

## **MEMORANDUM**

**Reorganization of OJSC of «Far East  
Telecommunications Company» in form of assets  
allocation  
(cellular business separation into a subsidiary)**

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## **1. Argumentation for reorganization: assets allocation goals, objectives and results**

The main goal of cellular business assets allocation of the OJSC «Far East Telecom» into a subsidiary is to increase net operating margin of cellular assets of the Company.

Main business characteristics of cellular connection of Magadan and Kamchatka branches, competitive situation, dynamics and prognosis of financial results of activity and trends for further growth are stated in the presentation.

## **2. Comparison and choice of optimum assets allocation variant**

The Company has studied the following alternative variants of own cellular assets allocation:

- 1) establishment of a subsidiary with assessment of cellular connection equipment, licenses and frequency authorization to its share capital.
- 2) reorganization of the OJSC «Far East Telecom» with cellular assets allocation into a subsidiary.

Consequently, it was decided to use the first variant for the following reasons.

Main and the most valuable asset of the OJSC «Far East Telecom» at the cellular market are frequency authorization and licenses for mobile radiotelephonic connection service in the relevant territories. The current legislation prohibits direct transfer of rights for activity under corresponding license from one person to another including via sale to the other person or payment of share capital by rights of the promoter on the basis of corresponding license.

The first variant (establishment (launching) by the OJSC «Far East Telecom» of a new company with payment of its share capital by corresponding property) will lead to the situation when this company will not have licenses for mobile radiotelephonic connection service as well as appropriate frequency authorization. In this regard obtaining of such authorization and licenses is almost impossible in the current situation on the market of mobile radiotelephonic connection service of the Far Eastern Federal district.

Meanwhile, the Federal Law «On communication» provides an opportunity of license re-issuance in the name of assignee of connection provider (article 31). The civil law understands assignation as transfer of all (part) civil rights and obligations from one person to another. In that respect as of the direct provision of the article 19 of the Federal Law «On Joint-Stock Companies» establishment of a joint-stock company with partial assignation of

establishing company rights and obligations without liquidation of the latter company is possible only via reorganization in form of assets allocation.

Thus, the cellular assets allocation of the OJSC «Far East Telecom» as an operating business is possible only via the OJSC «Far East Telecom» reorganization in form assets allocation into a new joint-stock company.

### **3. Terms of reorganization**

According to the decision of the Board of Directors of 03.04.2007 (protocol № 17) on approval of cellular business development, the Company has made preliminary procedures to concentrate the cellular business within its subsidiary that is launching via corresponding assets allocation of the «Far East Telecom».

As of «01» of July, 2008 the separation balance sheet has been drawn up according to which the subsidiary is transferred assets and liabilities concerned in Company's cellular connection service in the territory of Magadanskaya and Kamchatskaya regions including the rights to use licenses and frequencies. At the date of reorganization the detailed separation balance sheet will be presented that includes alterations in assets and liabilities made from 01.07.2008 prior to the reorganization date.

The Company will obtain the Federal Antitrust Service for reorganization in form of assets allocation.

Terms of separation and procedure of the OJSC «Far East Telecom» reorganization in form of assets allocation into a new Company:

1. The separated company is established as a closed joint-stock company.
2. Separated company's shares are to be placed via their purchase by the Company reorganized, thus, the OJSC «Far East Telecom» becomes the sole shareholder of the separated company holding 100% of its shares.
3. The supreme management body of the separated company is the General Meeting of Shareholders (the Sole Shareholder). According to the Articles of Association of the OJSC «Far East Telecom» decisions on issues relating to authority of the General Meeting of Shareholders of the Company 100% of votes belonging to the OJSC «Far East Telecom», shall be made by the Board of Directors of the OJSC «Far East Telecom».
4. Executive management bodies of the separated company shall be the Executive Committee and the CEO with authority defined by the Articles of Association of the separated company.

Terms of the OJSC «Far East Telecom» reorganization ensure rights of creditors as well as the shareholders who voted against the OJSC «Far East Telecom» reorganization or not taking part in the voting on the general meeting of shareholders agenda of the OJSC «Far East Telecom» reorganization in the form of assets allocation in compliance with the current legislation of the Russian Federation.

#### **Guarantee of creditor's rights**

Guarantee of the OJSC «Far East Telecom» creditors' rights observance with Company's reorganization is Company's obligation to notify the creditors about reorganization decision and right of the latter to claim termination or advance execution of liabilities.

This right of creditors and the procedure for its exercise is set forth by the Civil Code of the Russian Federation and the Federal Law «On Joint-Stock Companies», as follows:

- the separation balance sheet includes provisions on assignment of all OJSC «Far East Telecom» liabilities concerning all its creditors and debtors including disputable liabilities and procedure for assignment definition in relation to alterations of type, content, price of the reorganized company property as well as in relation to appearance, alteration or termination of rights and liabilities of the company reorganized that can take place after the date of assignment deed, separation balance sheet.

- at the date when reorganization is decided the Company makes the list of creditors that includes all Company's creditors.

- not later than in 30 days from the moment when the reorganization is decided the Company shall make an announcement of the decision taken in printed matter "Vestnik gosudarstvennoi registratsii" (Bulletin of State Registration) as well as send written notice about it to its creditors via registered mail of appropriate content. Company's creditors shall be entitled to claim advance termination or execution of corresponding liabilities of the Company and recovery of their losses not later than in 30 days from the date of notification.

#### **Guarantee of shareholders' rights**

The Shareholders who voted against reorganization or did not take part in the voting may claim the Company to buy back their shares. This right of shareholders and the procedure for its exercise is set forth by the Civil Code of the Russian Federation and the Federal Law «On Joint-Stock Companies».

Purchase price for ordinary and preferred shares is to be defined by the Board of Directors of the OJSC «Far East Telecom» with the help of independent evaluator. Purchase price will be stated in the data sent to Company's shareholders before the General Meeting of Shareholders convocation where Company's reorganization matter is going to be considered.

OJSC «Far East Telecom» ordinary and preferred shares purchased from the shareholders shall be sold within a year at the stock exchange of Moscow Interbank Currency Exchange (or with public subscription). Income obtained from the shares sale shall be used in Company's net income report at the end of fiscal year with allocation of certain part for dividend payment.

## **4. Analysis of financial and tax risks and their evaluation**

### **Financial risks**

1. At the present moment in the aggregate of telecommunication services the OJSC «Far East Telecom» (fixed-line telephony, inter-zone connection, traffic connection and passage) has achieved significant penetration. Average annual growth is expected to not to exceed 5-7% a year. There is only significant increase in services of broadband Internet access (about 50% year by year).

As a result, deep penetration of services leads to profit reduction of each. In relation to this telecommunication providers strategy is oriented to development and introduction of package offers including all types of services (cellular connection, fixed-line telephony, broadband access and different content services). Taking into account the trend of market development, efficiency growth of cellular connection services is ultimate for the OJSC «Far East Telecom».

2. Delay in cellular assets allocation of the OJSC «Far East Telecom» creates a risk of these assets depreciation since profit, amount of subscribers, market share and business profitability are decreasing.

3. Advance payment of Company's credit indebtedness (cl.6. art. 13. of the Federal Law «On Joint-Stock Companies»). Considering interest rate increase at the world financial markets and Russian capital market advance payment of credit indebtedness is highly expectable to be claimed. Amount of credit indebtedness claimed can be equal to the whole amount of credit indebtedness (including loans and advances) stated in the balance sheet. In that respect the Company will have to use borrowed funds for credit payments and incur additional interest costs. Consequently, Company's expenses with advance redemption may make a difference between interest rates of Company's current credit portfolio and existing at the market at the reorganization date. Considering financial market situation as well as the current antitrust legislation it is hard to make fast re-financing of this indebtedness volume.

4. Buy-back of equity from shareholders who voted against reorganization or not taking part in the voting (art. 75 of the Federal Law «On Joint-Stock Companies»). Maximum percentage of claims for shares buy-back may be about 10% of Company's net assets (about 728 million rubles). Correspondingly, Company's expenses can make a difference between purchase price and shares selling price at the secondary market as well interest for usage of monetary funds for

sharesbuy-back. Considering market situation probability of claim for purchase at maximum rate is almost equal to 100%.

5. Alteration of debt load (ratio debt-assets) of the OJSC «Far East Telecom». According to the separation balance sheet a new company will be transferred a part of the OJSC «Far East Telecom» assets, meanwhile the OJSC «Far East Telecom» indebtedness will be transferred to a new company in less amount than total assets. Correspondingly the OJSC «Far East Telecom» debt load will increase in some part.

### **Tax risks**

#### 1. Value-Added Tax

Considering that according to the subclause 2 clause 3 article 39 of the Tax Code of the Russian Federation Company's fixed assets, intangible assets and (or) other property assignment to its assignee in case of this company reorganization, is not considered to be a purchase and the Company shall bear no liabilities of calculation and payment of VAT. In this respect a newly established legal entity shall also have no reasons for withdrawing VAT value considering property assigned.

#### 2. Income Tax

Reorganization in form of assets allocation for taxation reasons shall not imply additional economic operations affecting tax base of a tax payer.

According to the norms set forth by articles 251 and 270 of the Tax Code of the Russian Federation the Company shall have no income and expenditure that form tax base on income tax.

In this respect according cl. 2.1, art. 252 of the Tax Code of the Russian Federation expenditure of newly established and reorganized organizations is regarded to be in particular cost (depreciated cost) of the property assigned in legal entities reorganization and that have been purchased (established) by reorganized organizations before reorganization is completed. Property cost shall be evaluated by data and documents of tax accounting of assignor at the date of title assignment for the said property.

#### 3. Property tax

On the basis of separation balance sheet assigned property is regarded to be discharged from Company's books at the date of separated companies' registration, shall be recognized in their documents and is liable to property tax in established organizations.

## **5. Reorganization impact on capitalization and financial results of the Company**

### **Impact on capitalization**

Impact of reorganization process of cellular assets allocation on Company's capitalization will have strong effect concerning the following reasons:

1. After reorganization via cellular assets allocation into a subsidiary the consolidated indexes of Company's performance will not show significant changes – subsidiary's performance results will be accounted according to the International Accounting Standards.
2. Information about cellular assets allocation from the OJSC «Far East Telecom» balance is currently expected on the market (by investors and analytics) and is implanted into Company's shares price. Previously the information of «Far East Telecom» plans to reorganize its cellular business was taken positively by the investment community.
3. News about performed cellular assets allocation will be verification of Company's selected strategy for cellular assets efficiency increase that can slightly promote stock quotation growth.

### **Impact on financial results**

Cellular business assets allocation into a subsidiary will not affect consolidated income of the OJSC «Far East Telecom», but will lead to costs reduction because of lower labour costs, other expenses, providers' cost and some other costs of Company's subsidiary. For detailed information on operating expenses movements and reasons for their reduction refer to the presentation attached.

## **6. Financial costs of reorganization**

Expected financial cost are reflected in the table:

<b>№.№</b>	<b>Name of cost item</b>	<b>Costs estimation</b>
1.	Evaluation of property transferred to the Share capital performed by an independent evaluator	300 thousand rubles
2.	Evaluation of the OJSC «Far East Telecom» in order to define the price for share buy-back from shareholders	500 thousand rubles
3.	Submission of application and obtaining the Federal Antitrust Service for a new company establishment via the OJSC «Far East Telecom» reorganization	10 thousand rubles
4.	Preparation for and convocation of the General Meeting of Shareholders on the matter of Company's reorganization via assets allocation of a subsidiary	About 3000 thousand rubles
5.	Making a list of creditors and their notification about the OJSC «Far East Telecom» reorganization. Company's reorganization announcement via mass media	About 5000 thousand rubles
6.	Advance redemption of credit indebtedness	Not a cost, it is just an earlier cash outflow. The Company predicts credit

		indebtedness claims of advance payment amounting at about 2450 million rubles.
7.	Shares buy-back from the shareholders claiming the redemption	Not a cost. Cash outflow – maximum rate up to 10% of net assets – is 728 million rubles. In future shares obtained will be sold on the public market at the market price to compensate for cash outflow and (with favourable run of the market) lead to additional income. With unfavourable run of the market there can be expenditure amounting at the difference between the purchase price and share sale.
8.	State registration of Company's subsidiary	2 thousand rubles
9.	Applying to the Multiregional Inspection of the Federal Taxation Service on the OJSC «Far East Telecom» reorganization in form of assets allocation Registration of alterations in constituent document of the OJSC «Far East Telecom»	0,4 thousand rubles
10.	Registration of created subsidiary shares issue in the Federal Service for Financial Markets	100 thousand rubles
11.	Re-issuance of licenses and frequency authorization of the OJSC «Far East Telecom» for a new company	360 thousand rubles
	<b>Total</b>	<b>About 9,3 million rubles *</b>

\*- without procedures of mandatory share buy-back and their subsequent sale on the market and credit indebtedness payment

## 7. Schedule of reorganization

Stages of reorganization including procedures for subsidiary's commercial activity preparation are stated in the table:

№	Name of objective	Commencement date	Termination date
1.	preparation for the General Meeting of Shareholders on the assets allocation matter	05.09.2008	30.10.2008
2.	Convocation of the General Meeting of Shareholders on the assets allocation matter	30.10.2008	30.10.2008
3.	the General Meeting of Shareholders minutes keeping	31.10.2008	06.11.2008
4.	submission of notice about decided assets allocation to the tax body	07.11.2008	11.11.2008
5.	making a list of and written notification of creditors (30 calendar days)	07.11.2008	08.12.2008
6.	Reorganization announcement via mass media	07.11.2008	08.12.2008
7.	collection of credit indebtedness claims (30 calendar days)	09.12.2008	08.01.2009
8.	credit indebtedness redemption (60 calendar days)	09.01.2009	11.03.2009
9.	collection of shareholders' claims for shares buy-back (45 calendar days from the date of the General	31.10.2008	16.12.2008

	Meeting of Shareholders convocation)		
10.	share buy-back from the shareholders claiming it (30 days from the deadline of claims collection)	17.12.2008	15.01.2009
11.	state registration of the subsidiary	25.12.2008	01.01.2009
12.	separation balance sheet update as of January 1, 2009	02.01.2009	27.02.2009
13.	registration of stock issue and its results report concerning shares of the established company in the Federal Service for Financial Markets	02.03.2009	31.03.2009
14.	actual transfer of assets and liabilities	16.02.2009	27.02.2009
15.	re-issuance of licenses and frequencies authorization for the subsidiary	02.01.2009	30.09.2009
16.	transition of subscribers to the subsidiary	01.10.2009	30.10.2009
17.	transition of employees to the subsidiary	01.10.2009	02.10.2009
18.	commencement of subsidiary's commercial activity	02.11.2009	02.11.2009