

MOBILE TELESYSTEMS OJSC
Form 20-F
June 16, 2004

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SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

Form 20-F

- o **Registration Statement pursuant to Section 12(b) or (g) of the Securities Exchange Act of 1934**
or
- ý **Annual report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the fiscal year ended December 31, 2003**
or
- o **Transition report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**
Commission file number 333-12032

MOBILE TELESYSTEMS OJSC

(Exact name of Registrant as specified in its charter)

RUSSIAN FEDERATION

(Jurisdiction of incorporation or organization)

4 Marksistskaya Street, Moscow 109147 Russian Federation

(Address of Principal Executive Offices)

Securities registered or to be registered pursuant to Section 12(b) of the Act:

Title of Each Class	Name of Each Exchange on Which Registered
AMERICAN DEPOSITARY SHARES, EACH REPRESENTING 20 SHARES OF COMMON STOCK	NEW YORK STOCK EXCHANGE
COMMON STOCK, PAR VALUE 0.10 RUSSIAN RUBLES PER SHARE	NEW YORK STOCK EXCHANGE⁽¹⁾

Securities registered or to be registered pursuant to Section 12(g) of the Act:

NONE
(Title of Class)

Securities for which there is a reporting obligation pursuant to Section 15(d) of the Act:

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10.95% NOTES DUE 2004

(Title of Class)

Indicate the number of outstanding shares of each of the issuer's classes of capital or common stock as of the close of the period covered by the annual report.

1,983,359,507 ordinary shares, par value 0.10 Russian rubles each, as of December 31, 2003

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes:

No.:

Indicate by check mark which financial statement item the Registrant has elected to follow:

Item 17

Item 18

(1)

Listed, not for trading or quotation purposes, but only in connection with the registration of ADSs pursuant to the requirements of the Securities and Exchange Commission.

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Unless the context otherwise requires, references to "MTS," "we," "us" or "our" refer to Mobile TeleSystems OJSC and its subsidiaries. "UMC" refers to Ukrainian Mobile Communications, our Ukrainian operations, which we acquired in March 2003. We refer to Mobile TeleSystems LLC, our 49%-owned joint venture in Belarus as MTS-Belarus. As MTS-Belarus is an equity investee, our revenues and subscriber data do not include MTS-Belarus. Our reporting currency is the U.S. dollar and we prepare our consolidated financial statements in accordance with accounting principles generally accepted in the United States, or U.S. GAAP.

In this document, references to "U.S. dollars," "dollars," "\$" or "USD" are to the lawful currency of the United States, references to "rubles" or "RUR" are to the lawful currency of the Russian Federation, references to "hryvnias" are to the lawful currency of Ukraine and references to "€," "euro" or "EUR" are to the lawful currency of the member states of the European Union that adopted a single currency in accordance with the Treaty of Rome establishing the European Economic Community, as amended by the treaty on the European Union, signed at Maastricht on February 7, 1992.

CAUTIONARY STATEMENT REGARDING FORWARD-LOOKING STATEMENTS

Matters discussed in this document may constitute forward-looking statements. The Private Securities Litigation Reform Act of 1995 provides safe harbor protections for forward-looking statements in order to encourage companies to provide prospective information about their businesses. Forward-looking statements include statements concerning plans, objectives, goals, strategies, future events or performance, and underlying assumptions and other statements, which are other than statements of historical facts.

Mobile TeleSystems OJSC, or MTS, desires to take advantage of the safe harbor provisions of the Private Securities Litigation Reform Act of 1995 and is including this cautionary statement in connection with this safe harbor legislation and other relevant law. This document and any other written or oral statements made by us or on our behalf may include forward-looking statements, which reflect our current views with respect to future events and financial performance. The words "believe," "expect," "anticipate," "intend," "estimate," "forecast," "project," "will," "may," "should" and similar expressions identify forward-looking statements. Forward-looking statements appear in a number of places including, without limitation, "Item 3. Key Information D. Risk Factors," "Item 4. Information on Our Company B. Business Overview" and "Item 5. Operating and Financial Review and Prospects," and include statements regarding:

strategies, outlook and growth prospects;

future plans and potential for future growth;

liquidity, capital resources and capital expenditures;

growth in demand for our services;

economic outlook and industry trends;

developments of our markets;

the impact of regulatory initiatives; and

the strength of our competitors.

The forward-looking statements in this document are based upon various assumptions, many of which are based, in turn, upon further assumptions, including without limitation, management's examination of historical operating trends, data contained in our records and other data available from third parties. Although we believe that these assumptions were reasonable when made, because these assumptions are inherently subject to significant uncertainties and contingencies which are difficult or impossible to predict and are beyond our control, we may not achieve or accomplish these expectations, beliefs or projections. In addition to these important factors and matters discussed elsewhere herein and in the documents incorporated by reference herein, important factors that, in our view, could cause actual results to differ materially from those discussed in the forward-looking statements include the achievement of the anticipated levels of profitability, growth, cost and synergy of our recent acquisitions, the timely development and acceptance of new products, the impact of competitive pricing, the ability to obtain necessary regulatory approvals, the condition of the Russian economy, political stability in Russia, the impact of general business and global economic conditions and other important factors described herein and from time to time in the reports filed by us with the Securities and Exchange Commission.

Except to the extent required by law, neither we, nor any of our respective agents, employees or advisors intends or has any duty or obligation to supplement, amend, update or revise any of the forward-looking statements contained or incorporated by reference in this document.

PART I

Item 1. Identity of Directors, Senior Management and Advisors

Not applicable.

Item 2. Offer Statistics and Expected Timetable

Not applicable.

Item 3. Key Information**A. Selected Financial Data**

The selected consolidated financial data for the years ended December 31, 2001, 2002 and 2003, and as of December 31, 2002 and 2003, are derived from the audited consolidated financial statements, prepared in accordance with U.S. GAAP included elsewhere in this document. In addition, the following table presents selected consolidated financial data for the years ended December 31, 1999 and 2000, and as of December 31, 1999, 2000 and 2001, derived from our audited consolidated financial statements not included in this document. Our results of operations are affected by acquisitions. Results of operations of acquired businesses are included in our consolidated financial statements from their respective dates of acquisition. The summary financial data should be read in conjunction with our consolidated financial statements included elsewhere in this document, "D. Risk Factors" and "Item 5. Operating and Financial Review and Prospects." Certain industry and operating data are also provided below.

Years Ended December 31,

	1999	2000	2001	2002	2003
(Amounts in thousands, except share and per share amounts, industry and operating data and ratios)					
Consolidated statements of operations data:					
Net revenues:					
Service revenues ⁽¹⁾	\$314,568	\$484,469	\$830,308	\$1,274,287	\$2,435,717
Connection fees	12,755	14,885	21,066	24,854	29,372
Equipment sales	31,004	36,358	41,873	62,615	81,109
Total net revenues	358,327	535,712	893,247	1,361,756	2,546,198
Cost of services and products exclusive of depreciation and amortization shown separately below:					
Interconnection and line rental	38,958	41,915	75,278	113,052	187,270
Roaming expenses	21,725	41,178	68,387	83,393	113,838
Cost of equipment	29,932	39,217	39,828	90,227	173,071
Total cost of services and products	90,615	122,310	183,493	286,672	474,179
Operating expenses ⁽²⁾	74,612	110,242	134,598	229,056	406,722
Sales and marketing expenses	23,722	76,429	107,729	171,977	326,783
Depreciation and amortization	53,766	87,684	133,318	209,680	415,916
Impairment of investment			10,000		
Net operating income	115,612	139,047	324,109	464,371	922,598
Currency exchange and translation losses (gains)	3,238	1,066	2,264	3,474	(693)

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Other expenses (income):					
Interest income	\$(801)	\$(7,626)	\$(11,829)	\$(8,289)	\$(18,076)
Interest expense	11,805	11,335	6,944	44,389	106,551
Other (income) expenses, net	(829)	(502)	(2,672)	(2,454)	3,420
<hr/>					
Total other expenses (income), net	10,175	3,207	(7,557)	33,646	91,895
Income before provision for income taxes and minority interest	102,199	134,774	329,402	427,251	831,396
Provision for income taxes	18,829	51,154	98,128	110,417	242,480
Minority interest in net (loss) income	(2,291)	(6,428)	7,536	39,711	71,677
<hr/>					
Net income before cumulative effect of a change in accounting principle	85,661	90,048	223,738	277,123	517,239
Cumulative effect of a change in accounting principle, net of income taxes of \$9,644			(17,909)		
<hr/>					
Net income	\$85,661	\$90,048	\$205,829	\$277,123	\$517,239
<hr/>					
Dividends declared	\$11,879	\$13,631	\$2,959		\$110,931
Pro forma net income giving effect to the change in accounting principle, had it been applied retroactively	\$78,258	\$93,108	\$223,738	\$277,123	\$517,239
Earnings per share, basic and diluted:					
Net income before cumulative effect of a change in accounting principle	0.052	0.050	\$0.113	\$0.140	\$0.261
Net income	0.052	0.050	\$0.104	\$0.140	\$0.261
Dividends declared per share	\$0.01	\$0.01			\$0.06
Weighted average shares of common stock outstanding	1,634,527,040	1,806,968,096	1,983,359,507	1,983,359,507	1,983,374,949
Consolidated cash flow data:					
Cash provided by operating activities	\$116,801	\$190,914	\$338,201	\$412,772	\$965,984
Cash used in investing activities	(115,184)	(423,349)	(441,523)	(697,921)	(1,910,087)
(of which capital expenditures) ⁽³⁾	(118,338)	(224,898)	(441,200)	(574,272)	(958,771)
Cash (used in) provided by financing activities	(11,557)	298,543	247,592	100,817	997,545
Consolidated balance sheet data (end of period):					
Cash, cash equivalents and short-term investments	\$10,000	\$245,828	\$304,933	\$64,661	\$335,376
Property, plant and equipment, net	250,270	439,307	856,056	1,344,633	2,256,076
Total assets	682,047	1,101,332	1,727,492	2,283,296	4,225,351
Total debt (long-term and short-term) ⁽⁴⁾	112,123	52,773	325,840	454,485	1,660,334
Total shareholders' equity	343,724	801,084	1,018,279	1,302,044	1,723,910
including capital stock	49,276	40,352	40,352	40,352	40,361
Financial ratios (end of period):					
Total debt/total capitalization ⁽⁵⁾	24.6%	6.2%	24.2%	25.9%	49.1%
Mobile penetration (end of period):					
Russia ⁽⁶⁾	0.9%	2.3%	5.5%	12.4%	25.0%
Ukraine ⁽⁷⁾	n/a	n/a	n/a	n/a	13.4%

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Operating data:⁽⁸⁾

Subscribers in Russia (end of period, thousands) ⁽⁹⁾	306	1,194	2,650	6,644	13,370
Subscribers in Ukraine (end of period, thousands) ⁽⁹⁾	n/a	n/a	n/a	n/a	3,350
Overall market share in the Moscow license area (end of period)	40%	55%	50%	43%	43%
Overall market share in Russia (end of period)	23%	35%	33%	38%	37%
Overall market share in Ukraine (end of period)	n/a	n/a	n/a	n/a	51%
Average monthly usage per subscriber in Russia (minutes) ⁽¹⁰⁾	224	151	157	159	144
Average monthly service revenue per subscriber in Russia ⁽¹¹⁾	\$124	\$54	\$36	\$23	\$17
Average monthly usage per subscriber in Ukraine (minutes) ⁽¹⁰⁾	n/a	n/a	n/a	n/a	97
Average monthly service revenue per subscriber in Ukraine ⁽¹¹⁾	n/a	n/a	n/a	n/a	\$15
Subscriber acquisition costs in Russia ⁽¹²⁾	\$148	\$69	\$56	\$35	\$26
Subscriber acquisition costs in Ukraine ⁽¹²⁾	n/a	n/a	n/a	n/a	\$32
Churn in Russia ⁽¹³⁾	20.7%	21.6%	26.8%	33.9%	47.3%
Churn in Ukraine ⁽¹³⁾	n/a	n/a	n/a	n/a	23.8%

- (1) Service revenues represent subscription fees, usage charges and value-added service fees, as well as roaming fees charged to other operators for their subscribers, or guest roamers, utilizing our network. Guest roaming fees were \$44.0 million, \$43.2 million, \$52.6 million, \$83.4 million and \$153.3 million for the years ended December 31, 1999, 2000, 2001, 2002 and 2003, respectively.
- (2) Operating expenses include taxes (other than income taxes), primarily revenue and property-based taxes, of \$15.6 million, \$26.9 million, \$25.3 million, \$39.1 million and \$40.4 million for the years ended December 31, 1999, 2000, 2001, 2002 and 2003, respectively.
- (3) Capital expenditures include purchases of property, plant and equipment and intangible assets.
- (4) Includes notes payable, bank loans, capital lease obligations and other debt.
- (5) Calculated as book value of total debt divided by the sum of the book values of total shareholders' equity and total debt at the end of the relevant period. See note 4 above for the definition of "total debt."
- (6)

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Source: Sotovik, J'Son & Partners and AC&M-Consulting.

(7)

Source: Ukrainian News.

(8)

Source: Sotovik, J'Son & Partners, AC&M-Consulting, Ukrainian News and our data.

(9)

We define a subscriber as an individual or organization whose account does not have a negative balance for more than 61 days. For the "Jeans" tariffs only, introduced in November 2002, we define a subscriber as an individual or organization whose account does not have a negative balance for more than 183 days. For a description of our "Jeans" tariffs, see "Item 4. Information on Our Company B. Business Overview Sales and Marketing Tariffs."

(10)

Average monthly minutes of usage per subscriber is calculated by dividing the total number of minutes of usage during a given period by the average number of subscribers during such period and dividing by the number of months in such period. For Ukraine, the figure has been calculated based on the months of March through December 2003.

(11)

Average monthly service revenue per subscriber is calculated by dividing our service revenues for a given period, including guest roaming fees, by the average number of our subscribers during that period and dividing by the number of months in that period. For Ukraine, the figure has been calculated based on the months of March through December 2003.

(12)

Subscriber acquisition costs are calculated as total sales and marketing expenses for the period per additional subscriber. Effective January 1, 2001, we changed our accounting policy and began expensing dealer commissions on new connections as incurred instead of amortizing them over the estimated average subscriber life. For Ukraine, the figure has been calculated based on the months of March through December 2003.

(13)

We define churn as the total number of subscribers who cease to be a subscriber (as defined above) during the period (whether involuntarily due to non-payment or voluntarily at such subscriber's request, including those switching to a different tariff plan), expressed as a percentage of the average number of subscribers during that period. For Ukraine, the figure has been annualized based on the months of March through December 2003.

B. Capitalization and Indebtedness

Not applicable.

C. Reasons for the Offer and Use of Proceeds

Not applicable.

D. Risk Factors

An investment in our securities involves a high degree of risk. You should carefully consider the following information about these risks, together with other information contained in this document, before you decide to buy our securities. If any of the following risks actually occur, our business, prospects, financial condition or results of operations could be adversely affected. The value of our securities could also decline and you could lose all or part of your investment.

Risks Relating to Business Operations in Emerging Markets

Emerging markets such as the Russian Federation, Belarus and Ukraine are subject to greater risks than more developed markets, including significant legal, economic and political risks.

Investors in emerging markets such as the Russian Federation, Belarus and Ukraine should be aware that these markets are subject to greater risk than more developed markets, including in some cases significant legal, economic and political risks. Investors should also note that emerging economies such as the economy of the Russian Federation, Belarus and Ukraine are subject to rapid change and that the information set out herein may become outdated relatively quickly. Accordingly, investors should exercise particular care in evaluating the risks involved and must decide for themselves whether, in light of those risks, their investment is appropriate. Generally, investment in emerging markets is only suitable for sophisticated investors who fully appreciate the significance of the risks involved and investors are urged to consult with their own legal and financial advisors before making an investment in our securities.

Risks Relating to Our Business

If UMC or our purchase of UMC is found to have violated Ukrainian law or the purchase is unwound, our business, prospects and results of operations would be materially adversely affected.

On June 7, 2004, the General Prosecutor of Ukraine filed a claim against us and others in the Kiev Commercial Court seeking to unwind the sale by Ukrtelecom of its 51% stake in UMC to us. The complaint also seeks an order that would prohibit us from alienating 51% of our stake in UMC until the claim is resolved on the merits. The claim is based on a provision of the Ukrainian privatization law that included Ukrtelecom among a list of "strategic" state holdings prohibited from alienating or encumbering its assets during the course of its privatization. While the Ukrainian Cabinet of Ministers in May 2001 issued a decree specifically authorizing the sale by Ukrtelecom of its entire stake in UMC, the General Prosecutor asserts that the decree contradicted the privatization law and that the sale by Ukrtelecom was therefore illegal and should be unwound. In addition, it is not clear whether UMC had met all of the legal requirements associated with its corporate structure prior to its acquisition, including those relating to capital contributions and amendments to its charter. In the event that UMC or our purchase of UMC is found to have violated Ukrainian law or the purchase is unwound, in whole or in part, our business, prospects and results of operations would be materially adversely affected.

Our principal shareholders have the ability to control our operations and their interests may conflict with those of holders of our securities, and they may make decisions that materially adversely affect your investment.

Together our principal shareholders, Sistema and T-Mobile, control directly or indirectly approximately 77% of our voting shares and Sistema alone controls 50.6% of our shares. As a result, our principal shareholders have the ability to implement actions requiring shareholder approval, including the election of directors and the declaration of dividends, and have the ability to control our operations. Therefore, decisions made by Sistema or T-Mobile will influence our business, results of operations and financial condition, and these decisions may conflict with the interests of the holders of our securities.

Moreover, under a shareholders' agreement between Sistema and T-Mobile, T-Mobile undertakes to vote to ensure (in so far as it is able) that Sistema has a majority of the members of our board of directors. However, certain corporate actions will require T-Mobile's approval, including new issuances of our shares, actions which would dilute T-Mobile's shareholding in us and acquisitions by us with a value greater than 25% of the balance sheet value of MTS OJSC's total assets, in accordance with Russian accounting standards. Under the shareholders' agreement, both Sistema and T-Mobile have a right of first refusal with respect to sales of our shares by the other party to third parties, subject to certain exceptions. The shareholders' agreement may, subject to a three-month remedy period, be terminated by either party, if the other party holds less than 25% of our share capital.

Our controlling shareholder Sistema has outstanding a significant amount of indebtedness, including \$350.0 million of notes maturing in 2008 and \$350.0 million of notes maturing in 2011. In addition, the notes maturing in 2011 can be redeemed at the option of the noteholders in 2007. Therefore, Sistema will require significant funds to meet its obligations, which may have to come in part from dividends paid by its subsidiaries, including us.

Under the shareholders' agreement, Sistema and T-Mobile have also agreed to consult each other with respect to any dividend policy, with the expectation that annual dividends will be not less than the equivalent of 25% of MTS OJSC's net profits, in accordance with Russian accounting standards. Our principal shareholders voted in favor of declaring dividends in 2003 and are expected to do so at our next annual shareholders' meeting in 2004. The indentures relating to our outstanding notes do not restrict our ability to pay dividends. As a result of paying dividends, our reliance on external sources of financing may increase, and our cash flow and ability to repay our debt obligations, or make capital expenditures, investments and acquisitions could be materially adversely affected. See "Item 5. Operating and Financial Review and Prospects B. Liquidity and Capital Resources."

In addition, Sistema has agreed to fund the full and timely repayment of one of our loans, which had a balance of \$23.4 million as of December 31, 2003. Sistema's failure to pay this amount could adversely affect our cash position. Sistema also owns interests in Skylink CJSC, JSC Personal Communications and MCC, which currently operate on CDMA and older NMT standards in the Moscow and St. Petersburg and certain other license areas, but plan to develop broader wireless network in Russia using the latest CDMA standard. These companies intend to be niche players, targeting high-end businesses and residential customers which could result in increased competition for us.

Increased competition and a more diverse subscriber base have resulted in decreasing average monthly service revenues per subscriber and increasing subscriber churn, which may adversely affect our results of operations.

While our subscriber base and revenues are growing as we continue to grow our operations, our average monthly service revenues per subscriber are decreasing and subscriber churn is increasing. We expect per subscriber revenues to continue to decrease and subscriber churn to continue to increase

due to tariff decreases, lower tariffs in the regions outside of the Moscow license area and the increase of mass-market subscribers as a proportion of our overall subscriber mix. See "Item 5. Operating and Financial Review and Prospects." This decrease in our average monthly service revenues per subscriber and increase in subscriber churn may adversely affect our results of operations.

We are substantially dependent on a single supplier of billing system software, which may adversely affect our ability to control our costs and expand our network.

We are substantially dependent on a single Russian supplier of our billing system equipment and software. As we have expanded and our subscriber base has grown, we have routinely required upgrades to our billing systems to manage the increased capacity. Because of the high cost of investing in and installing billing systems, our ability to change our suppliers is limited. As a result, our billing system supplier has the ability to unilaterally increase the costs for system and software upgrades to above-market prices which, in turn, may adversely affect our ability to control our costs and expand our network.

Our failure to implement the necessary infrastructure to manage our growth could have a material adverse effect on our business and results of operations.

Our billing system registers and debits the account of a subscriber for calls made by such subscriber one to two hours after such calls are made. There is also an additional delay between the time that a subscriber's balance reaches zero and the disconnection of such subscriber from our network. During the first quarter of 2003, certain dealers and subscribers together fraudulently exploited these billing time lags by placing a sizeable amount of domestic and international long distance calls using subscriber accounts registered under false names. We discovered this fraud in March 2003, and we estimate that we incurred approximately \$16.7 million in losses during 2003 as a result of this dealer fraud. We have taken measures that we believe will prevent further use of this scheme, such as requiring our subscribers to activate their long distance services in person at our service centers. This, in turn, may cause us to lose subscribers who view the new requirement as burdensome and adversely affect our market share. We have also canceled our contracts with certain dealers who had the highest numbers of fraudulent accounts.

The failure or breakdown of key components of our infrastructure in the future, including our billing system, could have a material adverse effect on our business and results of operations.

If we cannot successfully develop our network, we will be unable to expand our subscriber base.

We plan to expand our network infrastructure in the following ways:

extend coverage and increase the capacity of our existing network in the Moscow license area;

further develop our operations in Ukraine and make investments in MTS Belarus and further develop coverage in the other regions of Russia in which we currently operate; and

introduce service in the regions in which we have licenses and have not yet commenced operations.

Our ability to increase our subscriber base depends upon the success of our network expansion. We have expended considerable amounts of resources to enable this expansion. For a discussion of our regional expansion, see "Item 4. Information on Our Company A. History and Development Expansion." Limited information regarding the potential regional markets into which we are considering expanding, either through acquisitions or new licenses, complicates accurate forecasts of future revenues from those regions, increasing the risk that we may overestimate these revenues. In addition, we have expanded our network through acquisitions and we may continue to engage in further acquisitions. We may not be able to integrate previous or future acquisitions successfully or operate them profitably.

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The integration of our businesses, including those we may acquire in the future, requires significant time and effort from our senior management, who are also responsible for managing our existing operations. The integration of our businesses may also be difficult as our technical systems and culture may differ from those of the acquired businesses, unpopular cost cutting measures may be required, and control of cash flow may be difficult to establish. Any difficulties encountered in the transition and integration process could have a material adverse effect on our results of operations.

We also may face problems and complications during the course of our expansion into countries outside of the Russian Federation to which we are unaccustomed. For example, after we signed agreements for the acquisition of a majority stake in UMC in November 2002, a lawsuit was filed in Ukraine seeking to prevent the sale by one of the selling shareholders, Ukrtelecom, of its shares in UMC. This lawsuit was dismissed and our acquisition of a majority stake in UMC was consummated in March 2003. In June 2004, the General Prosecutor of Ukraine filed a claim against us and others seeking to unwind our purchase of Ukrtelecom's stake in UMC.

The buildout of our network is also subject to risks and uncertainties, which could delay the introduction of service in some areas and increase the cost of network construction, including difficulty in obtaining base station sites on commercially attractive terms. In addition, telecommunications equipment used in Russia is subject to governmental certification, which must be renewed at least every three years. The failure of any equipment we use to receive timely certification or re-certification could also hinder our expansion plans. We also, at times, put our equipment into operation prior to receiving certification, which could lead to administrative sanctions including fines and/or the seizure of such equipment. To the extent we fail to expand our network on a timely basis, we could experience difficulty in expanding our subscriber base.

Difficulty in obtaining adequate managerial and operational resources may restrict our ability to successfully expand our operations.

We have experienced substantial growth and development in a relatively short period of time. Management of this growth has required significant managerial and operational resources and is likely to continue to do so. In response to this growth, we have recently added two new first vice president positions, subordinate only to our chief executive officer. Our future operating results depend, in significant part, on the continued contributions of a small number of our key senior management and technical personnel. Management of growth will require, among other things:

stringent control of network buildout and other costs;

the ability to integrate new acquisitions into our operations;

continued development of financial and management controls and information technology systems, and their implementation in newly acquired businesses;

implementation of adequate internal control over financial reporting and disclosure controls and procedures;

increased marketing activities;

provision of additional service centers;

hiring and training of new personnel; and

coordination among our logistical, technical, accounting, finance, marketing and sales personnel.

Our success will depend, in part, on our ability to continue to attract, retain and motivate qualified personnel. Competition in Russia and Ukraine for personnel with relevant expertise is intense, due to the small numbers of qualified individuals. Although we attempt to structure our compensation packages in a manner consistent with evolving standards of the Russian and Ukrainian labor markets,

we are not insured against damage that may be incurred in case of the loss or dismissal of our key personnel. Our failure to successfully manage our growth and personnel needs could have a material adverse effect on our business and results of operations.

If we cannot interconnect cost-effectively with other telecommunications operators, we may be unable to provide services at competitive prices and therefore lose market share and revenues.

Our ability to provide commercially viable services depends on our ability to continue to interconnect cost-effectively with the Moscow City Telephone Network, or MGTS, in Russia, Ukrtelecom, in Ukraine, and other local, domestic and international telecommunications operators. Fees for interconnection are established by agreements with network operators and vary, depending on the network used, the nature of the call and the call destination. We have entered into interconnection agreements with several local, domestic and international telecommunications operators, including MGTS and Rostelecom in Russia and UTEL and Ukrtelecom in Ukraine. Interconnection with these operators is required to complete calls originating on our network but terminating outside of it and to complete calls to our subscribers originating outside of our network.

In Ukraine, mobile telecommunications operators currently charge Ukrtelecom a lower rate for its use of their networks than Ukrtelecom charges the mobile telecommunications operators for their use of Ukrtelecom's fixed line network. In addition, the Ukrainian government plans in 2004 to privatize Ukrtelecom, whose market share of all fixed line telecommunications services in Ukraine is over 80%, and it is unclear how this privatization will affect our interconnection arrangements and costs.

Although Russian legislation requires that operators of public switched telephone networks may not refuse to provide interconnections or discriminate against one operator by comparison with another, we believe that, in practice, some public network operators attempt to impede mobile operators by delaying interconnection applications and charging varying interconnect rates to different mobile operators and, in particular, more favorable rates to local mobile operators, potentially enabling our competitors to offer lower prices. Any difficulties or delays in interconnecting cost-effectively with other networks could hinder our ability to provide services at competitive prices or at all, causing us to lose market share and revenues, which could have a material adverse effect on our business and results of operations.

Governmental regulation of our interconnect rates in Ukraine could adversely affect our results of operations.

Under the Telecommunications Law adopted in November 2003, the State Committee on Communications and Informatization, or the SCCI, in Ukraine is entitled to regulate the tariffs for public telecommunications services rendered by fixed line operators, whereas the mobile cellular operators (including UMC) are entitled to set their retail tariffs and negotiate interconnect rates with other operators. However, the SCCI would be entitled to regulate the interconnect rates of any mobile cellular operator declared a "dominant market force" by the Antimonopoly Committee of Ukraine, or the AMC. In March 2004, the AMC began a review of the telecommunications services market for the purpose of determining the status of competition and the existence of dominant market forces. In April 2004, UMC reduced its interconnect rates at the recommendation of the AMC. Governmental regulation of our interconnect rates could cause our interconnect revenues to decrease or be limited, which could have a material adverse effect on our results of operations.

In addition, we believe that the state-owned fixed line operator monopolies, Ukrtelecom and UTEL, are currently able to influence telecommunications policy and regulation and may cause substantial increases in interconnect rates for access to fixed operators' networks by the mobile cellular operators. Such increases could cause our costs to increase, which could have a material adverse effect on our results of operations.

If frequencies currently assigned to us are reassigned to other users or if we fail to obtain renewals of our frequency allocations, our network capacity will be constrained and our ability to expand limited, resulting in a loss of market share and lower revenues.

There is a limited amount of frequencies available for mobile operators in each of the regions in which we operate or hold licenses to operate. We are dependent on access to adequate spectrum allocation in each market in which we operate in order to maintain and expand our subscriber base. While we believe that our current spectrum allocations are sufficient, frequency may not be allocated to us in the future in the quantities, with the geographic span and for time periods that would allow us to provide wireless services on a commercially feasible basis throughout all of our license areas. For example, the availability of frequencies in the GSM 900 MHz band in Ukraine is limited by the fact that the Ukrainian military has a number of frequencies for its exclusive use. While future capacity constraints could be reduced by an increase in the GSM frequencies allocated to us, including additional frequencies in the GSM 1800 MHz band, we may not be awarded some or all of the remaining GSM spectrum. In addition, the Ukrainian government is currently delaying the allocation of new frequencies to mobile communications operators in Ukraine which, in turn, may constrain our network capacity in those areas of Ukraine characterized by high subscriber usage.

A loss of assigned spectrum allocation, which is not replaced by other adequate allocations, could also have a substantial adverse impact on our network capacity. For example, on September 5, 2000, we received a letter from the State Service for Communication Control, a department of the Ministry of Information Technologies and Communications, informing us of the cancellation of the approval the State Service for Communication Control had given us in May 2000 for certain frequencies within the 900 MHz band in order to install base stations with restricted emanation, which we used primarily for the development of our network in the underground stations of the Moscow subway system. While the Department of Communications Control, also under the Ministry of Information Technologies and Communications, halted the implementation of this letter on September 14, 2000, and the Ministry of Information Technologies and Communications reinstated these frequency allocations to us on November 14, 2000, future such attempts may be made to remove frequency allocations from us. In addition, frequency allocations are often issued for periods that are shorter than the terms of the licenses, and such allocations may not be renewed in a timely manner or at all. If our frequencies are revoked or we are unable to renew our frequency allocations, our network capacity would be constrained and our ability to expand limited, resulting in a loss of market share and lower revenues.

We may be required to contribute to the cost of the Russian government's 900 MHz frequency conversion, which could have a material adverse effect on our results of operations.

A program was approved by the Russian government in November 2001 providing for the transfer during 2002-2003 of the frequency used by air traffic control systems in order to allocate additional frequency for mobile communications. In the event that we and other mobile operators are required by the Russian government to finance the costs of such frequency transfer and we are unable to pass on all or some of this expense to our subscribers, our results of operations could be materially adversely affected. To date, neither we nor, to our knowledge, any of our competitors have been required to make any such contribution.

Because we lack full redundancy and insurance for our systems, a systems failure could prevent us from operating our business and lead to a loss of subscribers, damage to our reputation and violations of the terms of our licenses and subscriber contracts.

We have back-up capacity for our network management, operations and maintenance systems, but automatic transfer to back-up capacity is limited. In the event that the primary network management center was unable to function, significant disruptions to our systems would occur, including our inability to provide services. Disruptions in our services in the Moscow license area have occurred on August 3, 2000, December 15, 2000, January 23, 2001 and May 30, 2003, and these types of disruptions may recur, which could lead to a loss of subscribers, damage to our reputation and violations of the terms of our licenses and subscriber contracts.

Our computer and communications hardware is protected through physical and software safeguards. However, it is still vulnerable to fire, storm, flood, loss of power, telecommunications failures, interconnection failures, physical or software break-ins and similar events. We do not carry business interruption insurance to protect us in the event of a catastrophe, even though such an event could have a material adverse effect on our business.

Failure to fulfill the terms of our licenses, including the payment of license contributions, could result in their suspension or termination, which could have a material adverse effect on our business and results of operations.

Our licenses contain various requirements. These include participation in a federal communications network, adherence to technical standards, investment in network infrastructure and employment of Russian technical personnel. GSM operators are required to provide service to the federal government at regulated tariff rates.

In addition, most of our current licenses provide for payments to be made to finance telecommunication infrastructure improvements, which in the aggregate could total approximately \$110.0 million as of December 31, 2003. However, no decisions regulating the terms and conditions of such payments have been formulated. Accordingly, we have made no payments to date pursuant to any of the current licenses which could require such payments.

Each of our licenses also requires service to be started by a specific date. Each of our licenses, other than the licenses which cover the Moscow license area, also contains requirements as to the number of subscribers and required territorial coverage to be reached by specified dates. Our licenses for the Moscow license area contain requirements relating to network capacity. These requirements are subject to adjustment during the term of the license.

If we fail to comply with the requirements of applicable Russian or Ukrainian law, or we fail to meet the terms of our licenses, our licenses and other authorizations necessary for our operation may be suspended or terminated. For example, our Ukrainian licenses have not been updated to reflect changes in our identification information. A suspension or termination of our licenses or other necessary governmental authorizations could curtail our operations, which could have a material adverse effect on our business and results of operations.

In addition, the regulatory authorities' review of our compliance with licensing regulations and terms of our licenses may be politically motivated. For example, according to press reports, the Russian governmental authorities' investigation in late 2003 of Vimpelcom on the grounds that Vimpelcom was illegally operating in Moscow pursuant to a license issued to its 100% owned subsidiary, rather than to Vimpelcom itself was politically motivated. The matter was thereafter resolved in favor of Vimpelcom.

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

Our ability to attract new subscribers and retain existing subscribers depends in part on our ability to maintain what we believe to be our favorable brand image. Negative rumors regarding our services

or our company could negatively affect this brand image, which could lead to loss of market share and revenues.

We may be unable to obtain licenses for third-generation, or UMTS, mobile cellular services on commercially reasonable terms or at all, which would hinder us from competing effectively with operators who are able to provide these services and limit our ability to expand our services.

The Ministry of Information Technologies and Communications has previously stated that it expected to announce the procedures for the award of licenses for UMTS mobile cellular services during 2002, and then during 2003. To date, however, no procedures have been announced. Depending upon the procedures adopted, we may be unable to obtain UMTS licenses on commercially reasonable terms or at all. Failure to obtain UMTS licenses for the Moscow and other license areas or Ukraine (although we do not believe that the award of UMTS licenses in Ukraine is imminent) would hinder us from competing effectively with operators who are able to provide these services and limit our ability to expand our services, which could have a material adverse effect on our prospects, business and results of operations.

Failure to renew our licenses or receive renewed licenses with similar terms to our existing licenses could have a material adverse effect on our business and results of operations.

Our licenses expire in various years from 2006 to 2013 and may be renewed in Russia and Ukraine upon application to the Federal Service