov was involved in developing infrastructure and a regulatory framework for the securities market in Russia. Between 1995 and 2002, Mr. Abugov was head of corporate finance at UFG (United Financial Group), seeing through a number of major fundraising, strategic consultancy, and merger and acquisition projects in various industries in Russia and Eastern Europe. In 1999, he was an adviser to RAO UES.

Between 2003 and 2006, Mr. Abugov was Managing Director of AKB Rosbank, in charge of its Corporate Finance Department. Prior to Rosbank, he was a partner in Eurasia Capital Partners, overseeing investment projects in Eastern European telecoms and Russian petrochemical businesses. From 1997 to 2006, he was strategic adviser to the TAIF Group of Companies, one of the biggest financial-industrial groups in Russia.

Alexey Buyanov

Senior Vice President, Head of Financial Group

Alexey Buyanov was born in 1969, in Moscow. He graduated in 1992 from the Moscow Physics and Engineering Institute (MPEI) specializing in applied mathematics and physics and was an intern researcher at the Institute of Mechanics Problems (IMP) of the Russian Academy of Sciences from 1992 to 1994.

Mr. Buyanov joined Sistema in 1994 and occupied various posts at the Property Group until 1995 when he was appointed Head of Administration at Sistema-Invest, later becoming Vice President in 1996 and First Vice President in 1997. He also served as Vice President of MTS from 1998 to 2002. Also in 2002, he was appointed Vice President of Sistema and Head of the Financial Restructuring Department.

Later that year, Mr. Buyanov became First Vice President and Head of the Finance and Investment Group. He is also a Member of the Board of the following companies: MTS, Sistema Telecom, MBRD, East-West United Bank, Sistema-Hals, Alliance-Rosno Asset Management, Comstar-UTS.

Sergei Drozdov

Senior Vice President, Head of the Property Group

Sergei Drozdov was born in 1970 in Archangelsk. He graduated in 1993 from the S. Ordzhonikidze State Academy of Management in Economics. Mr. Drozdov was head of the Administration for Financial Innovation and Marketing at the Moscow Property Fund from 1994 to 1995.

Mr. Drozdov has been working at Sistema since 1995. He managed the Department for Development and Investments from 1995 to 1998 and from 1998 and 2002, served as Vice President, Acting President and First Vice President of Sistema-Invest.

He became Acting First Vice President and Head of the Department for Corporate Property in May 2002. In September 2002, he was

appointed Director and First Vice President of Sistema and Chief of the Property Complex. He holds a number of other senior corporate positions, mainly among group companies, including Chairman of the Boards of Detsky Mir, Reestr, Detsky Mir Center and NII Stali. Mr. Drozdov also serves on the Boards of Sistema Telecom, MGTS, CSC, Sistema-International, Medical Technology MTH, Olimpiyskaya Sistema, Intourist Hotel Group and M-Consult.

Sergey Cheremin

Vice President, Head of External Relations

Sergey Cheremin was born in 1963 in Kislovodsk. He graduated with honors in 1989 from the Moscow State Institute of International Relations with a specialization in international journalism and completed his postgraduate course at Moscow State University specializing in global economic issues. In 1992, he was an intern at the New York Institute under the Investments and International Accounts Program and in 1993 joined a course for banking specialists at Fairfield University (USA).

From 1991 to 1992 Mr. Cheremin was Deputy CEO at Printbank and from 1992 to 1998 worked as the CEO of the Moscow Export-Import Bank. Between 1998 and 2000 he was Vice President of Ural Trust Bank and from 2000 to 2003 was Adviser to the President of Severo-Vostochny Alliance Bank where he subsequently became President. In 2004, he was appointed CEO of MBRD Bank and has acted as the Chairman of the Board there since April 2005. Since this time, he has also served as Sistema's Head of External Relations.

Ruslan Almakaev

Vice President,
Head of Economic and Information Security Group

Ruslan Almakaev was born in 1963 in Kharkov. In 1994 Mr. Almakaev graduated from Kharkov State University and in 2003 from the Krasnodar State University specializing in methods and systems of macroeconomic processes.

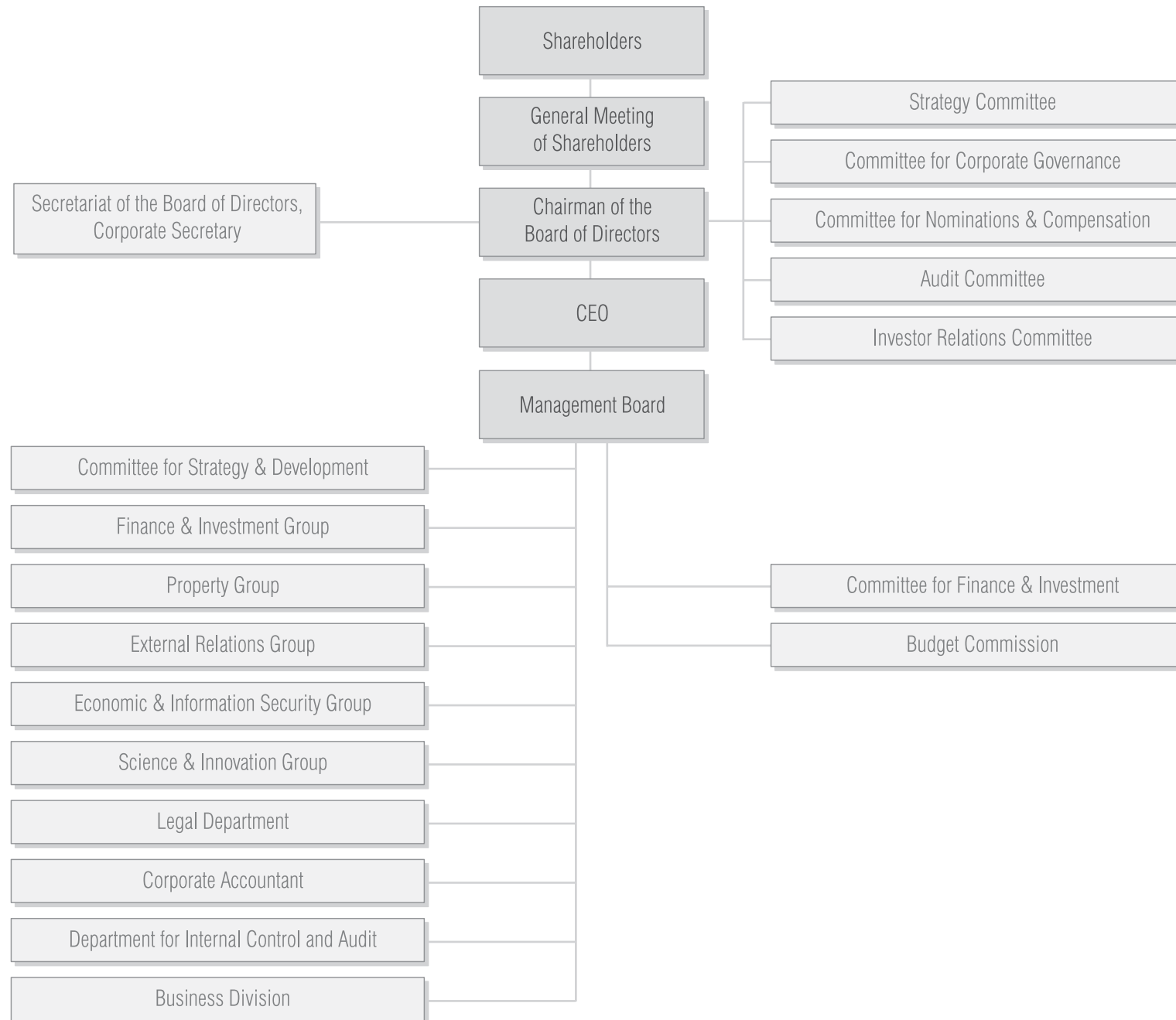
From 1993 to 2002, he worked as a Deputy Director General of AOZT Commercial and Industrial Company Eurasia and was an assistant to a member of the State Duma (parliament) of the Russian Federation, Deputy General Director of the regional public fund for the defense of Russian Air force workers and workers of the aviation fund (The Russian Aviation Fund). From 2002 to 2003, Mr. Almakaev was Head of the Department for Non-Corporate restructurings at Sistema.

Denis Muratov

Vice President, Head of Innovations and Science

Denis Muratov was born in Sverdlovsk, now re-named Ekaterinburg, in 1970. He graduated from the Sverdlovsk Institute of Architecture and the Chalmers University of Technology in Goteborg, Sweden. Between 1992 and 2004, he worked in Sweden, where he headed up several companies: Anton Invest AB, Nordic Industrial Development AB, Scantat AB and Media Resources International Scandinavia AB. In 2004, Mr. Muratov was appointed General Director of the Idea Innovation and Industrial Technopark in Kazan, and served as economic advisor to the First Vice Prime Minister of the Republic of Tatarstan. In February 2006, he was made Sistema's Vice President for Innovation and Science.

Corporate governance Management Structure



Corporate governance

Principles of Corporate Governance

Sistema is in the business of building businesses and maintaining and enhancing world-class systems of corporate governance for both the corporation and its subsidiaries. Good corporate governance for a company represents an important competitive advantage for the corporation. Managing a portfolio of leading consumer-focused businesses, Sistema sets high standards for its operating companies as they develop, tap into debt and equity markets and continue to evolve as public companies. In turn, the corporation's directors set the highest standards of transparency and the corporation has demonstrated a long-term ability to restructure rapidly to respond to changes in the marketplace and make its business more transparent.

A large corporation is a complex body. Its efficient management requires a high level of professionalism, precision and operational skills in taking decisions. The right set of corporate governance procedures allows managers and directors to achieve their goals for developing the business efficiently and crucially maintain the transparency of the company, the observance of minority shareholder interests and the necessary divisions of authority as well as a joint decision making approach. Doing all of this is ever more important for the modern corporation.

The principles and procedures of Sistema's corporate governance practices are defined by the company's charter. These rules define the corporation's relationships and communications with investors, employees, business partners, customers and government bodies. Specific codes on ethics and corporate conduct have been approved by the Board of Directors and are binding on directors and managers.

Sistema has developed and confirmed at the Board of Directors level the rules that establish a clear set of procedures for all levels of governance, including Annual and Extraordinary General Meetings of Shareholders, the Board of Directors, President, Executive Management, Audit Commission and so forth. Specific regulations cover information disclosure, dividend policies, procedures for internal financial control, the composition of the Board-level committees, management and mitigation of risks, conducting significant transactions and internal communications at all levels.

Since Sistema itself became a public company with its IPO on the LSE

in February 2005, the company is bound by additional stock exchange listing rules and securities markets regulations in the UK and Russia. Long before its IPO, Sistema has sought to exceed the minimum requirements for corporate governance set by the legislation. For instance, it began reporting its financial results prepared according to US GAAP requirements back in 1997 and the first board-level supervisory committee was established in 2001. In 2002, three years before the IPO, Sistema became the first Russian company to voluntarily disclose the identity of its beneficial owners.

The corporation took these steps not just because it allowed it to raise capital and attract business partners but because, as its founders believed, the corporation's long-term success rested on mutually advantageous relationships with all stakeholders. Building an innovation-led business is closely tied with developing a truly globally competitive economy in Russia. In this and many other ways, good corporate governance and social responsibility are tightly linked.

But while the charter and other normative documents are made to be comprehensive, they were also designed to be flexible enough to accommodate a rapidly changing marketplace. As with any competitive advantage, high standards and innovation in corporate governance require continuous change. Sistema is competing in an ever more crowded global marketplace to attract new investors who will maximize the price and liquidity of its shares. In Russia alone, according to recent estimates, there are around 25,000 open joint-stock companies. The country's sovereign debt has reached investment grade and booming equity and debt markets have seen a surge in stock market listings. Some 16 listings in 2006 raised around US\$20 billion in capital. Depending on a range of factors, some commentators suggest the number of listings could reach 30 in 2006, including a number of consumer-sector companies floating on Russian stock exchanges as well as international listings.

Sistema itself has been a major driver in this boom. The company's mobile communications operating company, MTS, which was listed on the New York Stock Exchange in 2000, performed the first Russian IPO after the Russian financial crisis of 1998. Sistema's IPO in February 2005 on the LSE was the largest Russian IPO ever conduct-

ted at the time, raising a total of US\$1.56 billion. The IPO of combined fixed-line operator Comstar was the second largest one year later. The listings of Sistema-Hals and Sitronics set benchmarks for their sectors.

These successful transactions demonstrated Sistema's ability to meet and exceed the strict disclosure and governance requirements of these markets. They also underscore that Sistema and companies in the holding now must compete globally against industry peers and other innovative emerging market companies. Along with delivering the right financial ratios, Sistema needs to demonstrate to portfolio investors that, whatever the size of their shareholding, their financial and legal rights and interests will be protected to the maximum degree and they will be allowed to participate in how Sistema is run.

The practice and standards of good corporate governance, combined with delivering strong financial results, work to establish trust in the corporation within the Russian and international investment community. It ensures Sistema can draw on the experience of leading global advisors and engage in an ongoing dialog with experienced investors. Sistema places particular importance on the development of effective investor communications. In 2003, the corporation created a dedicated Investor Relations department. Its main task is to provide investors, creditors, analysts, the financial media and other stakeholders with the required information about Sistema's financial and investment activities.

Sistema's directors and managers seek to deliver the best possible return on investments in the corporation's shares and bonds. The corporation has an established dividend policy and aims that dividends are paid regularly and predictably while insuring profit is also re-invested in development in order to ensure the long-term growth in the corporation's capitalization. Sistema aims to increase the liquidity and value of its securities and engage in an ongoing dialog with its investors through events such as Investor Days and road-shows conducted regularly in Russia and in global centers of capital. In addition, Sistema conducts regular surveys to determine the identity and scope of its shareholder base in order to better communicate information to current and prospective shareholders, beyond the bounds of exchange-mandated disclosure.

Effective corporate governance involves taking into account the interests of all stakeholders. As a fast-growing corporation that is constantly expanding its geographic presence and entering new product categories and sectors, this base of stakeholders is steadily increasing. This in turn requires new efforts by Sistema's managers and directors to ensure the needs of these groups are taken into account during the decision-making process of the corporation.

Local and national governments and regulators and social organizations are therefore important partners for the corporation

In April 2006, the Russian Institute of Directors and ratings agency Expert RA confirmed their top rating of 'A' for Sistema's corporate governance practices. In the report, their experts praised a high level of both financial and non-financial reporting, the inclusion of the interests of all stakeholders in the corporation's decision-making process and overall levels of corporate responsibility.

Corporate governance

Asset Structure

The table on the next page outlines Sistema's beneficial ownership and voting interests in subsidiary and associate companies where the corporation's ownership exceeds 20% of total ordinary shares. This list reflects shareholdings as of December 31, 2006.

Since the end of the reporting period, in February 2007, Sistema has sold 17.5% of its shares in Sitronics through an initial public offering on the London Stock Exchange and listings on the Moscow Stock Exchange and Russian Trading System.

On February 21, 2007, Sistema announced that it would sell 46.19% of ROSNO shares to Allianz as part of a share purchase agreement. Following the agreement, Sistema's shareholding in ROSNO was reduced to 3%.

Company	% of total ordinary shares owned by Sistema
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Telecommunications Business Area

Mobile TeleSystems	53%
Comstar United-TeleSystems	59%
MGTS	33%
Sky Link	50%
MTT	43%
Svyazinvest	25%

Medicine & Biotechnology Business Area

Medsi	67%
Medsi-2	74%

High-Technology Business Area

Sitronics	85%
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Real Estate Business Area

Sistema-Hals	80%
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Insurance Business Area

ROSNO	49%
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Finance Business Area

AKB MBRD	95%
East-West United Bank S.A., Luxembourg	51%

Retail Business Area

Detsky Mir Center	100%
Detsky Mir	75%

Company	% of total ordinary shares owned by Sistema
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Mass Media Business Area

Sistema Mass-Media	100%
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Tourism Business Area

Intourist	66%
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Radio & Aerospace Technology Business Area

Concern RTI Systems	100%
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Oil-extracting and oil-refining assets

ANK Bashneft	21%
Ufimsky NPZ	24%
Novoil	27%
Uralneftehim	23%
Ufaorgsintez	23%
Bashnefteproduct	25%

Biotechnology Business Area

Binnofarm	100%
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Shareholding Capital

General Information on Shareholding Capital

Sistema Joint Stock Financial Corporation was registered at the Moscow Registration Chamber on July 16, 1993. The corporation is registered at Prechistenka Street, House 17/8/9, Building 1, Moscow, 119034, Russian Federation.

The charter capital of the corporation is 868,500,000 rubles and consists of 482,500,000 ordinary shares with a nominal value of 1.8 rubles.

Sistema's shares are listed on the London Stock Exchange in the form of global depository receipts (GDRs) under the symbol 'SSA'. One GDR represents one ordinary share. Sistema's ordinary shares are traded on the Russian Trading System, under the symbol 'AFKS' and the Moscow Stock Exchange (MSE) under the ticker 'SIST'.

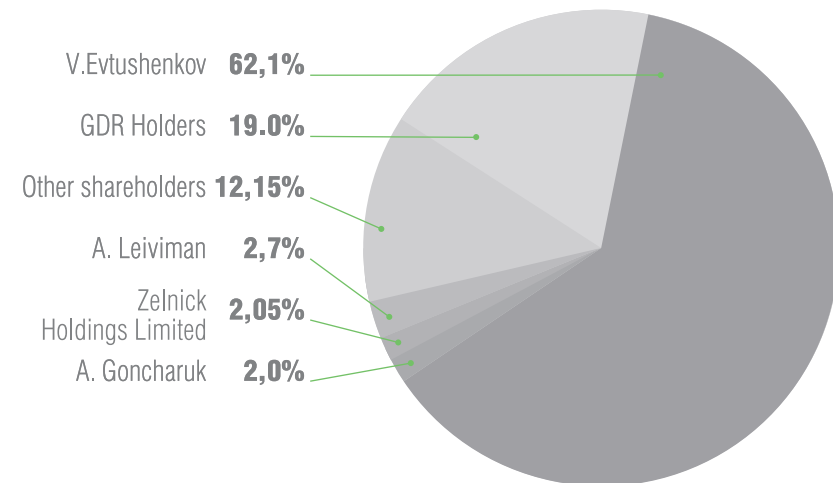
In addition, as of the end of 2006, a number of debt obligations issued by subsidiaries of the corporation traded on the financial market.

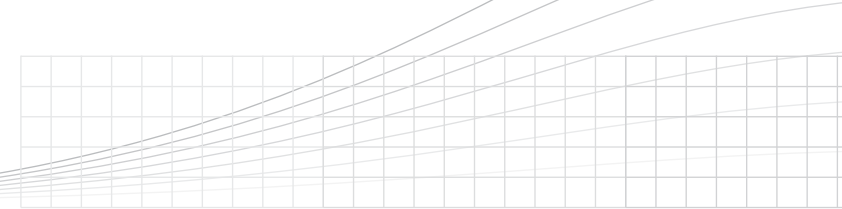
Shareholding Structure

As of December 31, 2006, the corporation had 22 entities and 12 individual shareholders, including 8 nominees. While the identities of the corporation's GDR holders are not generally reported to the corporation, Sistema undertakes regular research to discover the identity of its GDR holders. Such research allows the corporation to provide as much information as possible to the largest number of shareholders and is aimed at increasing the transparency of the corporation and providing greater liquidity for its shares on Russia and international exchanges.

Between March 2006 and mid-February 2007, Sistema purchased 284,243 of its own shares, equivalent to 2.95% of its outstanding shares, for approximately US\$347.3 million dollars. This share 'buy-back' was conducted as part of a previously announced plan to establish a share option program for the corporation's top management and these shares may also be used in future merger and acquisition activities.

Sistema Shareholders as of December 31, 2006





Share Price Performance

Since February 2005, when Sistema completed an initial public offering (IPO) on the London Stock Exchange, 19% of the corporation's outstanding shares have been in free-float in the form of global depository receipts (GDRs). Sistema's GDRs are listed on the LSE under the ticker 'SSA' and fifty GDRs represent one ordinary share.

In addition, Sistema's shares are traded on the Russian Trading System, under the symbol 'AFKS' and the Moscow Stock Exchange (MSE), under the ticker 'SIST'. Sistema's ordinary shares are a component of the MSE's technical index.

For the year 2006 as a whole, Sistema's GDR price on the LSE rose 26.6%, from US\$23.5 on January 2, reaching US\$32.0 on the last trading day of the year, December 29. The 12-month high share price was achieved on December 28. The yearly low came on June 26, when the closing price was 18.1. Price momentum was driven by company news, particularly interim financial results, such as the third quarter set of results released on December 21, as well as broader trends in the Russian economy the broader investor strategies linked to their desire to hold shares from emerging markets.

Sistema encourages current and potential investors to seek independent, expert financial advice when making decisions regarding the purchase and sale of shares. Sistema's equity shares, as well as its outstanding bond issues, are covered by analysts from a number of Russian and international brokerage houses. A list of these analysts, including contact details, is published on www.sistema.com and regularly updated.

Sistema - GDR Closing Price on LSE



Dividend Policy

Sistema's Board of Directors is guided by the corporation's current dividend policy as established in August 2005 when making its dividend recommendation to the Annual General Meeting. The target payout level stands at 2% of the corporation's consolidated net income under US GAAP. This policy aims to both provide for a predictable sizeable dividend flow and maintain a dividend history while simultaneously giving the opportunity to re-invest profits to meet Sistema's capital requirements in order to maintain sustainable growth.

At the Annual General Meeting held on June 30, 2006, the shareholders approved a cash dividend of RUR 28.0 per share (equivalent to US\$1.03 per share or US\$0.02 per GDR) for the twelve months ended 31 December 2005. The total dividend payable amounts to RUB 270.2 million (US\$9.98 million), which is equivalent to approximately 2% of Sistema's US GAAP consolidated net income for 2005. In recent years, the company paid a dividend equivalent to approximately 1.3% of its consolidated net income for the year 2003 and dividend payout equivalent to approximately 2.1% of consolidated net income for the year 2004.

Share Structure and Performance of Subsidiary Companies

MTS

Mobile TeleSystems placed a Level III ADR issue through its IPO on the New York Stock Exchange (NYSE) on June 30, 2000. The current ADR to ordinary share ratio is 1:5, following a 1:4 ADR split in January 2005. MTS's shares trade on the NYSE under the symbol 'MBT'. The company's major trading volumes are on NYSE.

MTS's depositary receipts are also traded on the LSE (ticker: MBLD), Frankfurt Stock Exchange (ticker: MKY), Berlin Stock Exchange and Munich Stock Exchange. MTS shares are traded on the Russian Trading System (RTS) as a non-listed security and were included on the RTS Index in March 2006 with a 5.7% weighting. Common shares of MTS have been included on the MICEX "B" Quotation List under the ticker 'MTSI'.

Presently, the company has 1,993,326,138 ordinary shares with a nominal value of RUB0.1 per share. As of December 31, 2006, Sistema owned 53% of Sistema's shares and 46% of shares were in free-float.

MTS's ADR price closed at US\$35.0 on the first day of trading of the year and reached a high of US\$50.18 on December 27, 2006, before closing at US\$50.08 on the last day of trading of 2006. As of December 31, 2006, the company's market capitalization was US\$19.97 billion.

MTS - ADR Closing Price on NYSE



Comstar-UTS

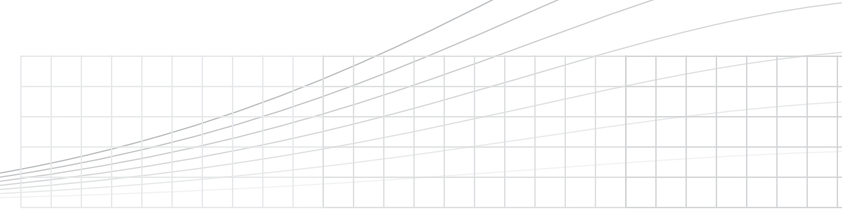
In February 2006, Comstar completed an IPO of 146,500,000 common shares. These shares included 139,000,000 newly issued shares and 7,500,000 shares sold by shareholders. The shares were admitted to trade on the London Stock Exchange (LSE) in the form of global depositary receipts (GDRs) at the value of 1 GDR per 1 common share.

Currently, the Group has 417,940,860 outstanding shares with a nominal value of RUB1 per share. As of December 31, 2006, Sistema directly or indirectly owned 59% of Comstar's common shares. Approximately 34% of Comstar's shares are in free-float, traded in the form of GDRs on the London Stock Exchange, under the ticker 'CMST'. A very limited number of common shares are traded on Russian stock exchanges, primarily the Russian Trading System (RTS) and the Moscow Stock Exchange, also under the ticker 'CMST'.

Comstar's GDRs closed at US\$6.87 after their first day of trading on the LSE on February 7, 2006 and reached their 2006 calendar year high of US\$8.59 on December 27th, 2006. The company's market capitalization as at December 31, 2006 was US\$3.51 billion.

Comstar - GDR Closing Price on LSE





Sistema-Hals

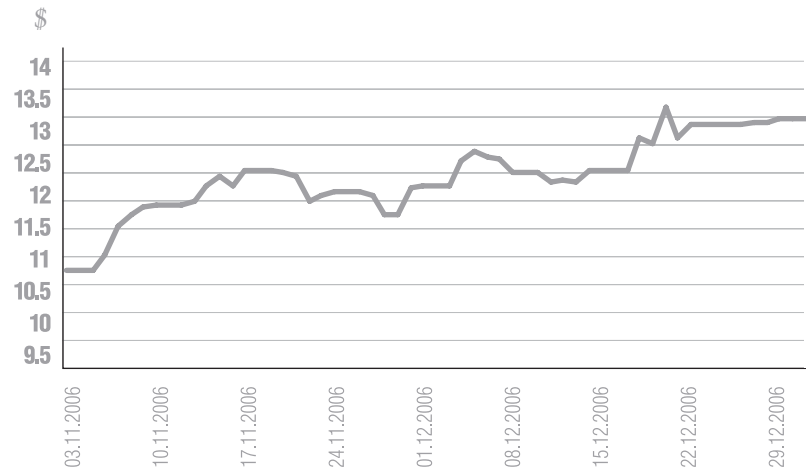
Sistema-Hals's shares were admitted to trading in the form of GDRs on the LSE on November 8, 2006. The company offered 1,738,650 newly issued shares and 112,171 shares from selling shareholders. In addition, the underwriters exercised an option to purchase 168,256 ordinary shares in the form of GDRs to cover over-allotments in the offering. The shares were offered at US\$10.7 per GDR and US\$214.00 per ordinary share, representing a ratio of 20 GDRs per ordinary share.

Sistema-Hals's shares are traded in the form of GDRs on the LSE under the symbol 'Hals' and the ordinary shares were included in the 'V' list of MICEX under the ticker 'HALS' on October 9, 2006 and in the 'V' list of the Moscow Stock Exchange on October 17, 2006.

Currently, Sistema-Hals has 9,813,084 ordinary shares. As of December 31, 2006, Sistema owned 80% of the ordinary shares of Sistema-Hals and 20% were in free-float.

The company's shares were sold at an offer price of US\$10.7 per GDR and reached a high of US\$13.5 on December 20, 2006, before closing at US\$13.3 on the last day of trading of the year. As at December 31, 2006, the company's market capitalization was US\$2.61.

Sistema-Hals - GDR Closing Price on LSE



Social Responsibility

The social responsibility of a large corporation today is a reflection of the complex network of relationships within a modern market economy. A critical component of responsibility is the nature of the business the corporation conducts and the contribution of its products and services to the economy as a whole. The relationship between a company and the community where it operates, is reflected by how it deals with its employees, its support for the local educational and scientific institutions, that train its future workers and management of the environmental impact of its activities. A socially responsible corporation also fosters a dialog with its many stakeholders, including government, consumers, workers, regulators, business partners and investors so it can address any possible concerns about the impact of its activities.

Sistema sees its primary social contribution as its business itself and this is incorporated in the vision and strategy of the corporation. Its social activities are integral parts of its mission as a company. By building service-oriented, high-technology businesses, the corporation is fostering the creation of an innovation economy in Russia and helping to diversify the economy to compete in the global economy. These services are helping to build a better quality of life in the future, tying individuals and businesses together through better communications, building modern housing, offices and infrastructure and offering financial services, that allow consumers to buy their first house or a new car.

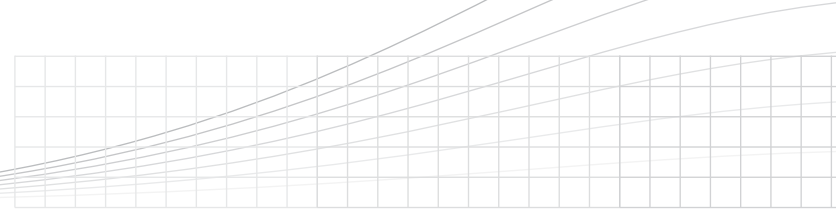
The corporation has played an important role in the growth of capital markets in Russia and the inflow of investment into Russia in recent years. The IPOs of Sistema and its operating companies Comstar, Sistema-Hals and Sitronics have injected capital into key, value-creating parts of the economy and increased the overall investment attractiveness of the Russian market as a whole. A sizeable proportion of this investment has been directed at developing emerging sectors of the economy, creating better paying jobs and developing services, that were absent just a few years ago. Sistema's development of venture-capital funds in partnership with the Russian federal government and regional administrations is also helping to foster new sources of capital for new firms, helping the government meet its declared strategy of developing high technology as a national priority.

Sistema continues to work to build a more comprehensive social dialog with consumers, regulators and federal and local government officials in the markets where it operates. One aspect of this process is the corporation's established policy of information openness. Sistema aims to disclose all material information about its business activities as quickly as possible through all distribution channels. If something adverse or unexpected happens, the company believes it is not only its obligation but to its benefit to share this information. Trust is critical to sustaining its many relationships in society.

Constructive dialog is also conducted through the business and social organizations the corporation and its directors belong to and through the media. In July and August of 2006, the corporation conducted a perception study of stakeholders from government, the media, the Russian investment community, employees at local affiliates and business and non-profit partners. The results allowed the corporation to see what it is doing right and what it can still do to foster dialog and to see how others view it today. Ultimately, the question before the corporation is: what information do stakeholders need from us and what are their concerns?

As a high-technology, consumer-sector company, the quality and motivation of its more than 90,000 employees and managers is of vital importance and human capital is Sistema's most important resource. The corporation prides itself on a culture of teamwork and shared priorities. Motivation of personnel includes not only wages and bonuses but also the prospect of advancement and a sense of security about their future and that of their families.

Sistema was one of the first companies in Russia to develop its own Corporate University. This and other extended education and training programs provide workers with the opportunity to enhance their qualifications and move into new fields. Sistema has established programs with a range of leading Russian universities and research institutes for training its employees, while also financing the creation and expansion of faculties and programs in various technical fields. Yearly performance reviews for workers and support in career planning allow employees to set goals for their development at Sistema, while knowing just what is expected of them.



In its charitable activities, Sistema applies the same strict criteria as it does for any other aspect of its business: its social programs should provide real and verifiable results that in turn improve society. The Sistema Charitable Fund is focused on supporting the development of science and education, preserving Russia's cultural and artistic heritage for future generations, promoting sport and aiding the development of local communities. All of these activities share the common goal of creating a more vibrant and educated society.

When selecting projects to support, Sistema looks for those that have a unique and innovative character. One characteristic project sponsored by the corporation is the creation of regional information and educational centers called 'The Virtual World of the Russian Museum'. Thanks to the latest technology developed for the project, millions of Russians across the country are able to make virtual visits to the collection of the Russian State Museum. The corporation's projects range from the creation of three-level support for professional training, the founding of departments in universities and technical institutes, to organizing youth hockey and rugby tournaments and supporting Russian Olympians. The link between these programs is that they promote education, healthy lifestyles and achievement.

Sistema has adopted internationally recognized principles of sustainable development and corporate social responsibility and integrates them into its business practices. The corporation became one of the first companies in Russia to sign the Global Compact of the United Nations (UN-GC) in 2002. In 2003, Sistema joined the World Business Council for Sustainable Development (WBCSD). As with other WBCSD members, the corporation has committed itself to maintain a high level of transparency and responsibility in all aspects of its business.



A Reliable
Foundation
Businesses

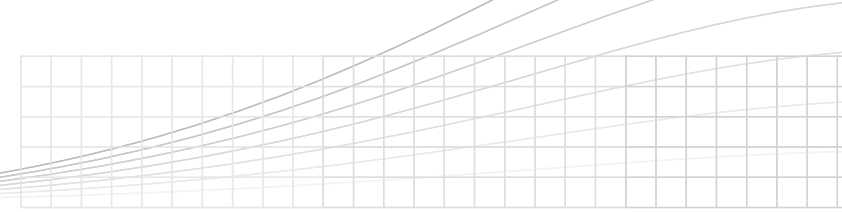


Sistema Telecom is Russia's largest telecommunications company, servicing around 80 million subscribers. The company includes more than 50 telecommunications operators working in all of the main segments of the telecommunications market.

A Reliable Foundation Telecommunications

Sergey
Schebetov
CEO,
Sistema Telecom





Marketplace

The market for telecommunications services continues to be one of the most dynamic and competitive sectors in Russia and the CIS today. The sector's significant growth potential is apparent in all key sectors of the telecommunications business. According to preliminary data from the Russian Ministry of Information Technologies and Telecommunications, the total volume of the Russian telecommunications market grew 21% year-on-year in 2006 to over \$27.5 billion.

In 2006, both wireless and fixed-line segments saw strong growth, although the mobile segment saw a far higher degree of market saturation and consolidation around three major wireless players. Mobile telephony penetration reached 104.6% at the end of 2006, representing an increase of 18% compared to 2005. Russia had 151.9 million mobile telephony subscribers, an increase of 26.2 million.

Fixed-line services for both residential and corporate subscribers, including voice, data-exchange and Internet broadband are developing dynamically, although there is still considerable unmet demand for services. Fixed-line penetration for Russia as a whole was 57.2% of total households in 2006. Moscow's broadband penetration rate, measured by numbers of households, was 26% at the end of 2006. However, broadband penetration for Russia as a whole was around 4.5%, compared to other Central and Eastern European markets such as Hungary (11.4%) and Poland (10.6%). Excluding Moscow, this rate was around 2.0% at the end of 2006.

The level of competition in the Russian telecommunications market is increasing rapidly. The provision of value-added services for both fixed-line and wireless subscribers is key to both increasing margins and building customer loyalty. Recent regulatory changes in the Russian telecommunications sector have also had an impact on the competitive landscape. Tariff regulations for interconnect and traffic exchange came into effect in October 2005. The principle of Calling Party Pays (CPP) was introduced from July 2006.

Outside of Russia, markets in the CIS countries offer significant long-term growth potential. These former Soviet republics have seen rapid economic growth, high rates of consumer spending and continuing, low rates of penetration of telephony services relative to Russia and Central and Eastern European peers. In addition, a number of markets in Central and Eastern Europe offer strong growth potential in particular segments, such as broadband Internet, and provide low-cost base for technology development.

Business

Telecommunications represents a core, long-term business for Sistema. Sistema Telecom is managing the companies in the Telecommunications business unit. Sistema Telecom is developing businesses along two key lines, wireless and fixed-line communications. At the same time, it is building convergent services across wireless and fixed-line. Sistema Telecom is delivering value-added services such as Internet banking employing synergies with other business areas at Sistema.

Wireless Communications

Mobile TeleSystems (MTS) operating in the wireless communications market is Sistema's largest asset and the leading cellular operator in Eastern Europe. MTS is one of the top-10 mobile companies in the world in terms of subscriber numbers. The company is the leader in Russia's highly competitive mobile telephony market, with a market share of 33.7%. MTS is also one of the market leaders in Ukraine, through its subsidiary UMS and a leading player in the emerging mobile markets of Belarus, Turkmenistan and Uzbekistan. As of December 31, 2006, MTS had 73 million subscribers in Russia and the CIS.²

Sistema is MTS's largest shareholder, with 53.1% of its shares. The company has been listed on the New York Stock Exchange since 2001 and 46.4% of its shares are in free float. A further 0.5% belongs to other investors.

Fixed Line

Comstar-United TeleSystems (Comstar) is an integrated holding under Sistema Telecom's management that encompasses all fixed-line businesses of Sistema, including the leading incumbent and alternative fixed-line operators in Moscow and growing regional and international alternative fixed-line services. It operates under three umbrella brands, Comstar (alternative fixed-line), MGTS (Moscow's incumbent fixed-line provider) and Stream (broadband Internet and content).

In addition, the holding is a leading provider of residential and business Internet broadband, data exchange and IPTV, Wi-Fi and hybrid fixed-line and mobile technology solutions in Russia.

At the end of 2006, Comstar had over four million fixed-line

subscribers and 359,895 broadband customers in Moscow and Moscow Region. The Group's Comstar and MGTS stand-alone networks in Moscow provide unrivalled capacity and form the base for a future New Generation Network.

In February 2006, Comstar conducted a successful IPO on the London Stock Exchange and around 35% of its shares are in free-float. In addition, since December 2006, Comstar-UTS has become a 25% plus one shareholder of Telecommunication Investment Joint Stock Company (Svyazinvest).

Results

Consolidated revenues in the Telecommunications segment grew 27% to US\$7.48 billion in 2006. Revenue growth outpaced the overall rate of the telecommunications market for the sixth year in a row. OIBDA increased 24% during the year, reaching US\$3.62 billion.

Joint capitalization of companies under Sistema Telecom's management grew by nearly 50% to US\$20 billion. At the same time, the share of telecommunications revenues in the consolidated revenues of the group stood at 69% in 2006, compared to 78% in 2005 and 80.5% in 2004. This reflects Sistema's long-term strategy of reducing the share of telecommunications in its overall revenues, while ensuring the business area remains part of its solid foundation for long-term profit growth.

In May 2006, the corporation launched a common visual brand identity for all of its operating subsidiaries in the telecommunications businesses. The common umbrella brand identity shares the simple, timeless form of an egg. For consumers and business partners, the common look and feel of the brands conveys shared traits of reliability, innovation and a customer-first approach across the Group. For the companies themselves, the brand represents current and potential synergies that can help each business achieve its goals.

During the year, the corporation purchased and later sold to a related party the first telecommunications asset outside of Russia and the CIS (UK wholesale operator WaveCrest LLC) and signed an SPA with Greek broadband Internet provider Hellas On-Line. The acquisitions underline Sistema's emergence as a truly global player in the sector and provide additional exposure to growing markets. For example, Greece had the lowest broadband penetration rate in Europe at around 6% of households at the end of 2006, versus the Western European average of around 36%.

MTS

MTS exceeded all market growth forecasts in 2006 and contributed the majority of revenues in the Telecommunications segment. Dynamic revenue and earnings growth, international expansion and maintenance of market share, were accompanied by the appointment of a new senior management team and adoption of a new long-term strategy aimed at maintaining and enhancing market share. Cost optimization across the company was a primary driver of bottom-line growth.

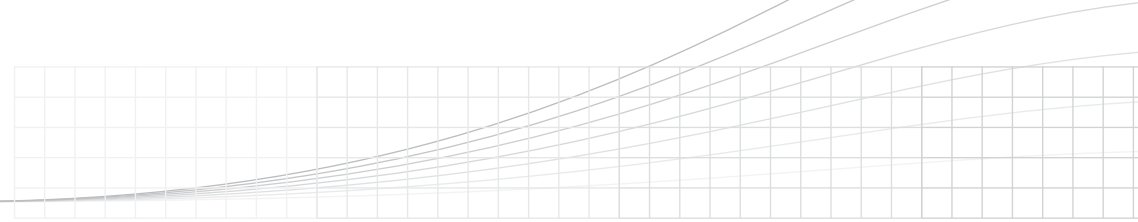
According to the company's US GAAP audited results, MTS's consolidated revenues increased by 27% year-on-year to US\$6.38 billion, compared to US\$5.01 billion in 2005. Net income increased by 11% to US\$1.25 billion in 2006. For the first time in the company's history, MTS became free cash-flow positive, with US\$646 million. During 2006, the company made a record dividend payout of US\$562 million for full-year 2005.

In April 2006, MTS appointed Leonid Melamed as CEO and Vsevolod Rozanov as a new CFO. Following these moves, the company adopted a new '3+1' strategy aimed at maintaining and enhancing market leadership, continuing growth and creating value. MTS is focused on strengthening its Russian market leadership, establishing leadership in CIS markets, building a base for selective acquisitions internationally and exploring additional opportunities for launching convergent services and pursuing vertical integration.

Comstar

Comstar achieved both impressive revenue and earnings growth, while carrying out an IPO and major restructuring during 2006. According to the company's US GAAP audited for the full year, consolidated revenues increased by 23% to US\$1.12 billion, compared to US\$907.6 million in 2005. Underlying net income increased by 69% year-on-year to US\$178.1 million, compared to US\$105.9 million in 2005.

After completing the first stage of restructuring and consolidation in late 2005, Comstar undertook a successful IPO on the LSE in February 2006, raising US\$1 billion for the further development of the company. During 2006, the company created an integrated Group headed by a new corporate center with five operating subsidiaries: Comstar Moscow, Moscow City Telephone Network (MGTS), Comstar Direct, Comstar Regions and Comstar International.



During 2006, Comstar retained its leadership in the Moscow broadband market with a 38.4% share at the end of 2006. The total number of broadband subscribers in Moscow was increased by 44% to 359,895 customers during the year. Stream accounted for 18.1% of the Pay-TV market in Moscow at the end of 2006 in terms of subscriber numbers, compared to just 2.1% the previous year. The 'double play' subscriber base in Moscow grew twelve-fold over the period, reaching 83,328 customers. MGTS further enlarged its subscriber base, reaching a total 3.6 million residential subscribers in Moscow. In addition, Comstar added 1,180 corporate subscribers through acquisitions in Ukraine and Armenia.

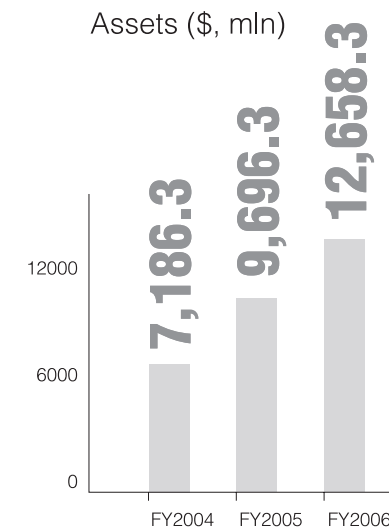
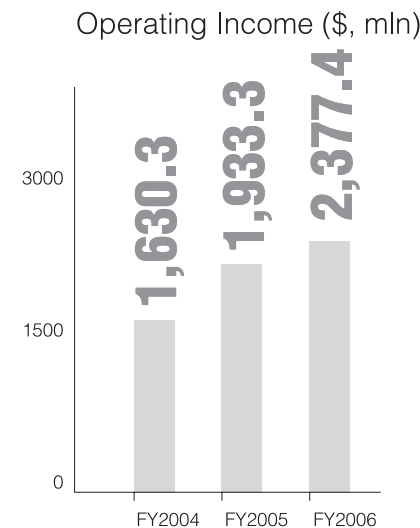
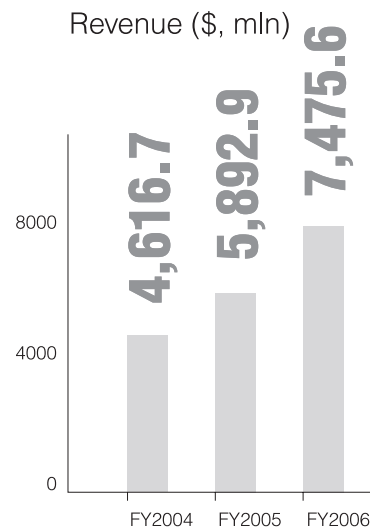
In addition to strengthening its position in Moscow and other regions of Russia through new product launches and selective acquisitions, such as Moscow Region alternative operator Astelit, Comstar expanded into the Ukrainian market. In the fourth quarter of 2006, Comstar acquired Kiev-based fixed-line carriers DG Tel and Technologic Systems. In December, Comstar purchased alternative carriers CallNet and Cornet in Armenia. The signing of an SPA with Hellas On-Line during the same month provided Comstar with an opportunity to develop its first operations outside of the CIS.

In late July, Eric Franke was appointed CEO of Comstar bringing some 20 years of experience in international telecommunications and 10 years in senior positions in Russia and the CIS to the job. In addition, a new executive team was put in place, including Alexander Gorbunov, VP for Strategy and Development, Nikolay Tokarev, CFO and Wolfgang Broeuer as CTO.

The acquisition of the blocking stake in Svyazinvest by Comstar in December 2006 was in line with Sistema and Comstar's declared strategy of participating in the development of Russia's incumbent fixed-line telecommunications sector. In the short term, Sistema and Comstar will seek to work with Svyazinvest's management and other investors to grow the value of the company and make its structure both more transparent and efficient. Looking forward, the Group has the potential to help Svyazinvest exploit synergies within the holding and develop new products. In the longer term, Sistema and Comstar aim to play a role in any potential future privatization or other transaction involving the holding.

- 1 Source: Comstar, Direct Info, by number of households
- 2 Source: Sistema Telecom handbook
- 3 Source: Direct Info, 4Q2006, including individuals, who connect to the Internet through Comstar Direct channels, by number of subscribers

Revenue, \$ **7,475.6 mln**
 Operating Income, \$ **2,377.4 mln**
 Assets, \$ **12,658.3 mln**



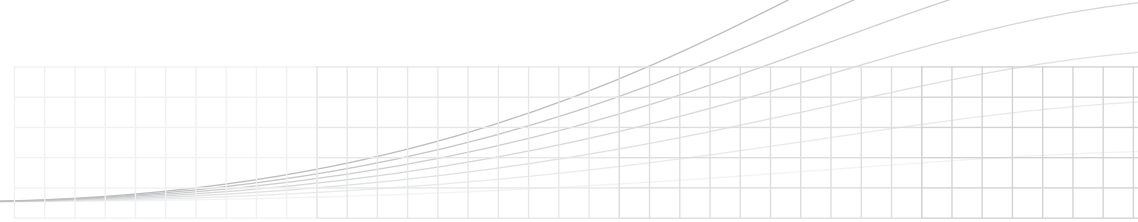


Sitronics is a leading Eastern European high technology company. The IPO of Sitronics was the second largest ever placement by a technology company in the history of the London Stock Exchange.

A Reliable Foundation Technology

Evgeny
Utkin
President,
Sitronics





Marketplace

Sistema's Technology business is represented by Sitronics, which operates in fast-growing markets for telecommunications solutions, including software, equipment and systems integration, IT solutions and microelectronic solutions. During 2006, this business area continued to see dynamic growth, while key market segments continued to show long-term growth potential in the company's key markets: Russia, the CIS, Central and Eastern Europe, the Middle East and Africa.

Telecommunications Solutions

According to data from market research group IDC, the total market for telecommunications equipment of the type produced by Sitronics in Russia, the CIS and Central and Eastern Europe was worth approximately US\$4.6 billion in 2005. The market in Russia alone was estimated at US\$1.9 billion. This total includes estimated expenditure on new generation fixed-line networks (NGNs) of US\$85 million, time-division multiplexers (TDM) of around US\$422 million, broadband access of around US\$25 million and products, programming support and services for WiMAX networks of around US\$25 million.

IDC forecasts indicate that overall demand for equipment in Sitronics's key international markets will grow by 5.8%. A significant part of this growth is attributable to the Middle East and Africa, where growth in 2006 was expected to have reached 39.6% and in the CIS, including Russia and Ukraine, where growth of 30.3% was forecast.

The demand for equipment for telecommunications infrastructure in the markets where Sitronics operates is driven by relatively low levels of mobile penetration compared to developed markets and often poor quality of fixed-line infrastructure. According to the International Telecommunications Union (ITU), mobile penetration in Russia in 2005 was 83.6% compared to 37% in Ukraine. In 2006, this level reached 104.6% in Russia and 79.3% in Ukraine¹. Operators are investing in new equipment and services to provide multimedia and other value-added content, with the prospect of launching third-generation (3-G) services as governments make licenses for these frequencies available. Investment in WiMAX and other alternative wireless and convergent technologies allow operators to provide corporate clients with services that circumvent poor fixed-line infrastructure.

Low-levels of fixed-line penetration have driven substantial investment by alternative operators in infrastructure for commercial and

residential customers. More recently, restructuring of fixed-line incumbent operators has fuelled demand for technology to upgrade existing networks. According to ITU, at the end of 2005, fixed-line penetration in Russia stood at 27.9% and in Ukraine at 25.8%. Fixed-line penetration in Russia reached 57.2% of households in 2006. Increasing demand for broadband Internet services, including IP telephony and gaming, is also driving investment in technology. Broadband penetration rates in Central and Eastern Europe and the CIS trail levels in Western Europe and North America. As of June 2006, broadband penetration in the US was 17% and in Western Europe 19.3%, compared to 2% in Russia, 0.1% in Ukraine, 2.8% in Greece and 7.5% in Czech Republic².

Information Technology

IDC forecasts indicate the global market for IT equipment, programming and services was worth US\$1.17 trillion in 2006 and will grow at an average annual rate of 6.0% through 2010. Growth in the global market for equipment was forecast at 7.6% in 2006, in programming at 7.8% and in services by 5.9%. The IT market in Central and Eastern Europe was forecast to have reached a total value of US\$35.9 billion in 2006. In Russia, the analogous figure was 14.3 billion. Purchases of equipment has been the main driver of the IT sector in these countries in recent years, although services, such as systems integration, are forecast to grow at the fastest rate, at 17.2% per annum through 2010 in Central and Eastern Europe, versus 13.6% for the market as a whole. In Russia, the rates are forecast at 24.7% compared to 17.8% accordingly.

Microelectronic Components

According to research group Gartner, the global market for semi-conductors grew from US\$155.6 billion in 2002 to US\$235 billion in 2005. The market is predicted to grow by an average annual growth rate of 6.4% between 2005 and 2010³, reaching a value of US\$321 billion. In Russia, the market for semi-conductors doubled from US\$400 million in 2002 to US\$800 million in 2005 and is forecast to grow by an annual rate of 25.4% between 2006 and 2010³. The largest consumers of microelectronic components in the Russian market are producers of industrial electronics, communications equipment makers and the defense industry.

Business

Sitronics is a leading provider of telecommunication solutions, including software, equipment and systems integration, IT solutions and microelectronic solutions in Russia and the CIS with a strong presence in Central Europe. It is majority owned by Sistema.

With the recent acquisition of Intracom Telecom in Greece, Sitronics has a strong presence in Eastern Europe and a growing presence in the Middle East and Africa. The company is particularly well-positioned to exploit fast-growing markets in CIS, Eastern Europe, Middle East and Africa ('EEMEA') as well as Central and Eastern Europe ('CEE').

Sitronics serves over 3,500 clients, maintains offices in 29 countries and exports its products and services to more than 60 countries. The company has over 10,000 employees, with around 4,600 involved in research and development.

The company's key Telecommunication Solutions operations are based in Prague, Czech Republic and Athens, Greece, while the company's IT Solutions and Microelectronic Solutions divisions are based in Kiev, Ukraine and Zelenograd, Russia, respectively.

Sitronics has developed strategic alliances in its home markets with Cisco Systems, STMicroelectronics, Infineon and Giesecke & Devrient for certain products and services. The company also has vendor relationships with Siemens, Ericsson, Motorola, ORACLE, Intel, Sun Microsystems and Microsoft. Key customers include Sistema group companies, such as MTS, Comstar UTS and MTT, as well as OTE, Cosmote, Vodafone, Ericsson, Arcelor Mittal (formerly Mittal Steel), Banca Intesa and TCL.

The IPO of Sitronics on the LSE valued the company at US\$2.3 billion, underlining the company's emergence as the leading high-technology company in the CIS and Central and Eastern Europe, with a growing presence in the fast-growing markets of the Middle East and Africa. The company's strategy continues to seek organic growth while pursuing carefully selected mergers and acquisitions to enhance both its geographical reach and research and development and production capabilities.

As part of its long-term strategy, Sitronics has focused on key technology segments: telecommunications solutions, IT solutions and microelectronics solutions. In addition, the company also has a consumer electronics business and provides contract production of electronics (EMS).

Sitronics is developing its telecommunications solutions business on the base of two key operating companies, Strom Telecom, based in Czech Republic and Intracom Telecom, based in Greece and

acquired in 2006. These units develop and produce equipment, provide programming solutions and support and provide systems integration services.

The IT solutions business is driven by Ukrainian group Kvazar-Micro. Kvazar-Micro has operations in several Central and Eastern European countries and is a key platform for further developing the company's higher margin systems integration and consulting business in Russia, the CIS and internationally.

The microelectronic solutions unit of Sitronics is based in Russia's long-established electronics research and production center of Zelenograd around the NIIME and Mikron enterprises. In addition, the company has the VZPP-Mikron production plant in Voronezh. Microelectronic Solutions is focused on design and production of integrated circuits and smart cards for both private sector and state-run enterprises in the aerospace, defense, consumer and other industries in Russia and internationally. In July 2006, Sitronics microelectronic solution started the project for modernization of production facilities with the introduction of 0.18 micron E2PROM technology, representing an unparalleled technological breakthrough for Russia.

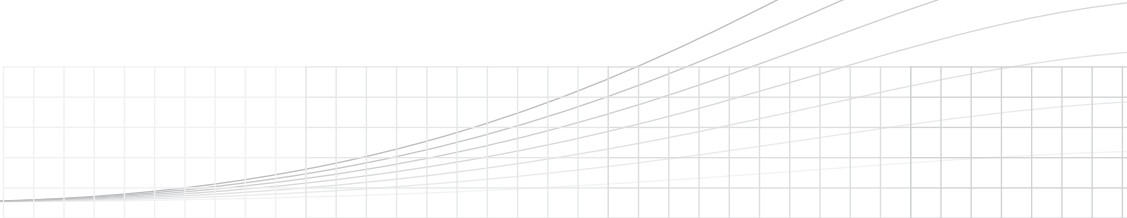
Results

During 2006, the High Technology segment was again one of Sistema's fastest growing business areas. Revenues grew 67% year-on-year to US\$1.61 billion in 2006, compared to US\$961.1 million in 2005. OIBDA increased 11% to reach US\$172.2 million.

Ahead of the company's successful IPO on the LSE in February 2007 saw the company raise US\$402 million, Sitronics undertook a number of key steps to improve its corporate governance and increase its efficiency. The company appointed independent directors to its board and continued to buy-out minority shareholders in its operating subsidiaries, including the purchase of the remaining 3.2% of Micron's shares, bringing its ownership to 100%.

The European Bank for Reconstruction and Development (EBRD) acquired 3.7% of Sitronics shares ahead of the IPO, providing additional funding and expertise for the company. Earlier in the year, the company placed a US\$200 million Eurobond issue at 7.875%, one of the lowest bond interest rates achieved by a Russian corporate issuer.

In February 2006, Sitronics significantly strengthened its telecommunications solutions business and expanded its geographic reach



with the acquisition of Greek technology company Intracom Telecom. The deal made Sitronics the leading high-technology solutions provider in Central and Eastern Europe. The important role played by the company in developing Russia's technological potential was underlined by a visit and meeting held by Russian President Vladimir Putin at Zelenograd in October 2006.

Sitronics emergence as the leading technology business in the region was underlined by the company's selection as CISCO's only global partner in Eastern Europe. The company also began construction of a 'turn-key' telecommunications network for ITC in Saudi Arabia.

Sitronics also began implementation of billing systems for Vodafone in Czech Republic as well as billing projects in Serbia and Pakistan, underlining its truly international scope.

During 2006, the company invested in modernization and expansion of its infrastructure, opening a new plant in Votitsa. As part of a wider upgrade at its Zelenograd facilities, the company implemented an unprecedented project to modernize its micro-electronics production from 0.80 to 0.13 micron technology. In addition, a new centralized research and development facility was opened and a project developed to create a unified scientific and experimental facility at Zelenograd. The company's R&D expertise led to the award of a grant by the Russian state NIOKR program.

In order to strengthen its added-value offerings, it also launched production of smart cards, including SIM cards and RFID technolo-

gy as well as chip modules. New product launches were made possible by the acquisition of Intracom Telecom, including networks for providing IPTV content, fixed-line and wireless access. Key pilot projects for NGN networks were also completed during the year.

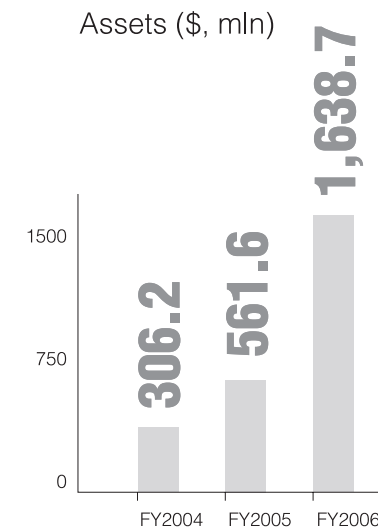
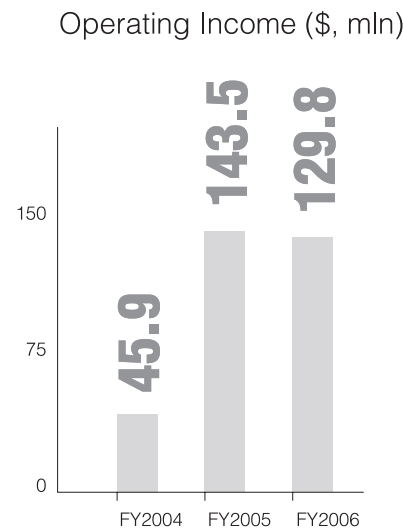
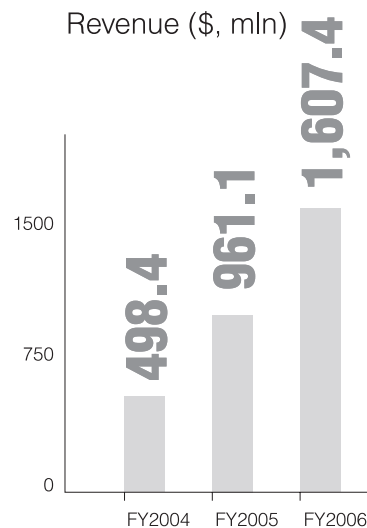
Sitronics also invested in human resources, providing incentives for senior managers and training for its employees. In March 2006, Sistema transferred shares equivalent to 14.72% of Sitronics issued share capital to Sitronics managers as part of a share option and incentive scheme. Some 1,300 employees completed internships and work experience programs during the year.

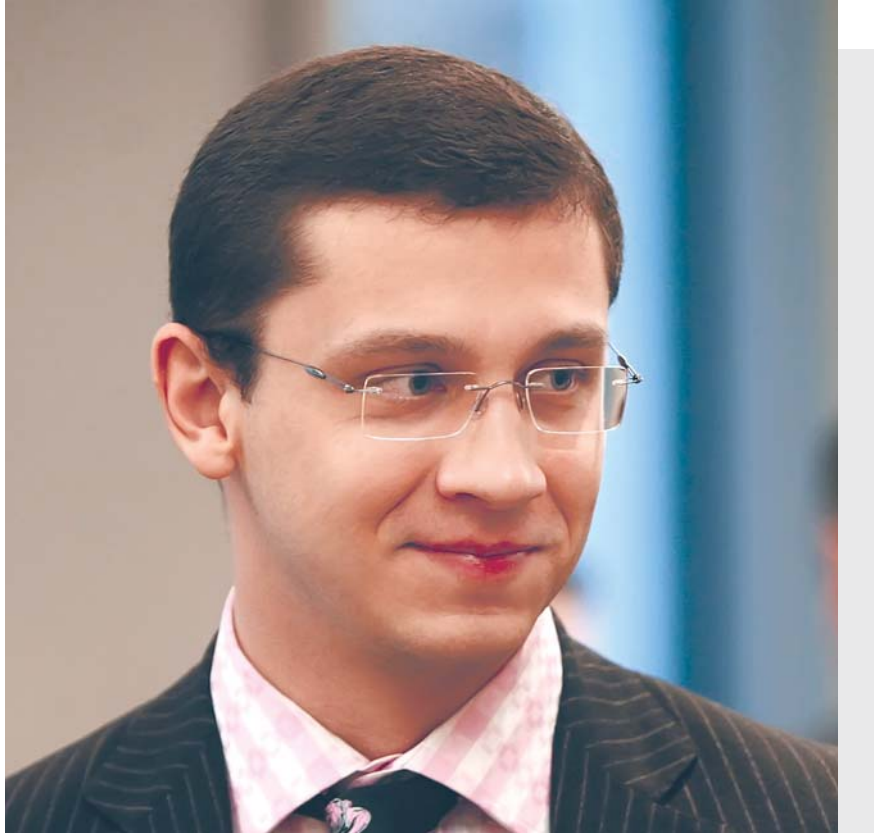
- 1 Ukraine data for 2006 from Business Monitor Int'l, based on operator data excluding inactive subscribers.
- 2 Data from Analysis Research
- 3 Russian data from Electronica Publishing House

Revenue, \$ **1,607.4 mln**

Operating Income, \$ **129.8 mln**

Assets, \$ **1,638.7 mln**



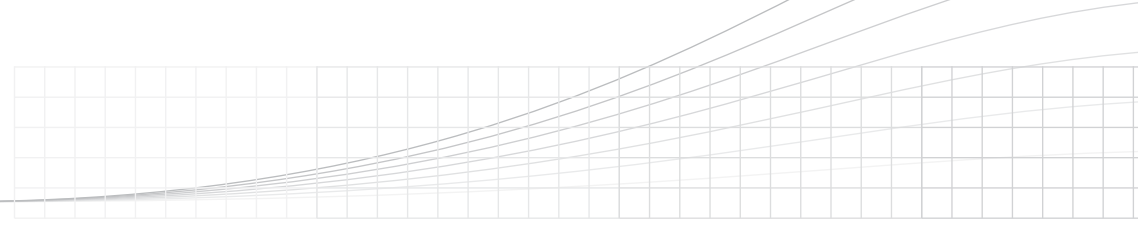


Sistema-Hals is one of the key players in the Russian market for construction and real estate. The IPO of Sistema-Hals was the first placement of a Russian development company in the Western capital markets.

A Reliable Foundation Real Estate

Felix
Evtushenkov
President,
Sistema-Hals





Marketplace

Sistema-Hals is Sistema's main operating subsidiary in the Property business area. Russia's real estate market is booming, based on continued strong demand for commercial property not only in Moscow but in an increasing number of Russian regional cities.

Sistema has been present in Russia's construction and property sector since the mid-1990s and the business area represents one of its longest-term investments. In recent years, this commitment has paid off. Along with favorable macroeconomic conditions, changes in the legal environment for development and property ownership over recent years have helped foster one of the most dynamic property marketplaces in the world.

Russian and international companies have expanded their presence in the country and require world-class office space. An emerging middle class is investing money in modern housing with modern infrastructure and the rapid recent expansion of the mortgage lending market is fuelling further demand. Another key area is the development of new hotels, particularly three star hotels for tourists and four and five-star hotels for business travelers in Moscow and other large cities. The closure or long-term renovation of a number of hotels built in the Soviet era, including the massive Rossiya hotel complex in central Moscow has sharply reduced capacity even as demand is growing.

In late 2006, some 1.38 million square meters of Class A office space had been completed or was in the pipeline in Moscow¹. According to real estate group Cushman & Wakefield Stiles & Riabokobytko (C&WS&R), the amount of Class A and B office space in Moscow alone is due to double over the 2007 to 2008 period but this is still insufficient to meet expected demand. In terms of prime office stock, total retail stock and number of international grade hotel rooms per capita, Moscow continues to lag Central and Eastern peers by a wide margin, suggesting continued upside potential. Vacancy rates for Class A and B offices were 1.2% and 3.5% respectively, according real estate consultant Colliers, the lowest levels in six years. These levels are predicted to drop even further in 2007.

Russia's ongoing 'retail revolution', characterized by rising consumer disposable incomes and spending, and a shift toward modern retail chains, saw 11 retail complexes with 377,900 square meters of trading space opened in 2006 in Moscow alone. This represented a 30% increase in retail capacity in a single year². International and Russian retailers expanded rapidly outside of Moscow as well, with large players such as cash and carry player

Metro and supermarket group X-5 retail expanding in emerging regional markets such as the Urals and Siberia. Outside of Russia, booming economies in the CIS and years of limited investment in modern residential and commercial property has created substantial unmet demand.

Business

Sistema-Hals is a major diversified company operating in the real estate markets of Russia and the CIS. The company provides integrated, high-quality services directed in four key strategic businesses: real estate development, project and construction management, asset management, and facility management. In providing development services, Sistema-Hals sees through the entire life-cycle of a property through a carefully defined system, from the initial design through to its management.

As part of asset restructuring during 2005 and 2006, the corporation's real estate portfolio was transferred to Sistema-Hals, which had previously operated as a developer of commercial property. Now operating as the legal owner of the corporation's property portfolio as well as a project management company, Sistema-Hals has considerably increased its capitalization and attracted finance for development through a successful IPO on the LSE in November 2006. Today, the company aims to become the largest real estate developer and a leading real-estate asset portfolio manager in Russia and the CIS.

Since its founding in 1994, Sistema-Hals has completed more than 30 projects with a combined area of more than 250,000 square meters, including such landmark buildings as the Russian headquarters of DaimlerChrysler, the Hals Tower office complex, the headquarters of TMK and the MaMaison hotel chain for the ORCO Property Group, among others. One of company's key competitive advantages in the Russian and CIS real-estate sector is the ability to manage projects in practically every market segment. Sistema-Hals has built up a broad and well-balanced portfolio of assets in growing segments of the Russian real estate market. The company focuses on the construction of Class A and B offices, mixed-use complexes, business-class residential housing, single-family homes, and land developments.

Today, Sistema-Hals is building the Lenigradsky Towers complex, consisting of two buildings including the future headquarters of Siemens in Moscow and valued at US\$159.3 million as of 1 January 2007. In addition, the company is managing the long-term project

of redeveloping buildings owned by Comstar-UTS subsidiary MGTS made redundant by modern technology. Other projects include the renovation of the landmark Pekin hotel in central Moscow and a range of other projects.

In October 2006, Sistema-Hals had the highest market share of any single company engaged in Class A office development in Moscow, at 9.5%. This figure includes completed projects, projects under construction and announced projects³. In the beginning of 2007, Sistema-Hals was present in seven regions in Russia and Ukraine with a number of additional regional cities earmarked for future expansion.

Results

The Real Estate business unit reported 261% revenue growth in 2006, reaching US\$282.9 million, compared to US\$78.4 million in 2005. OIBDA increased by 645% to US\$93.1 million. The real estate development division remained one of the primary growth drivers in the business area and accounted for 72% of total revenues in 2006, compared to 52% in 2005.

Primary contributors to this growth were the sale of the Pokrovka 40 development project, a mixed-use Class A office and hotel complex in central Moscow for US\$84.4 million and the sale of the Yartsevskaya 27 residential project in Moscow for US\$20.3 million. The Pokrovka 40 project saw a selling price of office space of US\$4,828 per square meter. Other key projects completed during the year include a residential housing complex at 15 Elninskaya Street with 178 apartments ranging from 55 to 250 square meters in area.

Sistema Hals's project construction management division contributed a US\$19 million increase in revenues while, asset management revenues increased 80% year-on-year in 2006 to US\$27 million, due to increasing resale of housing as part of the asset restructuring program and an increase in rental revenues from single-family housing. Average rental rates increased 39.8% year-on-year reflecting the continued strength of the market.

The IPO of Sistema-Hals on the London Stock Exchange in early November 2006 raised US\$409 million in the first such international listing by a Russian property developer. The offering was more than five-times oversubscribed. Following the IPO, 20% of the company's shares were in free-float. With the transaction, Sistema Hals achieved the highest-ever valuation for a Central and Eastern European real-estate company at time of IPO. Around 70 to 80% of the proceeds from the transaction were earmarked for investment

in existing development projects with remainder set aside for possible future mergers and acquisitions and other corporate goals.

In March 2007, the corporation announced the results of an independent valuation of its real estate property and projects. According to the valuation carried out by C&WS&R, the value of the Sistema-Hals stake in property and projects increased by 35% over the period from June 30, 2006 to January 1, 2007. C&WS&R has determined that on January 1, 2007, the aggregate market value of each 100% stake in the 88 projects and properties amounted to US\$2,546,825,000, of which the stake of Sistema-Hals (less the minority interests) amounted to US\$2,039,536,454.

Geographic and portfolio diversification remains a continued focus. In March 2007, Sistema-Hals acquired a 67.58% stake in the Kamelia Health Spa OJSC which holds a long-term (49-year) lease for a 6.3 hectare plot of land at 89 Kurortny Prospekt, in the Khostinsky district in the town of Sochi. The buildings of the Kamelia and Intourist hotels are located on this land. Sistema-Hals is planning to build a 60,600 square metre multi-use complex on this land, to include a 4- or 5-star hotel and an elite club-style apartment complex as well as internal infrastructure facilities.

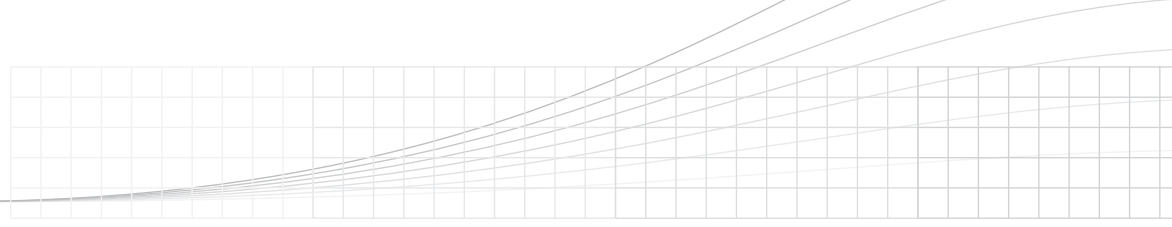
The shopping and entertainment complex Detsky Mir in Kazan is due to open during the third quarter of 2007. Another key retail project entering early 2008 is the Hals Mart/Leto project under construction in St Petersburg, which will have a floor space exceeding 100,000 square metres. When construction is complete, Sistema-Hals plans to keep the project in its asset portfolio to earn income from rental of retail space. The main anchor tenants will be a major hypermarket chain operator, a modern multiplex cinema, and major electronics, sports goods, computer and domestic appliance retailers.

Another key project due for completion in 2007 is the Aurora residential development with an estimated value of around US\$48.4 million and located in Stepan'kovo in Moscow Region. The total property comprises more than 90 hectares divided into 132 separate plots as well as a riverside plot held for development of a yacht club. In addition, Sistema-Hals acts as construction manager and technical supervisor for the city of Moscow's US\$1.3 billion Krasnopresensky Prospect infrastructure project aimed at connecting central Moscow to the MKAD orbital highway.

1 Source: Cushman&Wakefield Stiles&Riabokobilko

2 Source: Colliers International

3 Source: www.developery.ru

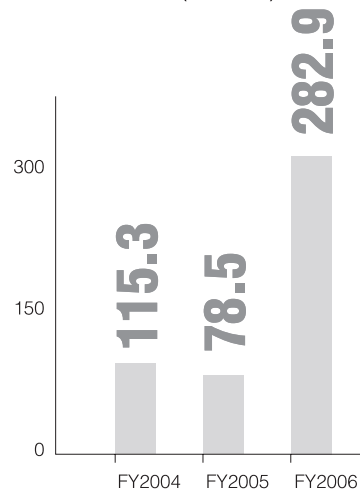


Revenue, \$ **282.9 mln**

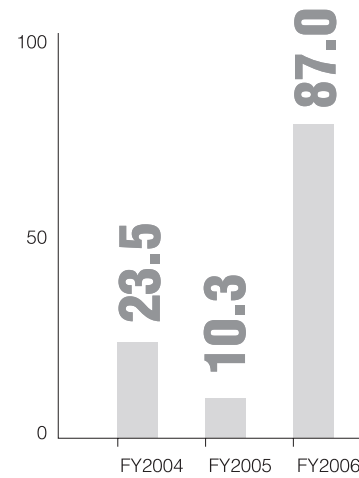
Operating
Income, \$ **87.0 mln**

Assets, \$ **943.3 mln**

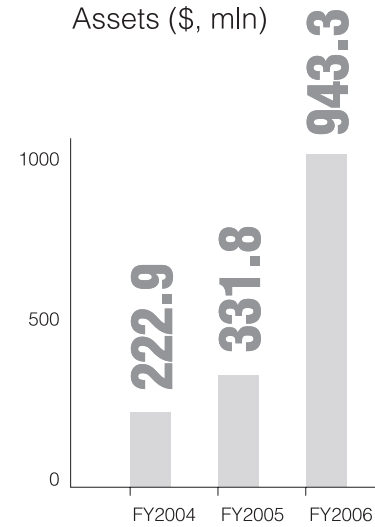
Revenue (\$, mln)



Operating Income (\$, mln)



Assets (\$, mln)





High Potential
Businesses

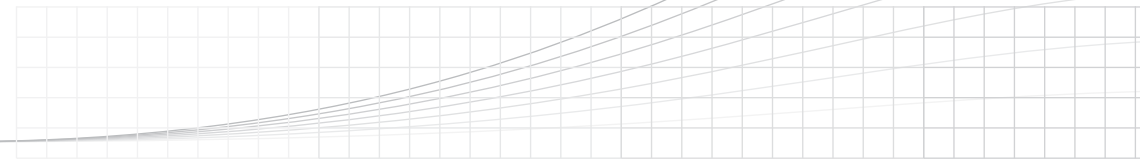


Detsky Mir
is the largest retail
network of children's
superstores in Russia.
68 stores work
under this
trademark in 33
Russian cities.

High Potential Retail

Maxim
Entyakov
CEO,
Detsky Mir Center





Marketplace

Sistema's retail business is operated through the Detsky Mir group and it owns the leading retailer of children's goods in Russia operating under the same name. Detsky Mir, which means Children's World, is one of Russia's oldest, most recognized and most trusted retail brands with a 50 year history and an iconic flagship store in central Moscow on Lubyanka Square.

The market for children's products represents a key long-term growth opportunity for Sistema. Russia's continued economic growth and stability has driven increases in real disposable incomes across the country while encouraging Russians to have more children after more than a decade of falling birthrates. Recent initiatives by the Russian government now provide increased monetary and social support for new parents.

In 2006, the Russian market for children's products was worth around US\$7 billion and is predicted to grow to US\$8.4 billion in 2007. Russia's official statistics agency, Rosstat, estimated that children accounted for more than 15% of the population of the country in 2006. For example, investment bank Deutsche UFG calculates that the Russian consumer sector as a whole will grow by an average annual rate of 22% between 2006 and 2010.

At the same time, modern retail networks are rapidly emerging across Russia, replacing traditional, poorly regulated outlets such as open markets and kiosks. This tendency is being actively supported by Russian federal and local authorities who seek to create modern, reliable, high-quality and safe channels to market for consumers while increasing the tax base. For Russia as a whole, modern retail formats accounted for around 20% of all consumer spending in 2006 and in Moscow this figure reached 40%. Around 30 retailers operate in the children's good segment, although most of these are relatively small with turnover under US\$40 million in 2006.

Patterns of purchasing children's products are dictated by income levels, with an emerging middle class spearheading consumption and children themselves playing an ever increasing role in dictating purchasing decisions. For wealthier parents, representing 20% to 25% of the population, time is at a premium. Parents seek a one-stop shopping experience offering high levels of service, comfort and the availability of a wide choice of products from well-known companies. Consumers on more limited incomes represent 45% to 60% of the population. They are price sensitive and their demand is limited to a narrower range of necessary goods.

Business

Sistema has been a shareholder in Detsky Mir since 1996 and runs the retail business through Detsky Mir Center, a 100% owned subsidiary of the corporation. Since acquiring control of the group, Sistema has spearheaded an aggressive expansion of the chain, while securing stable revenue and earnings growth. In an environment of increasing competition in the retail sector for children's goods, Detsky Mir's key competitive advantages include a strong and long-established brand, a wide product offering (up to 150,000 products), high quality goods, attractive store locations and a high level of customer service.

As of December 31, 2006, Detsky Mir operated 20 stores in Moscow and the surrounding Moscow Region and 45 stores in the regions with a total retail space of 108.6 thousand square meters. Detsky Mir stores are located in convenient, high-traffic locations such as shopping centers that are easily accessible by public transportation.

Detsky Mir also controls C-Toys, a leading Russian importer and distributor of toys that include some of the world's best-known brands. C-Toys is the exclusive Russian distributor of such brands as Bratz, Brio, Famosa, M&C, Gund, Lanard, Shelcore, Ja-ru and Playmates and an official distributor for Hasbro and Lemmi childrenswear.

The corporation's goal in the Retail business area is to maintain and enhance its market leadership in the children's goods segment of the retail market in Russia. The strategy of Detsky Mir is to expand its presence in Russia's regions and enter CIS markets. The chain will expand both in Moscow and other large Russian and CIS cities using its strengthened retail formats. An aggressive expansion policy will help the company benefit from consolidation in the currently highly fragmented retail marketplace. Currently the top-three retail players are accounting for only 10% of the total market. However, consumer preferences for the service, quality and convenience of modern retail formats will drive rapid consolidation.

The primary target market for Detsky Mir is the emerging Russian middle class and its product range focuses on the 0-10 children's and 10-14 pre-teen segments. At the same time, the company continues to expand its product offerings and proposes the latest products to its customers, while entering new categories, such as products for nursing babies and expectant mothers. The company's pricing proposition offers consumers prices that compete with those of department stores, hypermarkets and other 'universal retailers', while its large store formats allow a wider selection of goods to compete successfully against specialist retailers.

Detsky Mir appeals to its target market by providing friendly and convenient shopping environments that meet busy lifestyles. The company undertook the modernization of its existing stores in 2005. The company had used Sistema's proven expertise in delivering high levels of customer service to further improve service levels in its stores and put in place a single call center and website (www.detmir.ru) that allow consumers to easily find its products and shops.

Results

The Retail business area, increased its revenues by 61% year-on year in 2006 to US\$335.3 million in 2006, compared to US\$208.0 million 2005. OIBDA increased 73% to US\$20.9 million. Same-store sales¹ in the business area increased by US\$84.6 million to US\$218.3 million during the year. The combined retail space operated by the corporation nearly doubled year-on-year to 108.6 thousand square meters compared to 54.6 thousand square meters at the end of 2005.

As expected, profitability in the business area was impacted by the costs of the expansion of the Detsky Mir retail network. At the end of 2006, Detsky Mir had 65 stores in 27 regions in Russia, compared to 36 stores in 14 regions at the end of 2005. As of the end of March 2007, the company had 68 stores. Regional expansion saw the share of retail sales outside of Moscow grow to 33.1% of revenues in the business area, compared to 24.5% in 2005. Also during the year, Detsky Mir obtained a five-year, US\$20 million loan from Gazprombank to accelerate the retailer's regional expansion.

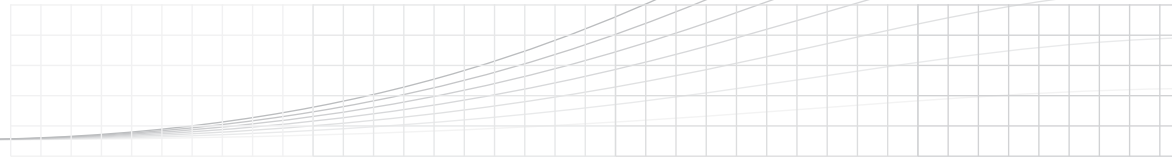
The growth in retail network in 2006 is expected to spread and will enable the company to continue to benefit from increased consumer purchasing power and will allow it to secure a sizeable footprint in the prime segment of the retail market. C-Toys, the corporation's wholesaler of consumer goods, accounted for US\$42.8 million in revenues during the year.

In 2006 Detsky Mir group adopted a new strategy aimed at establishing clear national leadership in the retail markets of Russia and the CIS for children's products for the 0 to 14 age group. Due to investments in modernization over the last few years, all of the stores in chain now share unified retail formats, have centralized marketing, stock planning and selection, purchasing, merchandising, human resources and logistics activities. These factors ensure common high levels of quality while allowing Detsky Mir to implement its aggressive expansion policy while still focusing on reducing costs and increasing synergies across the chain.

In order to enhance margins, the retail business area began the development of private label goods under its own trademarks. At the same time, the company continued to strengthen its terms of trade to reduce the price paid to suppliers and this enabled it to increase gross margins to 35.6% in 2006, compared to 31.3% in 2005. For shoppers, a 'one-stop shop' was developed during the year that aims to provide busy shoppers with a single place to buy everything they need.

Restoration of the company's flagship store in central Moscow, opened in 1957, began in 2006. The ambitious restoration will see the store turned into a fully fledged shopping and entertainment complex, with usable space increased from 22,000 square meters to 37,800 square meters. Some 150 other stores will share the complex with Detsky Mir and it will include cinemas and play areas to provide a complete experience for the entire family.

¹ Defined as stores opened before December 31, 2005.

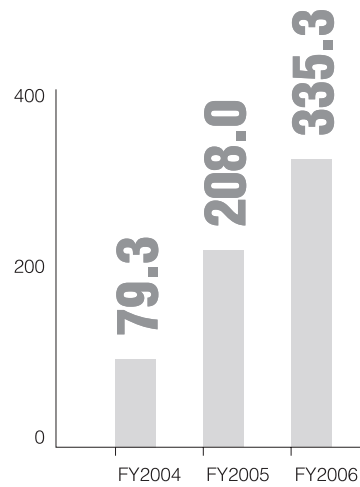


Revenue, \$ **335.3 mln**

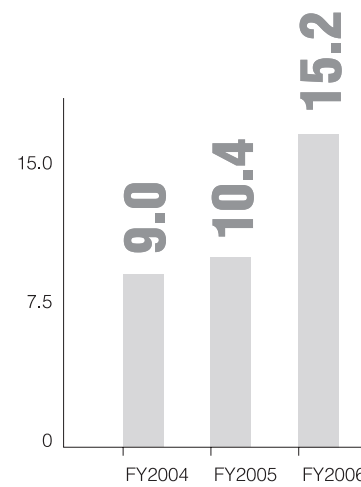
Operating
Income, \$ **15.2 mln**

Assets, \$ **238.1 mln**

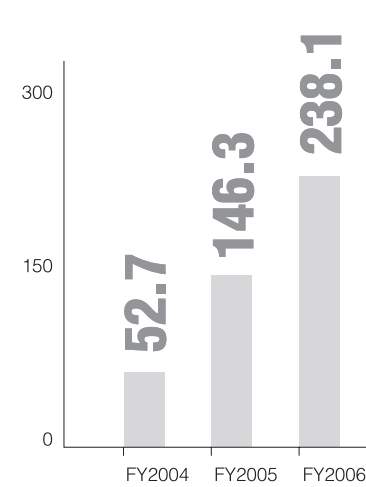
Revenue (\$, mln)



Operating Income (\$, mln)



Assets (\$, mln)





MBRD is aggressively developing in the fast-growing market for retail banking services in Russia. The purchase of a controlling shareholding in Luxembourg-based East-West United Bank is the first step to transforming the Moscow Bank for Reconstruction and Development into a fully fledged banking group.

High Potential Banking

Sergey
Zaitsev
Chairman of the
Management Board



Marketplace

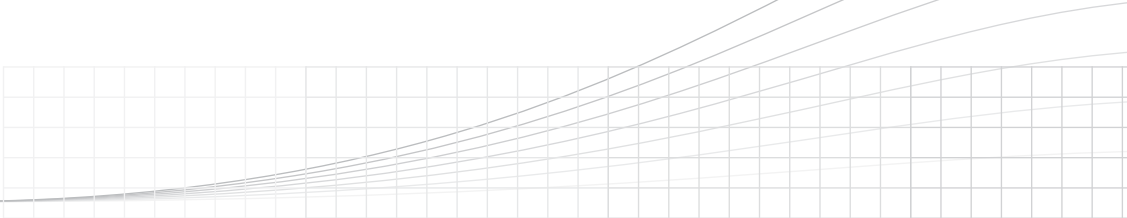
Sistema's banking business, the Moscow Bank for Reconstruction and Development (MBRD), has developed rapidly into one of Russia's leading retail banking networks, having entered the sector in 2004.

Overall, the Russian banking sector has benefited from Russia's macroeconomic growth and implementation of key legislation in recent years aimed at ensuring stability and encouraging the development of previously under-developed areas, such as consumer loans. The combined asset value of Russian banks grew by 44% in 2006, reaching RUB14 trillion (US\$516 billion). Bank assets grew from 45.1% of GDP in 2005 to 52.8% in 2006. Growth was fuelled by the development of both corporate and retail banking. Legislation enacted in 2005, including a deposit guarantee program for qualifying banks added stability to the sector. The law 'On Credit Histories' also passed that year, driving the market for consumer credit and spurring the development of the retail banking sector.

Deposits from individuals rose by 38% during the year from RUB2.8 trillion (US\$103 billion) to RUB3.8 trillion (US\$140 billion). Despite this rate of growth, the share of individual deposits in the sector fell somewhat, from 28.3% in 2005 to 27% in 2006. This was due to increased share of funds from commercial enterprises and international loans, as well as the development of private pension and share funds as an alternative destination for consumer deposits.

Still, the Russian banking sector is in many ways under-developed and fragmented, with a large number of small banks and treasury banks serving a single corporate client. The top 50 largest banks in the country accounted for around 75% of assets in 2006. Notably, the growth in banking capital has not kept pace with the growth in assets. On one hand this is linked to organic profit growth in the sector, with average return on equity for Russian banks at around 25%. However, this is also indicative of the reluctance of many bank owners to direct significant funds to build the capitalization of their banks. The result is that a number of large banks are approaching the threshold of their minimal capital reserve requirements, constraining further growth in the near term.

Despite these constraints, Russia's banking sector still demonstrates considerable long-term growth potential as measured against peers in Central and Eastern Europe. While universal service banks have long dominated the sector, more narrowly focused institutions, such as mortgage lenders and consumer credit providers, have seen



strong recent growth as increasing consumer spending power, coupled with an enhanced ability to judge consumer creditworthiness, lowered credit risks.

Business

Sistema's primary banking business is MBRD. In the past, the MBRD acted primarily as an in-house treasury function for Sistema. Today, however, MBRD is a fully fledged bank, offering a full range of services to corporate and consumer clients. It has focused on retail banking as its main avenue of development since 2004, when the bank launched a retail banking business using a business model, developed with the participation of international consulting firm Deloitte & Touche CIS.

The bank has built a balanced consumer credit portfolio through the expansion and improvement of its service offerings. At the beginning of 2007, MBRD offered 16 mortgage programs and concluded an agreement with the Russian Agency for Mortgage Housing Credit and regional operators. The bank has been able to attract new customers by repeatedly lowering its interest rates on credit, reducing ruble rates by 3% and US dollar rates by 2.5%. MBRD was also able to reduce the required upfront payment from 30% of cost of the property to just 10% during 2006. The maximum credit amount was doubled to RUB16.2 million or from US\$200,000 to US\$500,000. The number of homebuilders accredited by the bank also increased and now covers 50% of builders operating in Moscow Region.

In the market for automobile loans, the bank concluded around 70 agreements with leading car dealers in Moscow and Moscow Region during 2006, significantly expanding its potential consumer base.

MBRD offers another opportunity for Sistema to develop consumer services across its business areas and to gain access to the more than 65 million customers served by the corporation. The bank and MTS have developed internet and mobile access for customers and offers a range of banking services to existing clients in other business areas.

Results

MBRD demonstrated robust revenue growth of 114% year-on-year in 2006 to US\$228.2 million from US\$106.8 million in 2005 due to the rapid growth in its retail business.

OIBDA increased by 161% to US\$37.2 million.

MBRD has been able to expand its consumer and corporate client base by spreading its presence both in Moscow and in Russia's regional markets. As of year end, MBRD's retail network included 16 sub-branches and 50 mini-branches in Moscow and 55 in Russia's regions, a five-fold expansion of the bank's branch network during the year. The bank had 171,000 credit cards issued as of December 31, 2006.

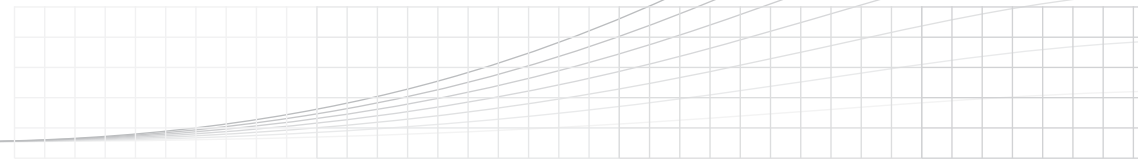
In 2006, MBRD accelerated the development of its retail banking business, increasing its retail credit portfolio five-fold to 9.7 billion rubles (US\$370.0 million) from RUB 1.7 billion (US\$58.2 million). The bank rose from 51st to 31st place among the largest banks in Russia by size of its retail credit portfolio. Just two years ago, MBRD was 173rd among Russian banks by this indicator. The bank has developed a balanced consumer credit portfolio, simultaneously developing mortgage and automobile loans along with unsecured consumer credit and credit card issuance.

The growth of retail banking operations allowed the MBRD to improve its position in the overall banking sector. The bank's assets grew 81.6% in 2006, to RUB 58.1 billion (US\$2.2 billion) from RUB 32.0 billion (US\$1.1 billion). In terms of net assets, the bank moved from 34th to 31st place among the largest banks in Russia.

According to rating agency RBC, MBRD was the second fastest growing mortgage issuer in Russia in 2006, with issuance of mortgage credits increasing 72-fold to US\$105.3 million. By the end of the year, the bank had reached 22nd place among the largest mortgage institutions in Russia. During the year, the bank issued automobile loans worth US\$155.9 million becoming the 16th largest Russian bank in terms of auto loans issued, a more than three-fold increase over 2005 levels.

In March 2006, MBRD issued \$60.0 million 8.875% Loan Participation Notes to finance a subordinated loan. The notes will mature in March 2016 and are listed on the Luxembourg Stock Exchange.

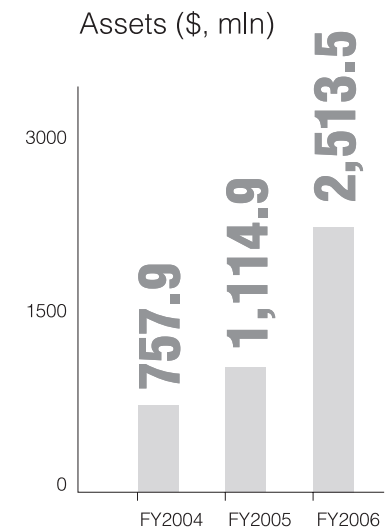
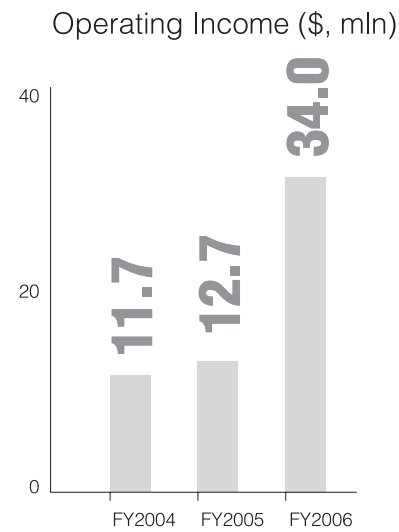
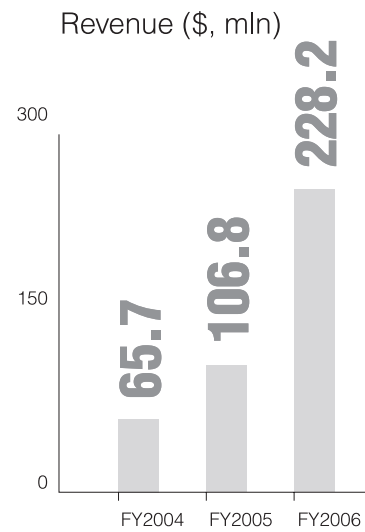
The bank's efforts were reflected by its award for 'Dynamic Growth in Consumer Credit' at the Financial Elite of Russia awards as well as overall laureate for achievements in the field of finance.



Revenue, \$ **228.2 mln**

Operating Income, \$ **34.0 mln**

Assets, \$ **2,513.5 mln**



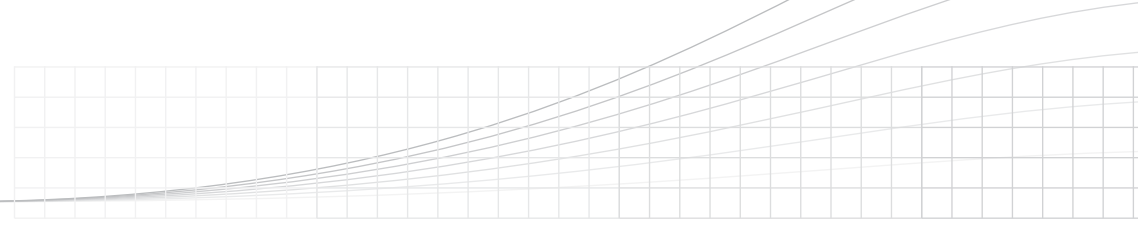


Sistema
Mass Media is a
leading company
in the Russian
Pay-TV market.
In 2006, the number
of Pay-TV subscribers
under the Stream TV
brand reached
1.5 million
households.

High Potential Mass Media

Mikhail
Dunaev
CEO,
Sistema Mass Media





Marketplace

Sistema Mass Media (SMM), the corporation's primary operating company in the media business area is focused on Pay-TV, content and advertising. These segments represent key, technology-driven businesses in the Russian media market as the corporation not only adapts to, but also drives the development of new media platforms and technologies.

The Russian Pay-TV market has developed at a rapid pace in recent years, with growth rates exceeding 30%. The market is expected to continue to grow quickly but remains at an early stage of market development, with considerable fragmentation and a number of local operators. According to market research group J'son & Partners, the number of Pay-TV household subscribers at the end of 2006 stood at 6.6 million, an increase of 43% year-on-year compared to 2005. The total number of subscribers is expected to grow to 11.7 million households by 2008.

The Pay-TV market is consolidating, with companies such as SMM acquiring smaller local cable operators. At the same time, the largest operators are getting increasingly focused on developing the content, while the smaller players are concentrating in expanding coverage and their overall technical capacity. 'Hybrid' operators are emerging in Russia, including Sistema with its umbrella Stream brand, which provide cable TV, IPTV, broadband and content from a single source.

Russia's expanding media market and ongoing consumer market boom has seen its advertising market grow at one of the highest rates of any major world market in recent years. The volume of the Russian advertising market was around US\$4.2 billion over the first nine months of 2006, representing 27% growth year-on-year.

Business

Sistema manages its media business area through the vertically integrated Sistema Mass Media holding company. Previously, SMM was active in advertising and print distribution, and was also engaged in publishing, terrestrial TV broadcasting and news services. However, following a major restructuring conducted in 2004-2006, the company exited a number of businesses to focus on high-revenue, high-technology segments of the media market.

Today, SMM is focused on the development of the Pay-TV business, including network operation, media content production and advertising. These core business segments will be increasingly combined and deployed over new technological platforms, including DVB-H and IPTV, developed by SMM, other Sistema business areas and international partners.

In Pay-TV, SMM is developing its business under the Stream-TV brand. The strategy of the corporation in this area is to create a large media group combining Pay-TV operations and multi-media services, content and other linked businesses. This strategy is focused on developing content and advertising and exploiting emerging technologies such as mobile and Internet content.

SMM is establishing nation-wide coverage for its Pay-TV network in Russia. In 2005 and 2006, the company acquired regional cable television operators Regional Cable Networks (RCN) and United Cable Networks (UCN) and became the leading cable television operator in Russia's regions. SMM is in the process of re-branding recently acquired and consolidated local cable operators under the umbrella Stream-TV brand and modernizing infrastructure to provide 'double-play' (Internet and Pay-TV) services.

At the end of 2006, SMM had cable television operations in 37 Russian cities covering a population of around 15 million people. At the end of 2006, according to data from J'son & Partners, SMM had a 15% share of the Russian Pay-TV market, making it by far the largest single player in a fragmented marketplace. Even as the company builds up its market share, it is driving deployment of new technology following successful pilot projects for mobile television during 2006.

SMM's Tema Productions subsidiary provides financing and production services for film production, manages content and rights libraries and will requisition film and television content from the company's film and television studio complex under development in St Petersburg.

SMM's integrated communications group Maxima, was rated the 11th largest agency in terms of media buying in Russia by Kommersant newspaper in 2006. At the end of the year, Maxima was present in Russia as well as Ukraine, Belarus and Kazakhstan as the company seeks to build upon fast-growing advertising and consumer markets in the CIS. Maxima provides a strong and established media buying platform that is integral to SMM's combined Pay-TV, content and advertising business.

Results

In 2006, the Media business area reported a 104% year-on-year increase in revenues to US\$106.7 million compared to US\$52.4 million in 2005. OIBDA increased 203% to US\$26.6 million. The results reflect the positive impact of the major restructuring of the business that took place in 2005 and continued in 2006 as well as growth in the three key priority business segments: Pay-TV, content and advertising. The company had 1.5 million subscribers at the beginning of 2007.

The company UCN (one of the country's largest cable television operators and providers of broadband Internet access), acquired in February 2006, contributed US\$45.5 million in revenues in 2006, along with revenues of US\$14.5 million generated by other companies acquired since the end of 2005. The company spent around US\$200 million on acquisitions and network modernization in 2006.

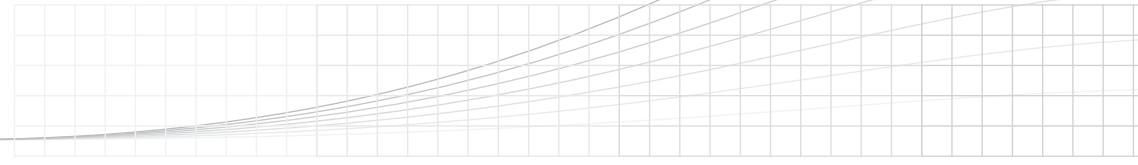
In 2006, SMM concluded the restructuring begun in 2005 with the sale of television channel TV-Stolitsa, the newspaper Metro, as well as stakes in the news agency Rosbalt and others. With these disposals, SMM has completed its exit from areas outside of its core Pay-TV, content and advertising businesses. The company has implemented a new affiliate structure to manage its cable operators and purchased remaining minority shareholdings in these companies, with assets consolidated under its Stream-TV subsidiary.

At the same time, the company had focused on its growing content business and launched a fifth TV channel featuring its own production on a CIS-wide scale. All the content production will be carried out by a specialized subsidiary, Stream Content. SMM has completed seven films for cinema release during the year. Investment in production facilities, including studios, continued in 2006 and the first new studio in St Petersburg is due to open during the first half of 2007. SMM plans to bring its content business under the management of a new subsidiary, Stream-Content. In addition, the company conducted negotiations with major international studios to acquire branded content to attract and retain subscribers.

SMM continued to develop promising technologies such as content for portable and mobile devices and conducted a pilot project for broadcasting, in DVB-H format. In addition, the company acquired frequencies in 16 largest Russian cities (top markets) for DVB-H broadcasting that will be used to develop the potential market for mobile TV in 2007 and 2008. Entering 2007, the company was in

negotiations with international partners for further developing the potential of this technology. The company also began the modernization of its regional cable operators with new technology (FTTB/HFC/MetroEthernet) to provide double and triple-play services for subscribers.

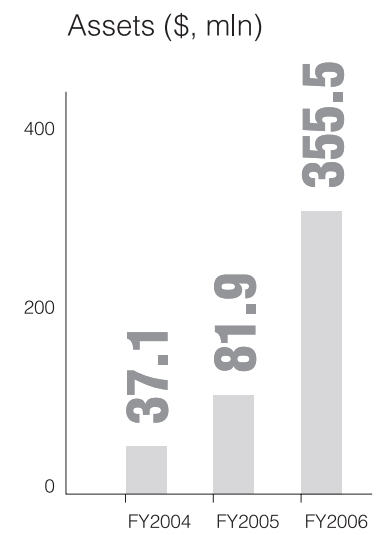
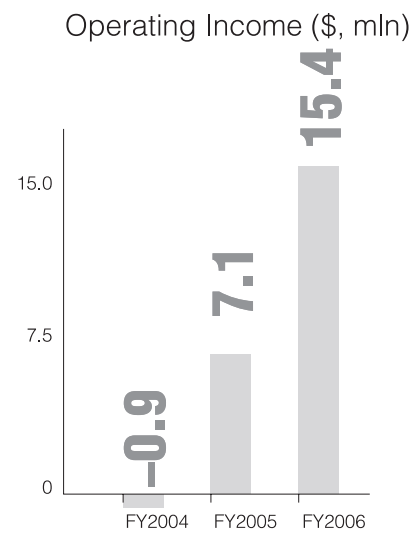
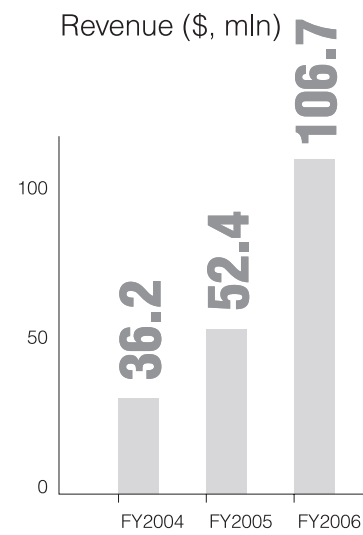
The company expanded its Maxima advertising business into other CIS markets and opened offices in Belarus and Kazakhstan during the year. The advertising group prepared a development plan for Russia's regions in 2006 to build upon rapid recent growth in regional advertising, which is being driven in part by the recent expansion of large Russian and international FMCG producers and retailers into regional markets.



Revenue, \$ **106.7 mln**

Operating
Income, \$ **15.4 mln**

Assets, \$ **355.5 mln**

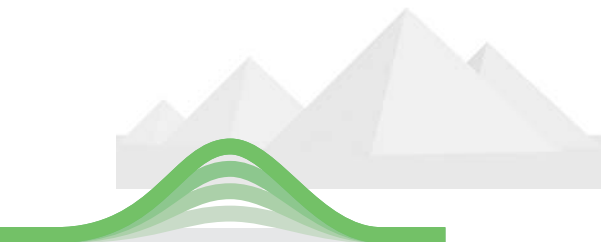


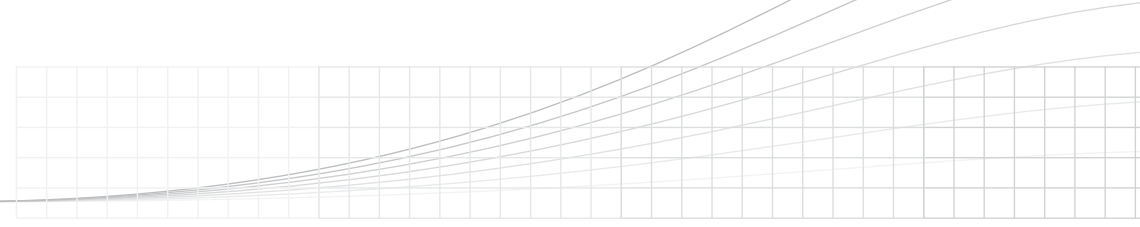


Intourist is best-known tourist company in Russia. In 2006, the number of foreign and Russian tourists serviced by the company reached more than 550,000 clients.

High potential Tourism

Alexander
Arutyunov
President,
Intourist





Marketplace

Intourist is Sistema's single business in the tourism industry and provides comprehensive services for Russian tourists traveling abroad and domestically as well as for international visitors to Russia. The company is a leading operator in Russia's fast-growing tourist industry, worth around US\$9.7 billion in 2006 (total outbound, inbound and domestic market segments).

The 'inbound' and 'outbound' tourism markets in Russia are driven by different, sometimes opposed dynamics, such as exchange rate levels. However, both of these key segments have seen continued strong growth driven by sustained economic and political stability in Russia. According to experts, the value of the market is forecast to grow at an average annual rate of 15.5% for the period 2005 to 2011 and will gain a total value of US\$19.6 billion by 2011.

The inbound market grew by an estimated 16% in value terms in 2006 to US\$740 million and is forecast to grow by around 10% through 2011. A challenge for the market is shortage of rooms in Moscow and in St.Petersburg caused by the shutdown of some older hotels, and historic lack of hotel capacity as measured by number of hotel rooms per capita compared to other Central and Eastern European capitals. However, a number of hotel projects are currently nearly completion and is expected to overcome this shortage of hotel rooms by 2008. Meanwhile, government efforts to encourage visitors to see Russia's historic and cultural attractions, and improving levels of service and infrastructure in the regions are encouraging growing numbers of tourists.

Outbound and domestic Russian tourism continued to grow dynamically in 2006 due to rising disposable incomes and broader economic confidence among consumers. The market was worth approximately US\$9 billion in 2006, representing a 18% year-on-year increase. Dynamic growth is forecasted to continue over the five year period through 2011, with average annual market value growth of 15%.

Tourists are moving away from traditional package destinations for Russian visitors to destinations such as Spain, Italy, the UAE, Tunisia and Thailand. Tour packages became more costly during the year due primarily to higher fuel costs for airlines and hotel rates growth in many popular destinations. For Russians traveling domestically, large-scale investment by domestic and international developers in building world-class hotel and resort facilities in destinations such as the Black Sea coast is spurring domestic travel.

Russia's tourist market is very fragmented and characterized by the presence of numerous operators and high levels of competition. However, there are indications of consolidation in the marketplace. The top 50 tour operators accounted for sales of around US\$3.1 billion in 2006, up 26% year-on-year¹, ahead of the 18% growth rate for the market as a whole. Diversification of services into management of hotels and resorts and the ability to provide both Russian and international travelers with complete tour packages allow larger operators to build market share and insulate themselves against cyclical or temporary drops in one market segment.

Business

The Intourist holding is Sistema's primary asset in the Tourist business area and the company is the oldest and best-known tourist business in Russia. Intourist was founded in 1929. In Soviet times, it was the monopoly provider of tourist services. In 1992, the assets of Intourist were restructured, the result of which left the company with only international and domestic tour operators. All of the other assets, including hotels and tour buses, were put under the control of the Russian government.

In 2006, following the completion of a significant restructuring in 2005, Intourist had established itself as a leading universal operator in the tourist market. Today, Intourist aims to create a fully integrated tourism group by exploiting synergies between its key business areas: tourism, retail chain, hotels and transport. This approach allows the group to develop high quality products at the right price for the client.

The company served more than 600,000 clients in 2006 and its primary competitive advantage is its ability to provide a comprehensive range of services through its international and domestic network of partners as well as overseas subsidiaries. The key acquisitions of large Russian tour firms Riviera and Skyway during 2006 further strengthened Intourist's leading position in the marketplace. The ability to offer comprehensive solutions was further bolstered by the company's acquisition of Russia's leading broker for chartered flights, Megapolis-Aviacharter.

With these recent moves, Intourist has strengthened its ability to provide complete, higher margin tour packages to such mass-market (Turkey and Egypt) as well as sub-mass-market destinations as Spain, Italy, Tunisia, Greece and Goa in India. At the same time, the company increased its range of travel solutions for corporate and government clients.

Another key advantage for Intourist is its unrivalled international network. Currently, the company has 10 affiliate companies overseas with 7,000 partners in 168 countries. This allows the company to provide comprehensive travel services world-wide. In addition, Intourist has a sales network present in 34 of Russia's regions. The network is one of the largest in terms of numbers of points of sale and the company's goal is to make it the largest such network in Russia.

The hotel business represents another priority growth area for Intourist and the corporation. The Intourist Hotel Group subsidiary operates both company-owned and third-party owned hotels, with some seven hotels in Russia and two international locations. Today, the company's hotel network has the largest number of rooms of any Russian hotel operator, with around 2,300 as of December 31, 2006. Within Russia, the hotel business is concentrated on adding three and four star hotels in Moscow and such tourist destinations as the Golden Ring cities and Black Sea coast to its network. Internationally, the group is focused on the operation of three- and four-star properties and business hotels in leading tourist locations.

The goal of the hotel business is to operate hotels in order to maximize the sales and earnings potential of each facility. This entails the introduction of rigorous accounting and management systems and application of the corporation's wider experience in areas such as human resources and IT. In addition, hotels operated by Intourist benefit from synergies within the company including access to the company's retail sales network and inclusion in tour packages.

Another priority area for Intourist is transport services. Intourist is currently Russia's largest broker for charter flights, a fast-growing business area. In addition, the company runs tourist bus services, a segment that has seen rapid growth due to an increase in the number of international and domestic tourists in the country.

In the beginning of 2007, Sistema and its affiliated companies controlled over 65.10% of the Group. The second and third principal shareholders are Moscow City Government and GAO Moskva. Owned by the Moscow City Government, GAO Moskva is focused on developing the city's potential as a tourist destination.

Results

Intourist's turnover significantly increased to US\$338 million in 2006, while revenue reached to US\$270 million in 2006. The company serviced more than 547,000 clients during the year, including 152,000 inbound tourists

In terms of market share, Intourist's share of the inbound market increased to 9.8% in 2006, compared to 9.5% in 2005. The company's share of the fragmented outbound tourist market grew ten-fold to 3.0% in 2006, making the company one of the top-three Russian companies in the market. Tour Operating accounted for around 66% of revenues during 2006.

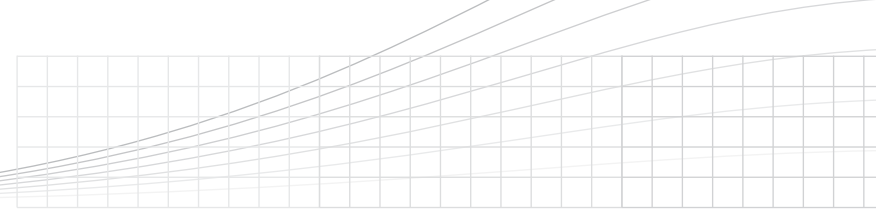
The acquisition of Megapolis-Aviacharter at the beginning of 2006 was a major step that has made Intourist the leading broker for charter flights in Russia. This significantly strengthens the ability of the company to offer comprehensive travel packages, and provides a clear opportunity to build upon synergies between Intourist's Tour Operating and Transport business areas.

During 2006, Intourist completed a number of important acquisitions to strengthen its core Tour Operating business, including 51% of the Riviera Holding group and Skyway. Riviera, the leader in the Northwest region of Russia and the largest tour operator in St Petersburg, has operations in more than 20 countries and serves around 120,000 clients annually. Skyway is a major Moscow-based tour operator in the marketplace since 1994 and leader in Egypt-bound tours. The addition of these companies allows Intourist to offer a broader range of complete packages to more destinations, including key mass-market and sub-mass market destinations.

Intourist also made two important acquisitions to strengthen its leading market position as hotel operator and management company. The company increased its share in Moscow's Cosmos Hotel to a 63.4% stake and also acquired Moscow's landmark Pekin Hotel, which enjoys a prime location in the city and is currently in the midst of a major renovation project.

In addition, the company continued to expand and restructure its sales offices in Russia. At the end of 2006, the company had 102 own retail sales outlets and 31 franchised sale offices in Moscow, St Petersburg and Russian regions.

Following the successful restructuring in 2005, in 2006 Intourist created a divisional corporate structure for the group reflecting key priority areas for long-term development. Divisions for Tour



Operating, Retail Sales, Transport Services and Hotel Business were created under the Intourist management company.

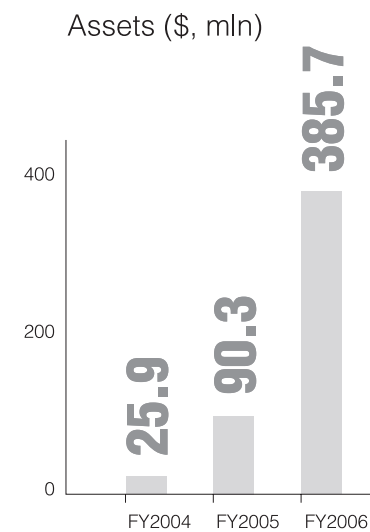
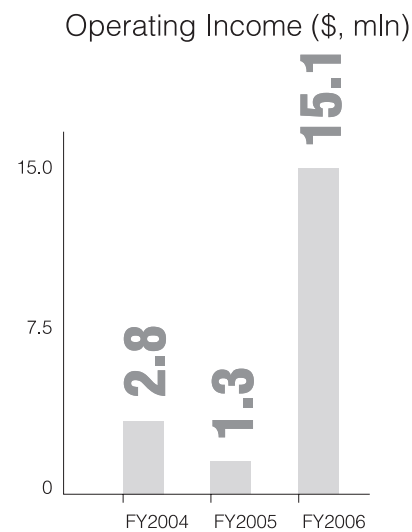
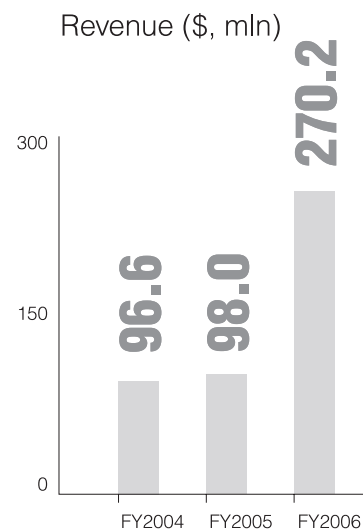
Intourist's strong financial results and focused restructuring helped to achieve first place in the 2006 Top-50 rating of Russian tour operators published by financial newspaper Kommersant in conjunction with information agency Turinfo. Previously, the company had never gained a higher position than sixth place.

1 Data from Kommersant/Turinfo ratings

Revenue, \$ **270.2 mln**

Operating Income, \$ **15.1 mln**

Assets, \$ **385.7 mln**



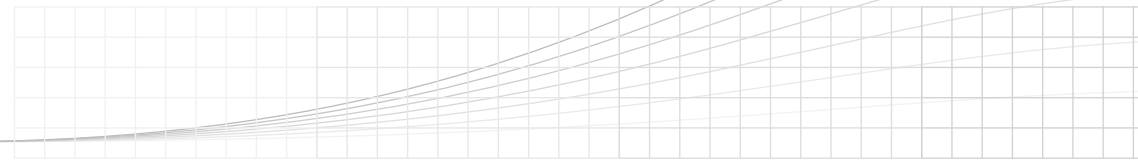


RTI Systems is one of Russia's largest defense companies and is developing unique and highly complex projects in the sphere of defense technology.

High potential Radio and Aerospace Technology

Sergey
Boev
CEO,
RTI Systems





Marketplace

Sistema's Radio and Aerospace Technology business area includes the RTI Systems holding and its subsidiaries. The company carries out the design, production and implementation of major systems projects, including radar systems and sets, aerospace control systems as well as building of power equipment.

The corporation's primary client in this business area is the Russian Ministry of Defense and therefore its main market is the Russian military and defense sector. This market is valued at US\$20 billion (This is much higher than the 2005 level of US\$7.7 billion cited in last year's AR), based on total Russian state defense procurements in 2006, which grew by 10 to 14% year-on-year. The market for weapons and military hardware was worth around US\$7.8 billion in 2006. The market for information systems was valued at around US\$750 million.

The future market for defense contractors will be largely defined by the State Program for Arms Development for 2007 to 2015, a program for the development and purchase of arms technology and equipment for the Russian military approved in its final form in November 2006. This envisions nearly RUB5 trillion (US\$185 billion) in spending over the period aimed at modernizing the Russian armed forces.

The program aims to introduce a range of new technologies, including radar stations with high factory readiness, so-called because they are modular and can be easily upgraded and require less energy than traditional systems. This innovative system has been developed and delivered by RTI Systems.

In addition, in May 2006, the Russian president approved a list of critical technologies for the development of the Russian economy. The list defines a number of priority areas for scientific research and development and serves as a basis for the disbursement of state funding through Federal Target Programs directed to state and private sector R&D and production enterprises. For RTI Systems as a high technology, R&D based company, these programs are an important part of the development of its business.

For defense contractors, government contracts generally represent orders for a fixed quantity of any given product manufactured over the period of the lifetime of the contract. In order to secure continued growth, RTI Systems seeks new clients among other state bodies and in the private sector while developing new technologies and products for its existing and new clients.

Business

RTI Systems and its subsidiary companies bring together leading Russian enterprises with strong track records in management of large-scale projects in the high-technology sphere and considerable research and production potential. Its primary client, the Russian Ministry of Defense, accounted for 69% of RTI Systems's sales in 2006. RTI Systems has developed the capacity to develop, build and deliver high-technology 'turn-key' systems.

The company has established dominant positions in key segments of the market for state defense contracts for information systems and devices. These include a 92% share of contracts for information systems for Missile Attack Early Warning Systems, a 93% share of contracts for information systems for Anti-Missile Defense Systems and a 70% share for information systems designed to monitor airspace.

RTI Systems, using the highly developed technology base at its facilities, continues to carry out work on major technology projects on behalf of the Russian government. These include systems for radar monitoring of maritime borders and the adjacent 200 mile economic zone and information systems for counter-terrorist operations. Another key project underway for the Russian Ministry for Emergency Situations is the development of 'situation centers' to provide critical information for the National Center for Management of Crisis Situations and the All-Russian System for Information and Notification of the Population. Other major projects include an integrated communications system based on geostationary satellite platforms and the development of the Glonass civilian navigation system.

RTI Systems is constantly developing new technology to create new products and expand its sales and market share. R&D costs account for around 50% of the company's final products. Innovative products allow RTI Systems to provide clients with superior and innovative technology and products that cannot be acquired elsewhere. RTI System's researchers have registered 37 patents for new technology developed at the company.

At the same time, the company seeks to diversify its client base and a primary goal is to lower the share of defense orders among total contracts from the 2006 level of 69% to 45%. The remaining 55% of contracts are to be sourced from other state and government clients.

As part of Sistema's strategy of consolidating and restructuring assets, Sistema combined a number of subsidiary businesses under

RTI Systems to create a market leader in fast-growing segments of the radio and aerospace technology market. Three main business areas were formed in 2005 and in 2006 RTI's main business areas will be restructured along a clear divisional structure, including Radio Equipment, Aerospace and Terrestrial Control Systems and Power Equipment.

The Aerospace and Terrestrial Control Systems division was created in late 2005. The main goal of the company in the next few years is to expand its presence in the domestic and overseas markets for military and civil control systems. The formation of the Power Equipment Building division began in the first quarter of 2006 after the acquisition of UralElektro. The company entered the market for equipment which is relatively small in volume terms at around US\$430 million. The main goal in the next few years is to complete the formation of the division and to enter the market for large systems projects in this sector.

Results

Revenues in the Radio and Space Technology segment grew 93% to US\$248.9 million in 2006, compared to US\$124.2 million in 2005. OIBDA grew 64% to US\$23.7 million.

During 2006, RTI Systems participated in a number of Federal Target Programs (FTPs), in particular such major FTPs as the development of the Russian defense industry. These programs have seen funding grow historically by 6 to 7% a year, a similar rate to overall growth in the economy.

RTI Systems has developed a modular radar system for the Voronezh-M early warning system, a high-profile defense project under the supervision of the Russian president. In January 2006, the company conducted preliminary tests of the system and in December 2006, the system entered into experimental combat duty after extensive testing.

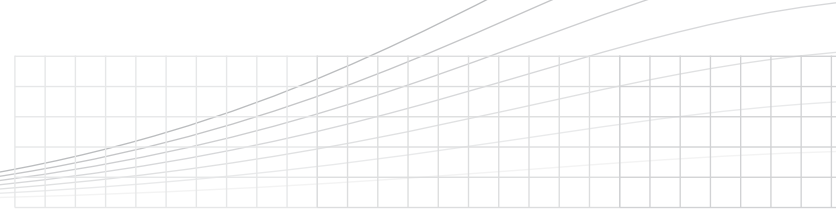
During the year, the company completed a radar system for surface-wave monitoring of the country's 200-mile economic zone and created a test-model for over-the-horizon radar used for airspace monitoring and control. Another key breakthrough was the testing of onboard aviation and ship-based data exchange systems.

In 2006, RTI Systems made important progress in completing preparatory development work and preparing for the construction of the surface section of the complex for the National Center for

Management of Crisis Situations and conducted preliminary tests of the center's automated management system. The All-Russian System for Information and Notification of the Population entered its construction phase.

In March 2006, RTI Systems purchased a 50% plus one share in UralElektro and 100% share in UralElektro-K for US\$5.4 million. Both companies are producers of electronic equipment and the acquisition further bolsters RTI Systems's competitive edge in the growing market for building power machines. Later in the year, UralElektro concluded its first defense contracts, worth US\$1 million, for the supply of low-voltage switching equipment. RTI Systems's DMZ Kamov aerospace subsidiary, acquired in 2005, signed a contract worth US\$6.3 million for the repair of aviation armaments.

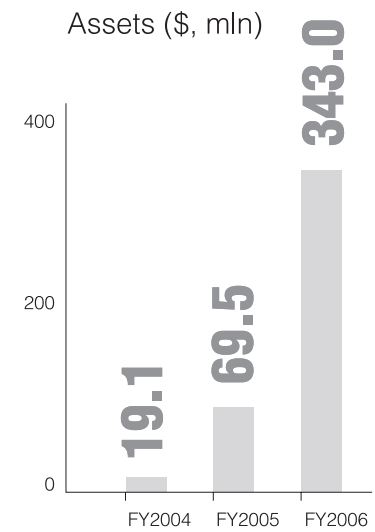
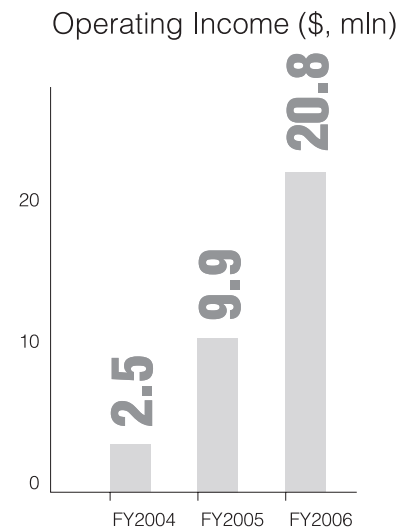
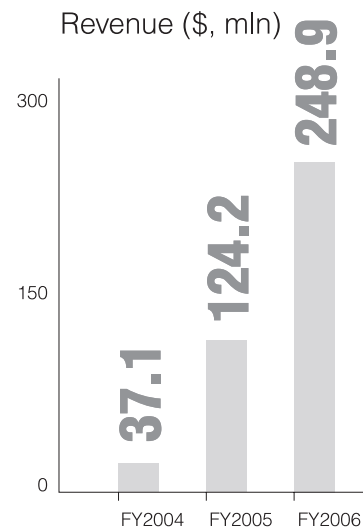
In recognition of its efforts to provide continuing training and education for its workers, RTI Systems won its second award for Qualification of Personnel and Systems for Training and Re-Training at the All-Russian competition held by the Russian Organization for High Social Effectiveness.



Revenue, \$ **248.9 mln**

Operating
Income, \$ **20.8 mln**

Assets, \$ **343.0 mln**





Other
Businesses

Other Businesses Insurance

In February Sistema sold 46.19% of ROSNO shared to Allianz. Sistema holding in ROSNO was reduced to 3%, while Allianz stake increased to 97%. The transaction was in line with the corporation's long-term development strategy, and the commitment of both Sistema and Allianz SE to consolidate the control over the company under one of them at a certain stage of ROSNO's development.

Insurance has been one of the fastest growing sectors of the Russian economy in recent years. According to the Russian Federal Insurance Supervision Service (FISS), the official insurance market, including life insurance and all types of obligatory insurance, grew by 21.0% to US\$14.8 billion in 2006. Excluding insurance schemes, the real market grew by 25.3% in 2006 and totaled US\$11.6 billion, according to ROSNO estimates. The market is forecast to grow by 20-25% per year.

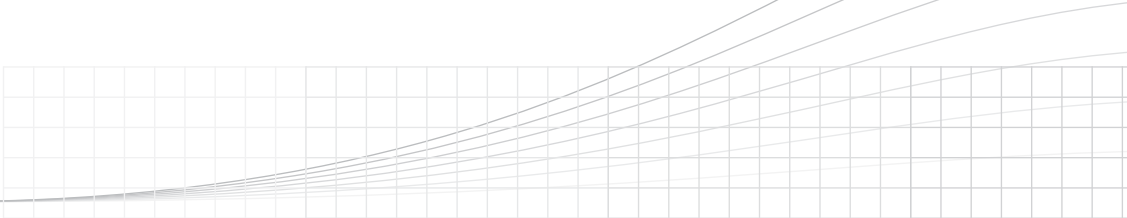
ROSNO is one of the largest universal Russian insurance companies. In 2006, ROSNO offered more than 100 types of insurance to its clients. The company's strategy and major principle is to take care of its clients and provide them with high-quality service. ROSNO's insurance policies are held by over 17 million people and over 50,000 companies. The qualitatively new level of development achieved by ROSNO has been the result of cooperation of two strong shareholders complementing each other's strengths. The leadership path chosen by Sistema as the company was being developed was strengthened by the experience and technology contributed by Allianz.

ROSNO's regional network consists of 100 branches combined into 10 territorial directorates and 300 agencies all over Russia. Further expansion in the regional markets is one of the key strategic priorities of ROSNO Group as well as development of retail sales. The Group's priority insurance lines are Motor, Voluntary Medical Insurance, Property and Life & Pension. In 2006 ROSNO had a 5.3% official market share, making it the fifth largest player and 6.8% of the real market, that placed the company third top insurer in terms of premium volume.

In 2006 ROSNO Group GPW increased by 70% and reached US\$787 million. Life insurance grew by 84% while non-life grew by 43% in 2006. The major driver in life insurance was development of Allianz. ROSNO Life agent network while VMI, Motor and OMTPL contributed to non-life business development.



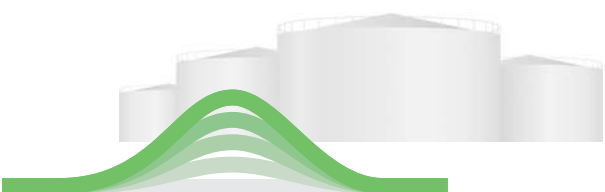
Other Businesses Petroleum



During the second half of 2005, Sistema acquired minority shareholdings in six raw oil processing and oil extracting companies located in the Russian Republic of Bashkortostan. The total acquisition costs were around US\$600 million. The acquisition of the shareholdings represents an opportunity to put shareholder's funds into a financial investment for the short to medium-term, while waiting for opportunities to conduct future M&A deals to boost key core businesses.

At the end of 2006, Sistema had 21% of the charter capital of oil extracting company Bashneft (amounting to 26% of the voting shares). It has 27% shares of the charter capital of Novoil (30% of the voting shares), 23% of the charter capital of Ufaneftekhim (29% of the voting shares) and 24% of the charter capital of Ufimskiy NPZ (28% of the voting shares), all oil processing companies. In addition, Sistema had acquired 25% of the charter capital of Bashkirnefteprodukt (27% of the voting shares), a company involved in the retail sale of oil products, and 23% of the charter capital (26% of the voting shares) of oil chemicals company Ufaorgsintez.

The companies occupy a leading position in the oil-energy market in the region and operate across the production chain, from oil extraction to petrochemicals. The shares of all of the companies are quoted and traded on the RTS and were acquired from Bashkirskiy Capital, which owns controlling shareholdings in all of the companies. Bashkirskiy Capital approached Sistema with the offer to purchase the shareholding in order to access the corporation's long-standing experience in restructuring businesses. Sistema's managers are working with Bashkirskiy Capital to create a transparent, vertically integrated holding with the goal of maximizing the shareholder value of each company as well as the holding. Sistema's management continues to believe that equity participation in the companies, provides the corporation with the ability to make efficient use of shareholder funds, to benefit from additional revenue from the dynamic development of the oil sector.



Other Businesses Healthcare Services and Pharmaceuticals

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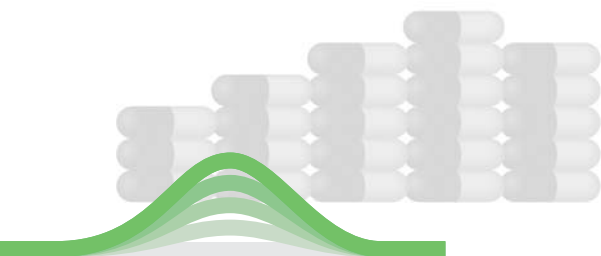
Healthcare services

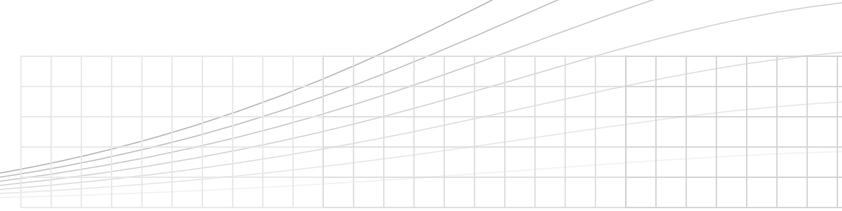
Sistema manages its healthcare services business through its Medsi and Medsi-II clinics in Moscow. The Russian market for paid healthcare services grew by 18% year-on-year to US\$5.3 billion in 2006, with Moscow accounting for 35% of this market and growing 20% year-on-year. The market for private medical clinics remains highly fragmented, with the top-three largest clinic operators accounting for about 3% of the total market in 2006¹.

Medsi provides outpatient and primary care services to patients over 15-years-old while Medsi-II specializes in pediatrics. Medsi is a full-service medical center for providing clinical diagnostics and treatment on outpatient basis. In addition, the center provides specialist care in its dedicated Diabetes Center, 40-plus Health Center and Moscow's first Center for Extracorporeal Healing. In 2006, Medsi began the construction of an extension to its clinic. The extension will allow Medsi to expand its range of services and more than double the total size of the Medsi facilities. The extension will include an expanded Diabetes Center that will be the leading private diabetes treatment center in Moscow. In 2006, Medsi served 32,618 patients.

The Medsi II children's clinic is Moscow's most advanced clinic of its type. It has specialized clinics for non-surgical vision correction, allergies, immunological and metabolic disorders, diabetes, posture correction and care for children under 12 months old. The clinic has a Scientific Committee composed of leading scientists and academics from the Russian Academy of Medical Science. The committee's aim is to conduct pediatric research and introduce new technologies and methods for prevention and treatment of pediatric illnesses. During the year, Medsi II provided services to 15,238 patients.

The Healthcare business area saw revenues increase 69% in 2006, reaching US\$16.9 million, with Medsi accounting for US\$12.5 million in revenues and Medsi II for US\$3.9 million. The company is developing a strategic plan focused on creating the leading provider of private medical care in Russia. This provider will aim to render the fullest possible range of medical services to patients.





Pharmaceuticals

Created in March 2006, Binnofarm is Sistema's holding company for its pharmaceutical and biotechnology assets. The Russian pharmaceutical market has grown very rapidly in recent years: 36% year-on-year in 2006 to US\$12.3 billion, following 35% increase in 2005. Russia's pharmaceutical market is currently dominated by foreign manufacturers controlling 75% of the market, although the introduction of a national drug reimbursement program in 2005 drove demand for cost effective domestically produced medicines.

Over the course of 2006, the consolidation of Sistema's pharmaceutical and biotechnology assets under Binnofarm was completed. The holding received a pharmaceutical license in May. At the beginning of 2007, Binnofarm is a vertically integrated pharmaceutical and biotechnology holding. The company is growing in three clearly defined directions: R&D and production facilities for innovative medicines, in-house and out-sourced production of generic medicines and an outsourcing business for finished pharmaceuticals and other innovative chemical substances.

Binnofarm produces a range of finished innovative and generic medicines. The company began the first industrial production of a vaccine for hepatitis B in 2005. Binnofarm is the only company in Russia conducting full-cycle vaccine production from substance to final-form product and is developing production of an array of immunobiological medicines. Binnofarm also produces central nervous system analgesics together with the Federal State Enterprise GZMP that accounted for around 50% of the Russian market in 2006.

The Biotechnology segment posted US\$53.7 million in revenues compared to US\$8.4 million in 2005. At the end of 2006, Binnofarm had registered eight medicines in Russia, with another 50 submitted for registration.

¹ Sources: Russian Ministry of Health and Social Development, Snegiri-Group, FSGS, RosBusinessConsulting

Innovation and Venture Capital

Research & Development Centers

Continuous innovation is critical to maintaining Sistema's competitive edge on both the corporate level and maintaining and enhancing market leadership in each business area. Sistema's operating companies have long maintained research and development centers responsible for innovation as well as well established relationships with leading research universities and institutes and international technology partners.

In a rapidly changing marketplace for technology and services, however, many of the lines between traditional businesses, such as telecommunications and media, are rapidly disappearing. A 'silo-based' approach to R&D, where research is focused on a single or small group of market segments, no longer makes sense. Therefore, Sistema has moved to establish a single scientific and technical policy for the corporation based on clear principles and goals and aimed at focused, marketing driven innovation that leverages economies of scale and synergies between business areas in the sphere of R&D.

On the corporate level, Sistema has created a Department for Innovation Projects to identify and coordinate priority R&D projects for each business area and the corporation as a whole. It will maintain a single database of ongoing innovation projects and house a special service to ensure the corporation's intellectual property rights are protected in Russia and internationally. The department is also responsible for developing more systematic and efficient modes of collaboration with specialized research institutes and universities. Sistema is also looking at how it can best make use of new, government-backed initiatives to foster innovation, such as so-called technical parks and special economic zones that provide infrastructure support and tax incentives for research and development based work.

At the same time, the corporation plans to establish centralized R&D centers in a number of its core business areas. Each center will be responsible for developing and introducing new technology for the operating companies in its business area. The relationship

between the R&D centers and operating companies is being structured as a two-way channel, with R&D driving new market launches, while operating companies provide expertise and intelligence about market trends and consumer responses to new products.

In 2006, this strategy was successfully implemented in the Telecommunications business area, where all research and development centers were unified in a single structure, Intellect Telecom. The centralized R&D center represents one of the most important resources available maintain both long-term market leadership and profit growth at Sistema's telecommunications operating companies. The primary focus of Intellect Telecom is to create flexible solutions, such as those based on the application of a number of wireless technology standards (such as UMTS, Wi-Fi, WiMAX, DVB-T and so forth) to deliver multimedia content and services. Another strategic focus is the efficient integration of digital mobile and fixed-line networks of the main telecommunications operators within Sistema Telecom.

Sistema plans to establish similar centralized R&D structures in other core business areas, with projects underway at high-technology holding Sitronics, radar and aerospace technology group RTI Systems, Pharmaceuticals and Biotechnology "Binnopharm". The corporation is also planning to strengthen its R&D efforts in other areas. One such area is banking, where the rapid development of MBRD's retail banking network requires innovative solutions to link branches and headquarters more efficiently, share information and access data such as consumer credit histories in order to provide customers with quick responses to mortgage and other credit applications.

Venture Capital

Another important pillar of Sistema's innovation infrastructure, put into place during 2006, is the corporation's leading role in establishing venture capital funds to act as incubators for new technologies, to develop existing business areas, and create opportunities to develop new market segments. Last year, Sistema organized a number of funds within private-public partnership frameworks, working with the Russian federal and regional governments to support the development of the country's innovation infrastructure.

Sistema acts as the primary off-taker of the projects and technologies financed by these funds. All of the funds have been developed as 50-50 joint-ventures between Sistema and third parties, generally federal and regional government bodies. The volume of Sistema's venture capital funds at the end of 2006 stood at around

RUB1.48 billion (approximately US\$54.6 million). The venture capital funds are oriented toward 'start-up' companies and involve a number of relatively small investments. The maximum investment allowed in any single projects by any fund is 10% of the fund's capital.

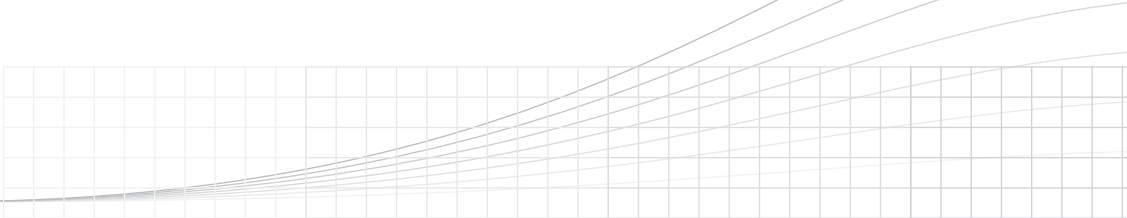
Besides capital, one of Sistema's key contributions to its funds is strategic vision and pool of management skill to developing projects. As with other areas of its business, Sistema has established a range of KPIs for projects receiving venture finance. The corporation has set return on investment criteria that require a minimum return of 25% per year for its investment. The lifecycle of the venture capital funds is seven years. At the end of this period, Sistema will sell the business, develop it into a separate business area or realize its investment through sale to a strategic investor.

Among the funds created in 2006 is the Moscow Venture Fund, with capital of RUB1 billion (approximately US\$37 million), established in cooperation with the government of the City of Moscow and the Ministry for Economic Development and Trade. This fund is focused in developing technology on the base of the city's large complex of universities and research institutes, to ensure the city develops the technological resources needed, to retain its position as a leading global business center.

Another fund has been created in partnership with the administration of the Russian republic of Mordovia. The fund aims to develop the Saransk-based assembly division of RTI Systems and foster regional research and development capacity for both RTI and third-party customers. The fund has an initial capital of RUB280 million (approximately US\$10.4 million). A third fund has been developed with the administration of Perm province around the base of Perm Motors, a facility acquired by Sistema in 2006.

In order to implement projects that have reached an advanced stage of development in the telecommunications and high-technology area, Sistema has established the Correll Sistema Strategy Fund with capital of US\$75 million. Co-investors in this fund are Sistema, MTS, Comstar and Sitronics, with international fund management firm Correll hired to provide management expertise as well as a 1% contribution to the fund.

This fund has already been involved in developing a large number of high-potential projects that are providing revolutionary new technology for Sitronics, MTS and other operating companies. This technology includes technology for providing customized telecommunications services, wireless Internet access, GPS through the



newly developed GLONASS navigation system and others. As part of GLONASS, Sistema is implementing a project aimed at creating a new All-Russian Cartographic Database with government support for clients such as the Russian Ministry of Defense and the Ministry for Emergency Situations. In future, GLONASS is expected to have significant commercial potential for civilian use.

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