

Sistema JSFC

A System for Transparency

Transparency	High
Accountability	Good
Investor Relations	Adequate
Financial Discipline	Under Review
Corporate Conduct	Under Review

Sistema JSFC, a company that was for a long time synonymous with opacity, today staged its first ever public conference call, presenting audited 2002 US GAAP results to a broad audience. The move is consistent with the company's stated intent to expand its presence on international capital markets and part of the proactive corporate governance policy launched by the management two years ago.

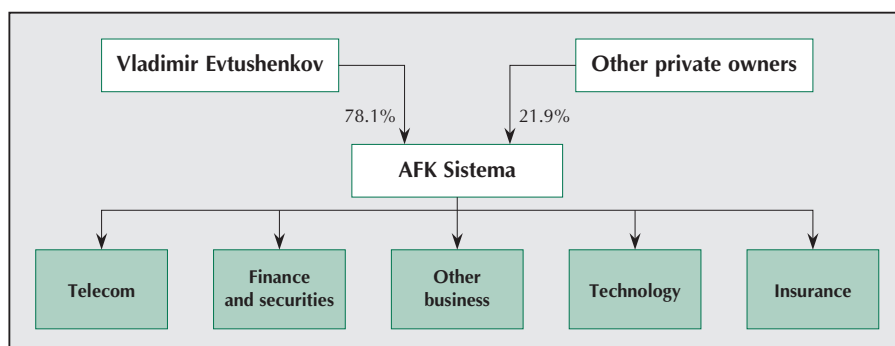
- The company has reiterated its desire to raise equity overseas and has been contemplating the launch of ADR programs at a number of subsidiaries.
- Sistema has stated that the call is part of a regular communication program, aimed at bringing a continual flow of information to a broad audience.
- Total assets are valued at \$2.3 bln and last year generated revenues of \$904 mln.

Launched in 1993, Sistema was for a long time one of the most opaque companies in the market. However, it has over the past two years made great strides in information disclosure and in improving its financial discipline.

We believe that this ongoing push for better corporate governance will lead to a further improvement in the perception and performance of MTS (50.4% of the voting stock owned by Sistema) and MGTS (56%).

In this note, we summarize the corporate governance profile of Sistema, which we will henceforth be monitoring on a day-to-day basis. The presentation provided during the call and playback of the call itself are available on our website: www.troika.ru.

Sistema reveals its ownership and business structure



Source: Company

Corporate governance profile

Corporate governance risk

The most active period of corporate building is understood to be over and Sistema is now working on streamlining its organizational structure and optimizing the management structure throughout the holding. At this stage, the corporate governance risks are relatively low, although it would add transparency and create a more favorable impression among investors if Sistema were to reveal the structure of the holding and the integrated companies and groups.

Holding company and subsidiaries

As end 2002, Sistema's assets, worth \$2.3 bln, included controlling stakes (50% or more) in 115 companies consolidated in its accounts and smaller stakes in another 250 companies reported as equity investees. 86% of the corporation's assets were in telecommunications, finance and securities, technology and insurance. The largest of Sistema's subsidiaries are Russian telecom operators MTS (mobile, 50.4% of the voting stock) and MGTS (fixed line, 56%). Both stakes are controlled via affiliated companies and managed through Sistema Telecom, a 100%-owned sub-holding company.

Information disclosure and financial discipline

The company has produced fully consolidated GAAP accounts starting from 1997, audited by Deloitte & Touche. All subsidiaries were moved to the same auditor in 2001. As a private company, Sistema does not fall under the FCSM's regular disclosure rule, nor is it bound by Russia's disclosure regulations to report major corporate news.

Incentives for good corporate governance

However, the holding company does have a strong incentive to pursue transparency and sound corporate governance practices at its subsidiaries; it is planning to sell more of their shares overseas and raise new capital. We believe that the company has reached a point where its corporate behavior is driven by market expectations. Both MGTS and MTS have invested a lot of effort in building up reputations as investor-friendly and transparent companies. Last year, S&P rated MTS as number 1 company in Russia for corporate governance, awarding it 7.4 out of 10. This image (and the fear of tarnishing it) has motivated the company to live up to investor expectations.

Voluntary norms

As a private company, Sistema is similarly exempt from disclosure obligations to the public. We deem the recent decision to unveil the beneficiary owners of 78% of the equity and communicate the 2002 financial results via a conference call as a gesture of goodwill on the part of the management and a reflection of its commitment to the international corporate principles adopted by Sistema in 2001, rather than a duty necessitated by existing rules and regulations.

Dialog with policy makers

The company is well placed to engage in dialog with policy makers and promote good corporate governance among the business community. The Russian Union of Industrialists and Entrepreneurs (RSPP) offers an excellent opportunity to channel this discussion. Sistema BoD Member Arkady Volsky is a founding member and chairman of the RSPP. He sent a clear message that corporates want change and are prepared to refine their practices, when in 2002 the RSPP established the Corporate Governance Committee, which in 2003 became a launch pad for the National Committee on Corporate Governance. The company's BoD chairman, Vladimir Evtushenkov, is also a member of that council and head of the RSPP working group on industrial policy.

Sistema's past and future: from opacity to transparency

Sistema is a private holding company that owns and controls enterprises in sectors right across the Russian economy. Its total assets, valued at \$2.3 bln, generated \$904 mln in revenues last year. Launched in 1993, it was for a long time one of the most opaque companies in the market. However, the last two years have seen it make great strides in improving information disclosure and financial discipline.

In October 2001, Sistema became a member of the World Economic Forum's "Corporate Governance Initiative" by committing itself to baseline rules of good corporate citizenship. Since then, it has become the third large Russian company to lift the curtain on its beneficiary owners and is gaining respect for its investor relations function.

The push for greater transparency has come, not unusually, at a time when the company has been growing its corporate debt portfolio. It has, on a number of occasions, also indicated a desire to raise equity capital overseas. However, Sistema may well first need to complete the reorganization of its business assets, a process that began in 2002 and could take some time yet. Even so, the incentive is clearly there to build better relationships with the financial community and investing public and thus ensure a fair and accurate market valuation.

Major events in 2000-03

July 2003	Sistema celebrates 10th anniversary. Stages first ever conference call to present 2002 financial results.
June 2003	Starts building up investor relations function, hires highly qualified investor relations team. Launches new corporate website.
May 2003	Acquires 33% of Belkamneft, an oil extraction company in Udmurtia.
April 2003	Sells \$350 mln in five-year Eurobonds. Purchases additional 10% stake in MTS from Deutsche Telecom, which will allow it to consolidate MTS in its financials starting 1H03.
March 2003	Vladimir Evtushenkov, principal shareholder, becomes member of National Council for Corporate Governance.
February 2003	Sistema becomes member of RSPP Committee on Corporate Governance. Issues \$100 mln in one-year credit-linked notes.
July 2002	Publicizes ownership structure. Launches pan-holding reorganization.
April 2002	Standard&Poor's rates MTS as number 1 in Russia for corporate governance.
October 2002	Obtains international credit ratings: 'B-' from S&P, 'B' from Fitch Ratings
October 2001	Becomes member of World Economic Forum "Corporate Governance Initiative".
September 2001	Completes sale of 45% of ROSNO insurance business to German Allianz.
June 2000	MTS goes public, selling Level 3 ADRs and gaining NYSE listing.

Investor relations and communication program

The decision to invite Eurobond holders to participate in the conference call is designed to be the start of a regular communication program, with the company broadcasting conference calls to the US and Europe on a quarterly basis and thereby ensure that it is fairly and accurately valued by the market.

As this suggests, the program is aimed at investors outside Russia. European institutions are a prime market for Sistema, which in April raised \$350 mln via a five-year Eurobond. The management's investor relations policy also includes meetings in London, New York and other locations with institutions, brokers and analysts.

Sistema is at the start of a proactive investor relations process and one bound to come under serious investor scrutiny over the next three years or so. We rate the efficiency of the investor relations team as "adequate". This will be upgraded to "high" once we are satisfied that this is a long-term commitment rather than a one-off marketing effort, i.e. if the management can:

- Execute its strategies and conduct its communications program on the basis of best corporate governance practices.
- Ensure a continuous flow of information and act on feedback received from the investment community.
- Maintain consistency in building up relations with the investment community and analysts.

Sistema follows WEF principles in naming beneficiaries

In July 2002, Sistema became the second major Russian company, after YUKOS, to reveal its beneficiary owners. This was one of the eight rules of conduct of the WEF Corporate Governance Task Force, a body that unites 11 Russian companies, YUKOS and Sistema among them. According to information provided to the FCSM, five individuals together control as much as 94% of the company, or \$2.2 bln worth of the equity capital:

The groups assets are owned by ten individuals

Evgeny Evtushenkov	Founder and BoD chairman	78.10%
Evgeny Novitsky	President	4.86%
Alexander Leiviman	Non-executive director	4.86%
Alexander Gorbatovsky	SEO	3.40%
Alexander Goncharuk	Sistema Telecom CEO	2.90%
Other private owners, less than 1% each		6.00%

Source: Company

However, while Sistema has lifted the veil around its ownership structure, its organizational structure remains opaque. It would certainly improve sentiment if it were to publicize the structure of the holding and the integrated companies and groups which comprise it, a total 365 companies, according to Sistema. Based on information provided by the company, we can attempt to assemble a picture of how this structure may look. However, since the information is not complete, the picture is fragmentary.

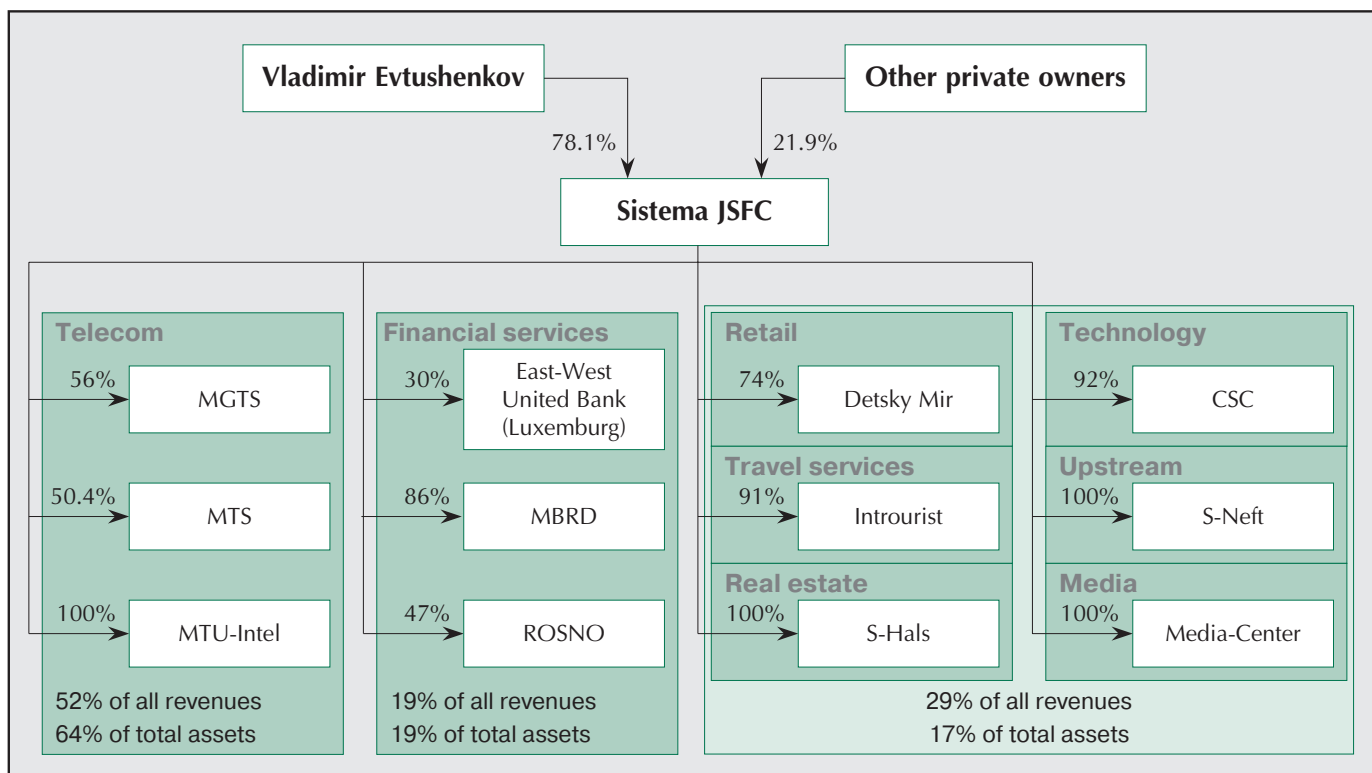
Sistema systemizes its holdings

In July 2002, Sistema Group launched a reorganization aimed at untangling its holdings into a more or less coherent system. A fully-owned subsidiary was created, Sistema Telecom, to manage its assets in the telecommunications sector; the group controls several Russian telecom companies, most notably two Moscow operators, fixed-line MGTS and mobile MTS. In December, it moved to bring its technology sector assets under the umbrella of CSC (Concern "Scientific Center"), a holding company jointly-owned with Czech Strom Telecom.

This restructuring was welcome:

- The new structure is much less convoluted, a big step forward. Sistema's stakes in its operational subsidiaries used to be dispersed among several cross-owned companies, obscuring the real control structure. Now, there is just one holder for each business, a company established specially to manage the assets of a particular sector and a fully-owned Sistema subsidiary.
 - The reorganization should improve financial management and cut administrative costs.
 - Sistema's wish to let MGTS consolidate most or all of its JVs is laudable because it is just.
- In short, the group is now much more transparent, in terms of both ownership and structure.

Sistema Group business structure: holding companies and sectors (% of votes)



Source: Company, Troika Dialog

Sistema through the prism of its track record in subsidiaries

We have been actively covering Sistema’s two major assets in the telecom sector, MGTS and MTS, which at end 2002 together accounted for almost 64% of Sistema’s total assets and 52% of its revenues. The corporate governance profiles of these companies can be found in our annual report (see “Corporate Governance Profiles: Long Crawl West” of October 2002).

The difference in risk perception of these companies is quite dramatic. In our assessment of the companies, we rate the corporate governance-related risks at MTS as “low” and at MGTS as “fair to vulnerable” and believe that Sistema needs to show greater consistency in its efforts.

Further progress over corporate governance at Sistema, as core shareholder, together with greater transparency of the holding company, should, in our view, bring about an improvement in the perception and performance of MTS and MGTS.

Moscow GTS (MGTS)

MGTS, jointly owned by Sistema (56% of the voting stock) and Svyazinvest (23.3%), boasts a transparent ownership structure, strong financial discipline (with GAAP accounts verified by Deloitte & Touche) and is listed on the RTS. Up until June 2003, institutional investors had one seat on the board, but this has since been lost.

The corporate governance risk is relatively low but should not be ignored. In 1997, MGTS carried out a dilutive 50% share issue which put it into the corporate governance risk category. Prior to June 2001, it had a record of paying merely notional dividends and mainly on preferred shares alone. However, since then, the company has been consistent in distributing high dividends.

MGTS is currently working to merge its four main subsidiaries (MTU-Inform, Comstar, Golden Line and Telmos) into a major “alternative” operator and issue ADRs on its shares. These plans make a lot of sense economically, as it should eliminate unnecessary competition between the units and create additional synergies. It could well also make the company the major provider of high value-added services (digital fixed line, data and internet) in Moscow, with an estimated 50-60% market share and around \$170-200 mln in sales.



Source: Troika Dialog

Mobile Telesystems (MTS)

MTS, owned jointly by Sistema (50.4%) and DeTeMobil (25.5%) has a proven high degree of transparency, efficient investor relations and strong financial discipline. The management is accessible to investors and accountable to all shareholders. The board is comprised of three representatives of DeTeMobil and four of Sistema. MTS has had its financials converted to GAAP format for periods starting 1997, with Deloitte & Touche as auditor. The company publishes audited accounts on its website on a quarterly basis.

The company is subject to US SEC scrutiny. The New York listing ensures a high degree of transparency and stringent disclosure requirements. The FCSM does not monitor MTS. Furthermore, many standard provisions of the JSC Law, which govern companies with at least 1,000 owners, do not apply to MTS. This increases the importance of studying the statutory documents, when making an investment decision.

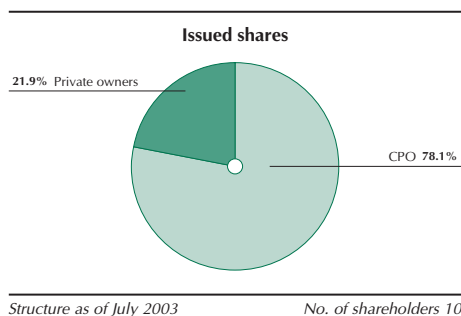
MTS went public in 2001, when it sold Level 3 ADRs against 15% of its locals. The offer was six times oversubscribed. It is the second Russian company after VimpelCom to raise new equity capital overseas. Inspired by its success, MGTS stated that it might sell new shares in ADR form in the near future and seek a listing in New York.



Source: Troika Dialog

Sistema JSFC

OWNERSHIP STRUCTURE AND TRANSPARENCY



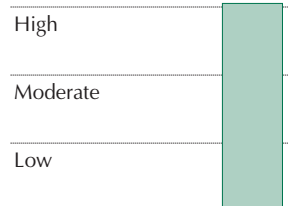
Owners and affiliates

CPO: Vladimir Evtushenkov, founder and board chairman
Other private owners: 9 individual shareholders, management and close associates of the chairman, who own between 0.5% and 5%

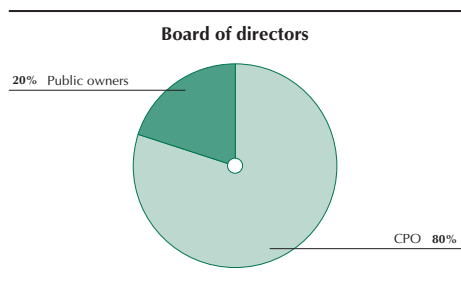
Owned by Sistema

MGTS	56%
MTS	50%
ROSNO Insurance	47%
MRD Bank	86%
Intourist	91%
Detsky Mir	74%
S-Hals holding	100%
S-Neft holding	100%
CSC holding	92%
MTU-Intel holding	100%

Degree of transparency



SUPERVISION AND CONTROL STRUCTURE: ACCOUNTABILITY TO SHAREHOLDERS



Effective as of June 18, 2003

	Executive/Outside	Nominated
Chairman: Vladimir Evtushenkov	NED	CPO
Evgeny Novitsky, president, Sistema	EXE	CPO
Dmitry Zubov, deputy chairman	NED	CPO
Arkady Volsky, president, RSPP	INE	CPO
Alexander Goncharuk, CEO, Sistema Telecom	EXE	CPO
Sergei Drozdov, CEO, Sistema	EXE	CPO
Vyacheslav Kopyov, CEO, Sistema	EXE	CPO
Evgeny Kurgin, CEO, Sistema; CEO, ROSNO	EXE	CPO
Vladimir Lagutin, CEO, MGTS	EXE	CPO
Mechislav Klimovich, private owner	NED	PvtOwn
Nikolai Mikhailov, private owner	NED	PvtOwn
Alexander Leiviman, private owner	NED	PvtOwn
Stanislav Emelianov, head of International Management Institute	INE	CPO

Degree of accountability



MANAGEMENT AND INVESTOR RELATIONS

CEO: Evgeny Novitsky (1957), in post since 1995
1991-1995: CEO, Zelenograd-based computer producer Kvant

Investors' contact

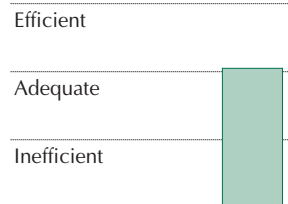
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Website information value: Moderate

Investor relations



Management structure and accountability

Management policy is determined by a small group of insiders. Over the past two years, it has made great strides in information disclosure and improved its financial discipline. In mid 2002, the company launched a pan-holding reorganization and made the unprecedented step of revealing the identity of its beneficiary owners. It intends to expand its presence on international capital markets and therefore has a strong incentive to build up good relations with the financial community.

CORPORATE CONDUCT

Governance track record	Not reviewed
Steel traps in charter	
Contingent risks	Not reviewed
Policy for corporate conduct	
BoD formal written mandate	None
General meeting protocol	None
Audit commission written charter	None
Incentives for good corporate governance	
Corporate governance charter	Pending
Pending ADR program	None

INFORMATION DISCLOSURE AND FINANCIAL DISCIPLINE

Accounting standards	GAAP (since 1997) RAS	Auditor: Deloitte & Touche Auditor: Audit-Garantiya-M
Independence of internal auditor	Not reviewed	
Disclosure record with FCSM	Not reviewed	
Level of ADR program	None	
Listing of ADR	None	
Listing of local stock	None	
Registrar	OAO Reestr, Moscow	
Registrar risk	Low	
Dividend history	Not reviewed	

Financial discipline

UNDER REVIEW

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Jacques Der Megreditchian

Chief Economist

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