

JSC SITRONICS AND SUBSIDIARIES

**Consolidated Financial Statements
Years Ended December 31, 2010 and 2009**

JSC SITRONICS AND SUBSIDIARIES

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INDEPENDENT AUDITORS' REPORT

To the Shareholders of JSC SITRONICS:

We have audited the accompanying consolidated balance sheets of JSC SITRONICS and its subsidiaries (the "Group") as of December 31, 2010 and 2009 and the related consolidated statements of operations, comprehensive loss, changes in equity, and cash flows for the years then ended. These consolidated financial statements are the responsibility of the Group's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Group's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such consolidated financial statements present fairly, in all material respects, the financial position of the Group as of December 31, 2010 and 2009, and the results of its operations and its cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

Deloitte & Touche

April 12, 2011

JSC SITRONICS AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS AS OF DECEMBER 31, 2010 AND 2009 (Amounts in thousands of U.S. dollars)

	Notes	<u>2010</u>	<u>2009</u>
ASSETS			
CURRENT ASSETS:			
Cash and cash equivalents	4	\$ 261,688	\$ 161,864
Short-term deposits and loans	5	1,229	2,315
Trade receivables, net	6	422,011	406,388
Other receivables and prepaid expenses, net	7	128,231	100,269
Inventories, net	8	152,418	154,790
Restricted cash	13	34	1,116
Deferred tax assets, current portion	20	28,020	30,868
		<u>993,631</u>	<u>857,610</u>
NON-CURRENT ASSETS:			
Property, plant and equipment, net	9	439,076	456,971
Intangible assets, net	10	175,698	197,319
Goodwill	10	86,858	86,858
Inventories, net	8	13,716	17,792
Long-term investments	11	230,716	222,384
Long-term trade receivables	12	38,725	58,154
Deferred tax assets, non-current portion	20	28,149	23,855
Other long-term assets		3,500	5,884
		<u>1,016,438</u>	<u>1,069,217</u>
TOTAL ASSETS		<u>\$ 2,010,069</u>	<u>\$ 1,926,827</u>

See notes to consolidated financial statements.

JSC SITRONICS AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS AS OF DECEMBER 31, 2010 AND 2009 (CONTINUED)

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

	Notes	<u>2010</u>	<u>2009</u>
LIABILITIES AND SHAREHOLDERS' EQUITY			
CURRENT LIABILITIES:			
Trade accounts payable		\$ 306,413	\$ 269,504
Taxes payable		58,507	34,466
Accrued expenses and other current liabilities	14	245,703	136,479
Short-term loans and notes payable	15	131,779	193,959
Current portion of long-term debt	16	397,552	135,596
Deferred tax liabilities, current portion	20	16,388	16,041
Total current liabilities		<u>1,156,342</u>	<u>786,045</u>
LONG-TERM LIABILITIES:			
Capital lease obligations	17	168,307	167,558
Long-term debt	16	215,324	416,299
Other long-term liabilities	19	8,693	9,937
Deferred tax liabilities, non-current portion	20	19,212	20,385
Total long-term liabilities		<u>411,536</u>	<u>614,179</u>
TOTAL LIABILITIES		<u>1,567,878</u>	<u>1,400,224</u>
EQUITY:			
SHAREHOLDERS' EQUITY:			
Share capital (9,547,087,190 and 9,547,087,190 shares authorized and issued as of December 31, 2010 and 2009, respectively, with par value of 1 Russian Ruble)		335,764	335,764
Treasury stock (1,000,089,605 and 688,052,044 shares as of December 31, 2010 and 2009, respectively, with par value of 1 Russian Ruble)	21	(56,817)	(46,158)
Shareholder's receivable	21	-	(10,215)
Additional paid-in capital		431,507	429,774
Accumulated deficit		(387,961)	(342,342)
Accumulated other comprehensive (loss)/income	21	(4,381)	7,543
Foreign currency translation		(4,341)	7,211
Defined benefit postretirement plan		(40)	332
TOTAL EQUITY ATTRIBUTABLE TO SITRONICS		<u>318,112</u>	<u>374,366</u>
Equity attributable to non-controlling interest		124,079	152,237
TOTAL EQUITY		<u>442,191</u>	<u>526,603</u>
TOTAL LIABILITIES AND EQUITY		<u>\$ 2,010,069</u>	<u>\$ 1,926,827</u>

See notes to consolidated financial statements.

JSC SITRONICS AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS (INCLUDING EARNINGS PER SHARE) FOR THE YEARS ENDED DECEMBER 31, 2010 AND 2009 (Amounts in thousands of U.S. dollars unless otherwise stated)

	Notes	2010	2009
Revenues		\$ 1,166,928	\$ 1,024,219
Cost of sales, exclusive of depreciation and amortization shown separately below		(884,253)	(746,501)
Research and development expenses		(18,686)	(21,162)
Selling, general and administrative expenses		(151,867)	(159,706)
Depreciation and amortization		(90,845)	(58,012)
Impairment losses and reserves	26	(16,475)	(94,387)
Other operating income, net		9,974	4,240
OPERATING INCOME/(LOSS)		14,776	(51,309)
Interest income		7,102	11,069
Interest expense		(78,544)	(62,942)
Foreign currency transactions losses		(890)	(3,167)
Gain on sale of associates		7,885	-
Equity in net income of investees		1,389	536
Other non-operating gains/(losses)		18	(9,282)
Loss from continuing operations before income tax		(48,264)	(115,095)
Income tax (expense)/benefit	20	(11,406)	14,288
LOSS FROM CONTINUING OPERATIONS		(59,670)	(100,807)
Loss from discontinued operations, net of income tax expense of \$nil and \$317, respectively		-	(404)
Loss from disposal of discontinued operations, net of income tax expense of \$nil and \$nil, respectively		-	(25,750)
Loss on discontinued operations	3	-	(26,154)
NET LOSS		\$ (59,670)	\$ (126,961)
Less: net loss attributable to non-controlling interest		14,051	7,886
NET LOSS ATTRIBUTABLE TO SITRONICS		\$ (45,619)	\$ (119,075)
EARNINGS PER SHARE – BASIC AND DILUTED, US cents:			
Loss from continuing operations:		(0.53)	(1.05)
Loss from discontinued operations:		-	(0.30)
Net loss		(0.53)	(1.35)
Weighted average number of common shares outstanding, basic and diluted:		8,615,020,320	8,828,989,131
AMOUNTS ATTRIBUTABLE TO SITRONICS:			
Loss from continuing operations, net of tax		(45,619)	(92,921)
Loss from discontinued operations, net of tax		-	(26,154)
NET LOSS		\$ (45,619)	\$ (119,075)

See notes to consolidated financial statements.

JSC SITRONICS AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF COMPREHENSIVE LOSS FOR THE YEARS ENDED DECEMBER 31, 2010 AND 2009

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

	Notes	<u>2010</u>	<u>2009</u>
NET LOSS		\$ (59,670)	\$ (126,961)
Other comprehensive loss, net of tax:			
Translation adjustment, net of tax		(21,792)	(8,548)
Unrecognized actuarial (loss)/gains, net of tax		(729)	306
Total other comprehensive loss, net of tax		<u>(22,521)</u>	<u>(8,242)</u>
COMPREHENSIVE LOSS		(82,191)	(135,203)
Comprehensive loss attributable to non-controlling interest		24,648	7,439
COMPREHENSIVE LOSS ATTRIBUTABLE TO SITRONICS		<u><u>\$ (57,543)</u></u>	<u><u>\$ (127,764)</u></u>

See notes to consolidated financial statements.

JSC SITRONICS AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS FOR THE YEARS ENDED DECEMBER 31, 2010 AND 2009 (Amounts in thousands of U.S. dollars)

	<u>2010</u>	<u>2009</u>
OPERATING ACTIVITIES:		
Net loss	\$ (59,670)	\$ (126,961)
Adjustments to reconcile net loss to net cash provided by/ (used in) operations:		
Depreciation and amortization	90,845	58,012
Gain from disposal of property, plant and equipment	(1,560)	(857)
(Gain)/ loss on disposal of subsidiaries and associates	(7,885)	26,154
Equity in net income of investees	(1,389)	(536)
Deferred income tax	(4,196)	(21,855)
Bad debt expense	9,447	54,627
Inventory obsolescence provision	5,956	18,882
Stock based compensation	2,596	5,248
Change in liability for uncertain tax positions	(1,300)	9,296
Impairment losses and reserves	1,072	28,666
Unrealized foreign currency transactions	76	14,393
Changes in operating assets and liabilities:		
Trade receivables	(24,596)	126,616
Other receivables and prepaid expenses	(33,180)	3,347
Inventories	(1,881)	17,401
Trade accounts payable	64,127	(15,687)
Taxes payable	26,324	7,268
Accrued expenses and other current liabilities	<u>112,715</u>	<u>(56,855)</u>
Net cash provided by operating activities	<u>\$ 177,501</u>	<u>\$ 147,159</u>
INVESTING ACTIVITIES:		
Purchases of property, plant and equipment	(42,331)	(29,569)
Proceeds from disposals of property, plant and equipment	1,938	1,050
Purchases of intangible assets	(40,036)	(62,113)
Purchases of businesses, net of cash acquired	-	(4,435)
Proceeds from sale of businesses	-	1,458
Cash disposed on the sale of businesses	-	(10,455)
Change in restricted cash	1,011	6,032
Purchases of short-term deposits and loans	(693)	(14,381)
Proceeds from short-term deposits and loans	441	3,924
Purchases of long-term investments	(7,969)	(554)
Proceeds from sale of long-term investments	<u>8,002</u>	<u>1,130</u>
Net cash used in investing activities	<u>\$ (79,637)</u>	<u>\$ (107,913)</u>

See notes to consolidated financial statements.

JSC SITRONICS AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS (CONTINUED) FOR THE YEARS ENDED DECEMBER 31, 2010 AND 2009 (Amounts in thousands of U.S. dollars)

	<u>2010</u>	<u>2009</u>
FINANCING ACTIVITIES:		
Proceeds from short-term borrowings	\$ 221,574	\$ 454,743
Principal payments on short-term borrowings and current portion of long-term borrowings	(405,543)	(771,454)
Proceeds from long-term borrowings	210,844	331,754
Principal payments on long-term borrowings	(7,216)	(8,227)
Principal payments on capital lease obligations	(3,882)	(7,555)
Debt issuance costs	(1,067)	(3,883)
Proceeds from stock options exercised	-	2,800
Acquisition of non-controlling interest in existing subsidiary	(3,510)	-
Repurchase of common stock	(307)	(1,119)
Net cash provided by/(used in) financing activities	\$ 10,893	\$ (2,941)
Effects of exchange rate changes on cash and cash equivalents	(8,933)	(136)
INCREASE IN CASH AND CASH EQUIVALENTS	\$ 99,824	\$ 36,169
CASH AND CASH EQUIVALENTS from continued operations, beginning of the year	161,864	116,720
CASH AND CASH EQUIVALENTS from discontinued operations, beginning of the year	-	8,975
TOTAL CASH AND CASH EQUIVALENTS, beginning of the year	\$ 161,864	\$ 125,695
CASH AND CASH EQUIVALENTS from continued operations, end of the year	261,688	161,864
CASH AND CASH EQUIVALENTS from discontinued operations, end of the year	-	-
TOTAL CASH AND CASH EQUIVALENTS, end of the year	\$ 261,688	\$ 161,864
CASH PAID DURING THE YEAR FOR:		
Interest, net of amounts capitalized	\$ (61,731)	\$ (42,991)
Income taxes	(6,866)	(5,457)
NON-CASH ITEMS:		
Equipment acquired under capital lease	\$ 2,567	\$ 173,413
Amounts due for purchase of long-lived assets	10,869	49,611

Non-cash investing and financing activities for the years ended December 31, 2010 and 2009 included acquisitions and disposals of subsidiaries and stock-based compensation, as described in Notes 3 and 22.

See notes to consolidated financial statements.

JSC SITRONICS AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY FOR THE YEARS ENDED DECEMBER 31, 2010 AND 2009 (Amounts in thousands of U.S. dollars)

	SITRONICS shareholders						Total SITRONICS equity	Non-controlling interest	Total equity
	Share capital	Treasury stock	Shareholder's receivable	Additional paid-in capital	Accumulated deficit	Accumulated other compre- hensive income/ (loss)			
Balances at January 1, 2009	\$ 335,764	(50,940)	(9,552)	423,999	(220,166)	16,096	495,201	159,676	654,877
Repurchase of common stock	-	(1,119)	-	-	-	-	(1,119)	-	(1,119)
Stock-based compensation	-	-	-	5,248	-	-	5,248	-	5,248
Stock options exercised	-	5,901	-	-	(3,101)	-	2,800	-	2,800
Change in shareholders' receivables	-	-	(527)	527	-	-	-	-	-
Comprehensive loss:									
Net loss	-	-	-	-	(119,075)	-	(119,075)	(7,886)	(126,961)
Other comprehensive loss:									
Unrecognized actuarial gains, net of tax	-	-	-	-	-	156	156	150	306
Translation adjustment, net of tax	-	-	(136)	-	-	(8,709)	(8,845)	297	(8,548)
Comprehensive loss	-	-	(136)	-	(119,075)	(8,553)	(127,764)	(7,439)	(135,203)
Balances at December 31, 2009	\$ 335,764	(46,158)	(10,215)	429,774	(342,342)	7,543	374,366	152,237	526,603
Repurchase of common stock (Note 21)	-	(10,659)	10,352	-	-	-	(307)	-	(307)
Stock-based compensation	-	-	-	1,596	-	-	1,596	-	1,596
Acquisition of non-controlling interest	-	-	-	-	-	-	-	(3,510)	(3,510)
Change in shareholders' receivables	-	-	(137)	137	-	-	-	-	-
Comprehensive loss:									
Net loss	-	-	-	-	(45,619)	-	(45,619)	(14,051)	(59,670)
Other comprehensive loss:									
Unrecognized actuarial losses, net of tax	-	-	-	-	-	(372)	(372)	(357)	(729)
Translation adjustment, net of tax	-	-	-	-	-	(11,552)	(11,552)	(10,240)	(21,792)
Comprehensive loss	-	-	-	-	(45,619)	(11,924)	(57,543)	(24,648)	(82,191)
Balances at December 31, 2010	\$ 335,764	(56,817)	-	431,507	(387,961)	(4,381)	318,112	124,079	442,191

See notes to consolidated financial statements.

JSC SITRONICS AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEARS ENDED DECEMBER 31, 2010 AND 2009

(Amounts in thousands of U.S. dollars, except share amounts or if otherwise stated)

1. BACKGROUND AND DESCRIPTION OF THE BUSINESS AND OPERATING ENVIRONMENT

Joint Stock Company SITRONICS (“SITRONICS”) and its subsidiaries (together, the “Group”) is a technology solution business with operations primarily conducted in the Russian Federation (“RF”), Ukraine, Czech Republic, Greece and Romania. The Group’s controlling shareholder is JSFC Sistema (“Sistema”).

The Group structure has evolved over the past years as a result of various acquisitions, disposals, and operating agreements including an investment agreement signed in October 2009 between the Group, Sistema and the Russian Corporation of Nanotechnologies (“RUSNANO”) to launch a full-scale 90 nanometer microchip production.

The Group currently has three operating segments:

Telecommunication Solutions segment is engaged in the design, manufacture and distribution of hardware and software products including convergence solutions. It also offers system integration and customization services for fixed line, mobile telecommunication and other operators.

Information Technologies Solutions segment is engaged in computer systems integration, IT consulting and software development services for telecommunication operators, banking and financial institutions and the public sector.

Microelectronic Solutions segment is engaged in the design, manufacture, testing and distribution of semiconductor products and components; distribution and production of chip cards, microchip packaging and related solutions.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation of Financial Statements – The accompanying financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America (“U.S. GAAP”). The Group’s entities maintain accounting records in local currencies in accordance with the requirements of accounting and tax legislation in the countries of their incorporation. The accompanying consolidated financial statements differ from the financial statements prepared for statutory purposes. The consolidated statements are expressed in terms of US dollars (see “Foreign Currency” below) and reflect certain adjustments, appropriate to present the financial position, results of operations and cash flows in accordance with U.S. GAAP, which are not recorded in the accounting books of the Group’s entities.

Significant subsidiaries and joint ventures – the effective ownership interest and proportion of voting power of SITRONICS in its significant subsidiaries and joint ventures, as well as the locations of their principal business operations as of December 31, 2010 and 2009 were as follows:

Operating entities	Locations of principal business operations	Effective ownership interest as of December 31,		Voting interest as of December 31,	
		2010	2009	2010	2009
Telecommunication Solutions segment:					
Intracom S.A. Telecom Solutions	Greece	51%	51%	51%	51%
Intrarom S.A.	Romania	34% ⁽¹⁾	34% ⁽¹⁾	67%	67%
JSC “SITRONICS Telecom Solutions, Czech Republic a.s.” (“SITRONICS TS CR”)	Czech Republic	100%	100%	100%	100%
JSC “SITRONICS Telecom Solutions” (“SITRONICS TS”)	Russia	100%	100%	100%	100%
Information Technologies Solutions segment:					
SITRONICS IT B.V.	Netherlands	100%	100%	100%	100%
JSC “SITRONICS Information Technologies Ukraine”	Ukraine	100%	100%	100%	100%
LLC “SITRONICS Information Technologies”	Russia	100%	100%	100%	100%

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEARS ENDED DECEMBER 31, 2010 AND 2009

(Amounts in thousands of U.S. dollars, except share amounts or if otherwise stated)

Operating entities	Locations of principal business operations	Effective ownership interest as of December 31,		Voting interest as of December 31,	
		2010	2009	2010	2009
Microelectronic Solutions segment:					
JSC "NII of molecular electronics and Micron manufacturing plant" ("Mikron")	Russia	77%	77%	77%	77%
JSC "VZPP Mikron"	Russia	100%	100%	100%	100%
LLC "SITRONICS Smart Technologies"	Russia	100%	65%	100%	65%
LLC "SITRONICS-Nano"	Russia	50% ⁽²⁾	50% ⁽²⁾	50% ⁽²⁾	50% ⁽²⁾
All Other segments:					
LLC "Network Systems"	Russia	51%	51%	51%	51%
LLC "SITRONICS Bashkortostan"	Russia	100%	100%	100%	100%
JSC "Kvant"	Russia	78%	78%	88%	88%
JSC "Elaks"	Russia	84%	84%	84%	84%
JSC "Elion"	Russia	75%	75%	90%	90%
JSC "Koncel"	Russia	100%	100%	100%	100%

⁽¹⁾ Including indirect ownership.

⁽²⁾ Variable interest entity where SITRONICS is not the primary beneficiary and, accordingly, it is accounted for as an equity method investment (Note 11).

Principles of Consolidation – The consolidated financial statements include the accounts of SITRONICS, and its majority-owned subsidiaries. The consolidated financial statements also include accounts of variable interest entities, where the Group is the primary beneficiary. All intercompany transactions, balances and unrealized gains/(losses) on transactions are eliminated on consolidation.

Business Combinations – Acquisitions of businesses from third parties are accounted for using the purchase method. On the acquisition date, the assets acquired, liabilities assumed and any non-controlling interest in the acquiree are measured and recognized at their fair values as at that date. Goodwill arising on acquisition is recognized as an asset and initially measured as the excess of the consideration transferred plus the fair value of any non-controlling interest in the acquiree at the acquisition date over the fair values of the identifiable net assets acquired. Any excess of the Group's interest in the total acquisition date fair value of the identifiable net assets over the fair value of consideration transferred plus any non-controlling interest in the acquiree is recognized in earnings as a gain attributable to the acquirer.

Changes in the Group's ownership interest while the Group retains its controlling financial interest in its subsidiary are accounted for as equity transactions. No gain or loss is recognized in consolidated net income or comprehensive income. The carrying amount of the non-controlling interest is adjusted to reflect the change in its ownership interest in the subsidiary. Any difference between the fair value of the consideration received or paid and the amount by which the non-controlling interest is adjusted is recognized in equity attributable to the parent.

The results of acquired entities are included in the Group's financial statements from the date control was acquired.

Disposed entities are excluded from the Group's financial statements from the date when control does not rest with the Group.

Variable Interest Entities – The Group evaluates its equity investments for consolidation in accordance with a standard issued by the FASB that provides guidance on entities subject to consolidation as well as how to consolidate. The standard focuses on controlling financial interests that may be achieved through arrangements that do not involve voting interests. A variable interest entity ("VIE") is a legal structure that does not have equity investors with voting rights or has equity investors that do not provide sufficient financial resources for the entity to support its activities. The standard requires that a VIE be consolidated by a company if that company is the primary beneficiary of the VIE. The primary beneficiary of a VIE is an entity that is subject to a majority of the risk of loss from the VIE's activities or entitled to receive a majority of the VIE's residual returns or both. The standard requires continuous reassessment of VIE and primary beneficiary status.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEARS ENDED DECEMBER 31, 2010 AND 2009

(Amounts in thousands of U.S. dollars, except share amounts or if otherwise stated)

As of December 31, 2010, The Group had no investments in affiliates that have not been consolidated that would be considered VIEs where the Group is determined to be the primary beneficiary. The Group applies the equity method of accounting for the financial results of SITRONICS-Nano, a variable interest entity of which the Group is not the primary beneficiary.

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

Significant estimates include revenue recognition, costs to complete projects, allowance for doubtful accounts, carrying value of long-lived assets and inventories, useful lives and recoverability of long-lived tangible and intangible assets, fair value of financial instruments, valuation allowance on deferred tax assets, warranty liabilities, obligations related to employee benefits, and contingencies.

Foreign Currency – The primary financial statements of the entities of the Group are prepared and presented in the currency of the primary economic environment, in which each entity operates, i.e. its functional currency. Management has determined that the functional currency of SITRONICS and its significant subsidiaries for the year ended December 31, 2010 are the currencies of the countries of their domicile.

Monetary assets and liabilities in foreign currencies are translated into the functional currency of the relevant subsidiaries at the rate of exchange ruling at the balance sheet date. Transactions in foreign currencies are translated into the relevant functional currency at the rate of exchange ruling at the date of the transaction. Transaction gains and losses, other than those related to current and deferred tax assets and liabilities, are recognized as foreign currency transactions gains and losses in the consolidated statements of operations. Transaction gains and losses arising on foreign currency denominated current and deferred tax assets and liabilities are included within income taxes in the consolidated statements of operations.

The Group has selected the United States Dollar (“USD”) as its reporting currency and has translated the financial statements of the Group into the USD. Assets and liabilities are translated at the exchange rates current at the balance sheet date. Equity is translated at the applicable historical rates, income and expense items are translated at weighted-average rates of exchange prevailing during the period. The resulting translation gains and losses are recorded as a separate component of other comprehensive loss.

Cash and Cash Equivalents – Cash and cash equivalents include cash on hand, amounts on deposit in banks and cash invested temporarily in various instruments having original maturities of less than three months. Any cash over which there is restriction as to its use is excluded from cash and cash equivalents and is reflected as restricted cash on the consolidated balance sheet. Deposits and loans with original maturity of greater than three months are included in short-term deposits and loans in the consolidated balance sheets.

Derivative Financial Instruments and Hedging Activities – All derivatives are measured at fair value and recognized as either assets or liabilities on the balance sheet. The Group’s derivatives have not been designated as hedges for accounting purposes. Accordingly, gains and losses from changes in the fair value are included in the consolidated statements of operations. At December 31, 2010 and 2009 the Group had no derivatives.

Fair Value Measurements – Fair value is determined based on the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants.

The valuation techniques are based on observable and unobservable inputs. Observable inputs reflect market data obtained from independent sources, whilst unobservable inputs reflect our market assumptions. Observable inputs are used as the preferred source of inputs. Unobservable inputs are only used in the absence of market inputs.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEARS ENDED DECEMBER 31, 2010 AND 2009

(Amounts in thousands of U.S. dollars, except share amounts or if otherwise stated)

The inputs are categorized into the following fair value hierarchy:

Level 1	Quoted prices for identical instruments in active markets.
Level 2	Quoted prices for similar instruments in active markets; quoted prices for identical or similar instruments in markets that are not active; and model-derived valuations whose inputs are observable or whose significant value drivers are observable.
Level 3	Significant inputs to the valuation model are unobservable.

As of December 31, 2010 the Group had no financial instruments treated using Level 1 or Level 2 of the hierarchy.

Financial instruments carried on the balance sheet include cash and cash equivalents, accounts receivable, investments, accounts payable and fixed and variable rate debt. The particular recognition methods adopted are disclosed in the individual policy statements associated with each item.

The Group has estimated the fair value of its financial instruments as follows:

- The fair value of short-term financial instruments approximates the carrying value due to the short term nature of the instruments;
- The carrying value is equivalent to fair value for long-term variable rate financial instruments as management believes these are consistent with the terms upon which it could enter into similar agreements at December 31, 2010;
- The fair value of the RUB – denominated bonds (Note 16) approximates their carrying value as the coupon rate is revised semi-annually to respond to the market environment;
- The fair value of other long-term loans approximates their carrying values;
- According to the requirements of ASC 820 “Fair Value measurements and Disclosures” the Group does not apply fair value measurement techniques to financial instruments with related parties. Therefore, fair value of such financial instruments may be different from their carrying value.

Accounts Receivable – Accounts receivable are stated net of allowance for doubtful accounts. Such allowance reflects either specific cases of delinquencies or defaults or estimates based on evidence of collectability.

The Telecommunication Solutions segment of the Group enters into sale agreements with certain of its clients, including, but not limited to, Sistema subsidiaries and affiliates, where the final payment is not due until more than 12 months from the delivery date. Long-term trade receivables are measured at amortized cost using the effective interest method less any allowance.

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

The Information Technologies Solutions segment accounts for its inventories using the first-in, first-out (“FIFO”) cost method. The cost of inventories of the Group’s other segments is computed on an average cost basis.

The cost of raw materials includes the cost of purchase, customs duties, transportation and handling costs. Work-in-progress and finished goods are stated at production cost, which includes manufacturing overheads.

The Group periodically assesses its inventories and spare parts for obsolete and slow-moving stock.

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Property, Plant and Equipment – Property, plant and equipment (“PP&E”) is stated at cost, less accumulated depreciation. The cost of PP&E includes major expenditures for improvements and replacements which extend the useful lives of the assets or increase their revenue generating capacity. Repairs and maintenance are charged to the consolidated statements of operations as incurred.

Items of PP&E that are retired or otherwise disposed of are eliminated from the consolidated balance sheets along with the corresponding accumulated depreciation. Any gain or loss resulting from such retirement or disposal is included in the consolidated statements of operations.

PP&E, excluding land which is not depreciated, is depreciated on a straight-line method utilizing estimated useful lives of the assets as follows:

Buildings	40-50 years
Leasehold improvements	Lesser of the estimated useful life or the term of the lease
Plant, machinery and equipment	3-15 years

Intangible Assets – Intangible assets represent values of purchased and internally developed software, values of customer contracts and the related customer relationships, trademarks and licenses.

Software development costs are capitalized upon the Group establishing technological feasibility and marketability of a software product. Technological feasibility is established when the Group has completed all planning, designing, coding, and testing activities that are necessary to establish that a product can be produced to meet its design specifications including functions, features, and technical performance requirements.

Customer relationships are amortized on an accelerated basis determined in proportion to the estimated discounted future cash inflows expected from these relationships. Other finite-life intangible assets are amortized on a straight-line basis. The useful lives of intangible assets are estimated as follows:

Software development costs	Greater of the ratio of current product revenues to total projected product revenues or the estimated economic life of the product (3-5 years)
Customer contracts and customer relationships	3-7 years
Purchased software, licenses and other intangible assets	3-10 years

Investments – Investments in businesses in which the Group does not have control but has the ability to exercise significant influence are accounted for by the equity method of accounting whereby the investment is carried at acquisition cost plus Group’s equity in undistributed earnings or losses since acquisition. Investments in which the Group does not have the ability to exercise significant influence are accounted for by the cost method. Equity and cost method investments are included in long-term investments in the consolidated balance sheets.

Debt Issuance Costs – Debt issuance costs are capitalized and amortized using the effective interest method over the terms of the related debt. Unamortized debt issuance costs amounted to \$4.4 million and \$6.6 million as of December 31, 2010 and 2009, respectively.

Impairment of Long-lived Assets excluding Goodwill – The Group evaluates the recoverability of the carrying amount of its long-lived assets, excluding goodwill, whenever events or changes in circumstances indicate that the carrying amounts of those assets may not be recoverable. The Group compares the undiscounted net cash flows estimated to be generated by those assets to the carrying amount of those assets. If the undiscounted cash flows are less than the carrying amounts of the assets, the Group records impairment losses to write the asset down to fair value. Fair value is usually measured based on the estimated discounted net future cash flows associated with such assets.

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Goodwill – In business combinations completed subsequent to January 1, 2009, goodwill represents the excess of the fair value of the consideration given and the fair value of any non-controlling interest in the acquiree over the fair value of all the identifiable assets and liabilities acquired. For business combinations completed prior to January 1, 2009 goodwill represents the excess of the fair value of the consideration given over the fair value of the interest in identifiable assets and liabilities acquired.

Goodwill is not amortized to operations, but instead is reviewed for impairment, at least annually or whenever events or changes in circumstances indicate that the carrying value may not be recoverable. Goodwill is reviewed for impairment by comparing the carrying value of each reporting unit's net assets (including allocated goodwill) to the fair value of those net assets. If the reporting unit's carrying amount is greater than its fair value, then a second step is performed whereby the portion of the fair value that relates to the reporting unit's goodwill is compared to the carrying value of that goodwill. The Group recognizes a goodwill impairment charge for the amount by which the carrying value of goodwill exceeds the fair value. The Group has determined that there are no impairment losses in respect of goodwill for any of the reporting periods covered by these consolidated financial statements.

Leasing Arrangements – Leases of property, plant and equipment where the Group has substantially all the risks and rewards of ownership are classified as capital leases. For capital leases, the present value of the future minimum lease payments at the inception of the lease or fair value, whichever is less, is reflected as an asset and a liability in the consolidated balance sheets. Principal amounts due within one year are classified as current liabilities and the remaining balance as long-term liabilities.

Leases in which a significant portion of the risks and rewards of ownership are retained by the lessor are classified as operating leases. Payments made under operating leases are charged to the consolidated statements of operations on a straight-line basis over the period of the lease.

Postretirement benefit plans – According to the Greek labor legislation, Intracom Telecom is obliged to provide certain postretirement benefits to its employees. The defined benefit postretirement plan is unfunded (Note 18).

The regular contributions for defined benefit plans constitute net periodic costs for the year in which they are due and as such are included in staff costs.

The liability in respect of defined benefit retirement plan is the present value of the defined benefit obligation at the balance sheet date minus the fair value of plan assets together with adjustments for actuarial gains/(losses) and past service cost. Independent actuaries using the projected unit credit method calculate the defined benefit obligation annually.

Cumulative actuarial gains and losses arising from experience adjustments and changes in actuarial assumptions in excess of the greater of 10% of the value of plan assets or 10% of the defined benefit obligation are spread to the statement of comprehensive income over the employees' expected average remaining working lives. Past-service costs are recognized immediately in the statement of comprehensive income, unless the changes to the plan are conditional on the employees remaining in service for a specified period of time (the vesting period). In this case, the past-service costs are amortized on a straight-line basis over the vesting period.

Revenue Recognition – The Group recognizes revenues when all of the following conditions have been met: (i) there is persuasive evidence of an arrangement; (ii) delivery has occurred; (iii) the fee is fixed and determinable; and (iv) collectability of the fee is reasonably assured. Provisions for warranty and product returns are provided for as reductions to revenue in the same period as the related sales are recorded. The Group monitors and tracks the amount of sales deductions based on historical experience to estimate the reduction to revenues.

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

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Telecommunication Solutions segment

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

If the services element of the arrangement is deemed essential to the functionality of the software arrangement, the accounting for performance of construction-type contracts is applied, provided that the following conditions are met: (a) contracts executed by the parties normally include provisions that clearly specify the enforceable rights regarding goods or services to be provided and received by the parties, the consideration to be exchanged, and the manner and terms of settlement; (b) the buyer can be expected to satisfy its obligations under the contract; and (c) the Group can be expected to perform its contractual obligations. The measurement of progress towards completion is based on efforts devoted to a contract at the particular stages. At SITRONICS TS CR, the extent of progress is measured by the ratio of hours performed to date as compared to the estimated total hours at completion. Intracom Telecom calculates the extent of progress based on the ratio of costs incurred to total estimated costs. A contract is considered as substantially completed when (a) the product is delivered, and (b) the product is accepted by the customer.

If the services element of the arrangement is not deemed essential to the functionality of the software, the service revenues are accounted for separately from the software revenues. In such multiple-element arrangements, the software component is accounted for using the residual method.

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

Information Technologies Solutions segment

The sale of systems integration services typically includes multiple elements, such as equipment and software, installation services and post-contract support. A multiple-element arrangement is separated into more than one unit of accounting if all of the following criteria are met: i) the delivered items have value to the customer on a standalone basis; ii) there is objective and reliable evidence of the fair value of the undelivered items; and iii) the arrangement includes a general right of return relative to the delivered items, delivery or performance of the undelivered items is considered probable and substantially in the control of the Group.

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

Revenue and cost of sales from contracts involving solutions achieved through modification of complex telecommunications equipment and software are recognized by reference to the stage of completion of the contract activity at the balance sheet date when the outcome of a contract can be estimated reliably. This is normally measured by the proportion that contract costs incurred for work performed to date relate to the estimated total contract costs, except where this would not be representative of the stage of completion. Variations in contract work, claims and incentive payments are included to the extent that they have been agreed with the customer. Where the outcome of a contract cannot be estimated reliably, contract revenue is recognized to the extent of contract costs incurred that it is probable will be recoverable. When it is probable that total contract costs will exceed total contract revenue, the expected loss is recognized immediately.

Microelectronic Solutions segment

The products within this segment are generally sold with a limited warranty of product quality. The product return reserves, warranty and other post-contract support obligations are accrued at the time of sale. The Group accrues for known warranty if a loss is probable and can be reasonably estimated, and accrues for estimated incurred but unidentified issues based on historical activity.

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There are contracts with agents who sell products on behalf of the Group. In the case of agreements with agents, the revenue is recognized upon notification by the agent that goods have been shipped to the customer. For provision of research and development services to customers, revenue is recognized at the end of each phase within a contract. This is upon acceptance by the client that the phase is complete and all contractual deliverables provided.

Research and Development Costs – Research and development (“R&D”) costs are charged to the consolidated statements of operations when incurred. The costs of materials and equipment, facilities that are acquired or constructed for research and development activities are capitalized when acquired or constructed and depreciation expense associated with R&D activities is included in research and development costs.

Income Taxes – Current income taxes for the Group’s subsidiaries have been computed in accordance with the respective local laws.

Deferred income taxes are recognized for the differences between the tax bases of assets and liabilities and their reported amounts in the accompanying consolidated financial statements that will result in future taxable or deductible amounts. The deferred tax assets and liabilities are measured using the enacted tax laws and rates applicable to the periods in which the differences are expected to affect taxable income. A valuation allowance is provided against deferred tax assets, if it is more likely than not some portion or all of the deferred tax assets will not be realized.

The Group recognizes uncertain tax positions for tax positions which are considered more likely than not of being sustained based on the technical merits of the position on audit by the tax authorities. The measurement of the tax benefit recognized in the consolidated financial statements is based upon the largest amount of tax benefit that, in management’s judgment, is greater than 50% likely of being realized based on a cumulative probability assessment of the possible outcomes. The Group recognizes interest accrued related to unrecognized tax benefits in interest expense and penalties in operating expenses.

Borrowing Costs – Borrowing costs are recognized as an expense in the period in which they are incurred. Borrowing costs for assets that require a period of time to get them ready for their intended use are capitalized and amortized over the related assets’ estimated useful lives. The capitalized borrowing costs for the years ended December 31, 2010 and 2009 amounted to \$2.5 million and \$15.2 million, respectively. The remaining borrowing costs are recognized as an expense in the period in which they are incurred.

Asset Retirement Obligations – The Group records an asset retirement obligation and an associated asset retirement cost when the Group has a legal or contractual obligation in connection with the retirement of tangible long-lived assets. The Group’s obligations relate primarily to the cost of removing equipment from its leased production facilities and other leased sites. As of December 31, 2010 and 2009, the estimated assets retirement obligations were not significant to the Group’s consolidated financial position and results of operations.

Stock Options – Stock based compensation represents the cost of stock options granted to employees. The Group measures compensation cost based on the estimated fair value of the instruments on the date they are granted using option pricing models and the cost is recognized as an expense over the period during which the employees are required to provide services in exchange for the equity instruments (Note 22).

Discontinued Operations – The results of operations of a component of an entity that either has been disposed of or is classified as held for sale are reported in discontinued operations if both of the following conditions are met:

- (a) The operations and cash flows of the component have been (or will be) eliminated from the ongoing operations of the Group as a result of the disposal transaction;
- (b) The Group will not have any significant continuing involvement in the operations of the component after the disposal transaction.

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In a period in which a component of an entity either has been disposed of or is classified as held for sale, the consolidated statements of operations of the Group for current and prior periods report the results of operations of the component, including any gain or loss recognized, in discontinued operations. The results of operations of a component classified as held for sale are reported in discontinued operations in the period(s) in which they occur. The results of discontinued operations, less applicable income taxes (benefit), are reported as a separate component of income before extraordinary items (if applicable). The Group has elected not to disclose separately the cash flows pertaining to discontinued operations.

New Accounting Pronouncements

To be adopted in future periods

In October 2009, the Financial Accounting Standards Board (the "FASB") issued Accounting Standard Update ("ASU" or "Update") No. 2009-14, "Software" (Topic 985): Certain Revenue Arrangements That Include Software Elements - a consensus of the FASB Emerging Issues Task Force, that amends Subtopic 985-605, "Software: Revenue Recognition". The Update excludes from the scope of ASC 985-605 certain tangible products that contain software that functions together with nonsoftware deliverables to deliver the tangible product's essential functionality. The Update does not create any new methods of revenue recognition, but its amendments to the scope of existing guidance can significantly affect an entity's periodic revenue. The amendments in the Update are effective prospectively for revenue arrangements entered into or materially modified in fiscal years beginning on or after June 15, 2010. The Group is currently evaluating the potential impact of this Update on the Group's consolidated financial statements.

Adopted During the Current Year

In October 2009, the FASB issued ASU No. 2009-13, "Revenue Recognition" (Topic 605): Multiple-Deliverable Revenue Arrangements a consensus of the FASB Emerging Issues Task Force that amends Subtopic 605-25, "Revenue Recognition – Multiple-Element Arrangements", of the FASB Codification. The amendment requires the allocation of the overall consideration to each deliverable, using the estimated selling price in the absence of vendor-specific objective evidence or third-party evidence of selling price for the deliverables. The Update also eliminates the residual method of consideration allocation and improves disclosure requirements. The amendments in the Update are effective prospectively for revenue arrangements entered into or materially modified in fiscal years beginning on or after June 15, 2010, with early adoption permitted. The Group has chosen to early adopt the Update from January 1, 2010. The adoption did not have a material impact on the Group's results of operations, financial position, cash flows or disclosures.

In July 2010, the FASB issued ASU 2010-20, Receivables (Topic 310): Disclosures about the Credit Quality of Financing Receivables and the Allowance for Credit Losses ("ASU 2010-20") that amends Topic 310, Receivables, of the FASB Codification. ASU 2010-20 amends existing disclosures and requires the entity to provide additional disclosures to facilitate financial statement users' evaluation of the following: 1) the nature of credit risk inherent in the entity's portfolio of financing receivables; 2) how that risk is analyzed and assessed in arriving at the allowance for credit losses; 3) the changes and reasons for those changes in the allowance for credit losses. ASU 2010-20 also introduces a new terminology, in particular, the term financial receivables. For public entities, the disclosures as of the end of a reporting period are effective for interim and annual reporting periods ending on or after December 15, 2010. The amendments in ASU 2010-20 encourage, but do not require, comparative disclosures for earlier reporting periods that ended before initial adoption. However, an entity should provide comparative disclosures for those reporting periods ending after initial adoption. The Group estimates that ASU 2010-20 unlikely to have any significant impact on the volume of disclosure made in the notes to the consolidated financial statements.

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In January 2010, the FASB issued ASU (Accounting Standards Update) No. 2010-06, "Fair Value Measurements and Disclosures" (Topic 820): Improving Disclosures about Fair Value Measurements that amends Subtopic 820-10, of the FASB Codification. The Update requires provision of a greater level of disaggregated information and more robust disclosures about valuation techniques and inputs to fair value measurements. The Group adopted the provisions from January 1, 2010, except for the disclosures about purchases, sales, issuances and settlements in the roll forward of activity in Level 3 fair value measurements, which are effective for interim and annual periods beginning after December 15, 2010. This adoption did not have any significant impact on the volume of disclosure made in the notes to the consolidated financial statements.

In January 2010, the FASB issued ASU No. 2010-01, "Equity" (Topic 505): Accounting for Distributions to Shareholders with Components of Stock and Cash – a consensus of the FASB Emerging Issues Task Force. This Update clarifies that the stock portion of a distribution to shareholders that allows them to elect to receive cash or stock with a limit on the amount of cash that will be distributed is not a stock dividend for purposes of applying Topics 505 and 260. The Group adopted the provisions from January 1, 2010 retrospectively. This adoption did not have an impact on the Group's results of operations, financial position or cash flows.

In August 2009, ASU No. 2009-05, "Measuring Liabilities at Fair Value", was issued and was adopted by the Group from January 1, 2010. This ASU amends ASC No. 820, Fair Value Measurements and Disclosures, and provides additional guidance on how companies should measure liabilities at fair value. While reaffirming the existing definition of fair value, this ASU reintroduces the concept of entry value into the determination of fair value. Entry value is the amount an entity would receive to enter into an identical liability. Under the new guidance, the fair value of a liability is not adjusted to reflect the impact of contractual restrictions that prevent its transfer. The adoption did not have an impact on the Group's results of operations, financial position or cash flows.

In June 2009, the FASB issued ASC No. 810 "Consolidation" (former SFAS No. 167, "Amendments to FASB Interpretation No. 46(R)") which changes how a reporting entity determines when an entity that is insufficiently capitalized or is not controlled through voting (or similar rights) should be consolidated. The determination of whether a reporting entity is required to consolidate another entity is based on, among other things, the purpose and design of the other entity and the reporting entity's ability to direct the activities of the other entity that most significantly impact its economic performance. ASC No. 810 also requires additional disclosures about a reporting entity's involvement with variable interest entities and any significant changes in risk exposure due to that involvement. A reporting entity is required to disclose how its involvement with a variable interest entity affects the reporting entity's financial statements. This update was adopted by the Group from January 1, 2010. The adoption did not have an impact on the Group's results of operations, financial position or cash flows.

In June 2009, the FASB issued amendments to ASC No. 810 (former FASB Interpretation No. 46(R), "Consolidation of Variable Interest Entities") to address the effects of the elimination of the qualifying special purpose entity concept. More specifically, it requires a qualitative rather than a quantitative approach to determine the primary beneficiary of a variable interest entity, it amends certain guidance pertaining to the determination of the primary beneficiary when related parties are involved, and it amends certain guidance for determining whether an entity is a variable interest entity. Additionally, these amendments require continuous assessment of whether an enterprise is the primary beneficiary of a variable interest entity. ASC No. 810 is effective for fiscal years beginning after November 15, 2009, and interim periods within those fiscal years. The Group adopted the provisions effective January 1, 2010. This adoption did not have an impact on the Group's results of operations, financial position or cash flows.

Revision of comparative information for prior periods – During the third quarter of 2010 the Group identified an amount relating to contributed equipment in respect of SITRONICS-Nano that should have been reclassified in 2009 to long-term investments. The reclassification of \$38.6 million is considered immaterial, both qualitatively and quantitatively. The Group has retrospectively revised values of property, plant and equipment and long-term investments in its consolidated balance sheet as of December 31, 2009 to reflect this adjustment.

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3. ACQUISITIONS AND DISPOSALS

In April 2010, the Group acquired the remaining 35% interest in its subsidiary LLC "SITRONICS Smart Technologies" from the non-controlling shareholder, Giesecke & Devrient GMBH, for consideration of \$3.5 million.

In April 2009, the Group acquired a 74% shareholding in JSC SITRONICS-PARAVAN, a Russian engineering company specializing in industrial automation systems and security solutions and also acquired a 51% shareholding in LLC Network Systems, a Russian developer of information security and encryption-based data protection programmes and software.

In September 2010, the Group acquired a 100% stake in COSMOS WEALTH. Before the acquisition this company was treated as a VIE, of which the Group was the primary beneficiary and its accounts were included in the consolidated financial statements of the Group.

During 2009 and 2010, the Group established new subsidiaries to introduce the complete range of SITRONICS' products and solutions to the markets in India (SITRONICS INDIA), in Bashkortostan (SITRONICS Bashkortostan), in Tatarstan (SITRONICS-TATARSTAN) and in Armenia (SITRONICS Armenia). The subsidiary in Armenia has been created in order to centralize the management of the CJSC Mars plant and three scientific research institutes, and the management of a free economic zone, which is being created on these sites. These assets are owned by the Russian Federal Agency for State Property Management (Rosimushchestvo), and have been managed by SITRONICS since 2008.

Discontinued operations

In April 2009, SITRONICS disposed of a portion of the distribution business of its wholly-owned subsidiary, SITRONICS IT B.V. The business disposed of consisted of seven entities that were engaged in the distribution of hardware and software in Eastern Europe and the CIS, which represented the distribution business of SITRONICS in this geographic region. The business was sold to MELROSE HOLDINGS S.A. (a company owned by current and former management of SITRONICS IT B.V.) for a total consideration of \$49.8 million. The transaction resulted in a loss of \$26.2 million in 2009.

The assets and liabilities of the discontinued operations of SITRONICS IT B.V. as at the date of disposal, April 14, 2009, consisted of the following:

	<u>April 14, 2009</u>
Current assets	\$ 121,066
Non-current assets	1,096
Total assets of discontinued operations	\$ 122,162
Current liabilities	\$ 33,164
Non-current liabilities	13,000
Total liabilities of discontinued operations	\$ 46,164

The results of operations of discontinued operations for the year ended December 31, 2009 were as follows:

	<u>2009</u>
Total revenues	\$ 60,845
Total expenses	(60,932)
Income tax expense	(317)
Loss from discontinued operations after income tax	\$ (404)
Loss on sale of discontinued operations	(25,750)
Loss from discontinued operations net of income tax	\$ (26,154)

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The components of the loss on the sale of discontinued operations, net of tax as at December 31, 2009

	<u>2009</u>
Consideration	\$ 49,844
Carrying value of net assets disposed	(75,998)
Income taxes	-
Loss on sale	\$ <u>(26,154)</u>

4. CASH AND CASH EQUIVALENTS

Cash and cash equivalents as of December 31, 2010 and 2009 comprised the following:

	<u>2010</u>	<u>2009</u>
RUB, USD current accounts with subsidiary of Sistema:		
Moscow Bank for Reconstruction and Development (MBRD)	\$ 56,946	\$ 35,932
RUB deposits with subsidiary of Sistema:		
Moscow Bank for Reconstruction and Development (MBRD)	28,448	3,835
Term deposits with third parties:		
EUR deposits	47,606	10,068
USD deposits	21,899	25,950
JPY deposits	-	42,487
UAH deposits	8,579	322
RON deposits	4,142	204
RUB deposits	-	198
Other deposits	940	354
Current accounts with third parties:		
RUB current accounts	54,554	20,997
USD current accounts	23,756	5,291
EUR current accounts	3,628	2,126
CZK current accounts	2,821	2,252
Other current accounts	7,633	10,123
Cash on hand	736	1,725
Total	\$ <u>261,688</u>	\$ <u>161,864</u>

Term deposits have original maturities of less than three months.

As of December 31, 2010 term deposits with MBRD and third parties bear interest at rates varying from 0.5% to 18.0% per annum. Interest income earned on MBRD current accounts and deposits is disclosed in Note 24.

5. SHORT-TERM DEPOSITS AND LOANS

USD and RUB denominated short-term deposits and loans as of December 31, 2010 and 2009 comprised the following:

	Annual interest rate (Actual at December 31, 2010)	Maturity date	<u>2010</u>	<u>2009</u>
Bank deposits (above 3 months)	4.5%	2011	\$ 2	\$ 410
Short-term loans	6%-14%	2011	682	762
Short-term loans to Sistema and subsidiaries	17%	2011	545	1,143
Total			\$ <u>1,229</u>	\$ <u>2,315</u>

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6. TRADE RECEIVABLES, NET

Trade receivables, net of provision for doubtful accounts, as of December 31, 2010 and 2009 comprised the following:

	<u>2010</u>	<u>2009</u>
Trade receivables	\$ 472,500	\$ 460,013
Less: provision for doubtful accounts	(50,489)	(53,625)
Total	\$ <u>422,011</u>	\$ <u>406,388</u>

Included in trade receivables as of December 31, 2010 and 2009 are receivables for services provided and products shipped to subsidiaries and affiliates of Sistema in the amounts of \$83.3 million and \$99.7 million, respectively (Note 24).

7. OTHER RECEIVABLES AND PREPAID EXPENSES, NET

Other receivables and prepaid expenses, net of provision for doubtful accounts, as of December 31, 2010 and 2009 comprised the following:

	<u>2010</u>	<u>2009</u>
Advances to suppliers	\$ 59,988	\$ 49,860
Prepaid expenses	35,258	16,980
Receivable from Digital Electronics JSC	15,871	18,037
Other taxes prepaid	14,206	19,357
Recoverable VAT	12,564	6,990
Receivable from EU programs	3,256	3,145
Loans to employees	1,018	1,155
Debt issuance costs, current portion	870	1,060
Other	10,631	8,947
Less: provision for doubtful accounts	(25,431)	(25,262)
Total	\$ <u>128,231</u>	\$ <u>100,269</u>

8. INVENTORIES, NET

Inventories, net of provision for obsolete and slow-moving stock, as of December 31, 2010 and 2009 comprised the following:

	<u>2010</u>	<u>2009</u>
Raw materials and spare parts	\$ 63,486	\$ 77,373
Work-in-progress	37,721	45,696
Finished goods and goods for resale	<u>64,927</u>	<u>49,513</u>
	166,134	172,582
Less: long-term portion	(13,716)	(17,792)
Total	\$ <u>152,418</u>	\$ <u>154,790</u>

The Group has evaluated the classification of inventories and determined that \$13.7 million of inventories is expected to be sold or used in periods in excess of one year from the 2010 balance sheet date. Accordingly, this amount has been classified into long-term assets.

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9. PROPERTY, PLANT AND EQUIPMENT, NET

Property, plant and equipment, net of accumulated depreciation, as of December 31, 2010 and 2009 comprised the following:

	<u>2010</u>	<u>2009</u>
Land	\$ 19,929	\$ 20,790
Buildings and leasehold improvements	191,675	196,352
Plant, machinery and equipment (including leased vehicles and equipment of \$193,983 and \$193,431 as of December 31, 2010 and 2009, respectively)	333,053	320,288
Construction in progress and equipment for installation	<u>31,111</u>	<u>23,690</u>
	575,768	561,120
Less accumulated depreciation:		
Buildings and leasehold improvements	(61,953)	(56,016)
Plant, machinery and equipment (including leased vehicles and equipment of (\$29,473) and (\$11,154) as of December 31, 2010 and 2009, respectively)	<u>(74,739)</u>	<u>(48,133)</u>
	(136,692)	(104,149)
Total	\$ <u>439,076</u>	\$ <u>456,971</u>

Depreciation expense for property, plant and equipment for the years ended December 31, 2010 and 2009 was \$40.4 million and \$30.8 million, respectively.

Increase in depreciation expenses between years ended December 31, 2010 and 2009 primarily reflected the depreciation of 180 nanometer equipment in the Microelectronic Solutions segment. This equipment was acquired under financial lease agreement between SITRONICS-Nano and Mikron and started production in the end of 2009.

Land, buildings and equipment with an approximate carrying value of \$48.6 million and \$107.2 million as of December 31, 2010 and 2009, respectively, were pledged to collateralize the outstanding balance of debt to Sberbank, Bank of Moscow and BAWAG Bank (see Note 15, Note 16).

10. INTANGIBLE ASSETS AND GOODWILL, NET

Intangible assets, net of accumulated amortization, and goodwill as of December 31, 2010 and 2009 comprised the following:

	<u>2010</u>			<u>2009</u>		
	Gross carrying value	Accumu- lated amorti- zation	Net carrying value	Gross carrying value	Accumu- lated amorti- zation	Net carrying value
Finite-life intangible assets:						
Customer contracts and the related customer relationships	\$ 87,434	(32,908)	54,526	\$ 87,434	(25,623)	61,811
Software costs	157,265	(92,014)	65,251	156,217	(77,945)	78,272
Licenses	28,425	(7,409)	21,016	23,534	(4,548)	18,986
Other	45,901	(11,000)	34,901	39,021	(776)	38,245
	<u>319,025</u>	<u>(143,331)</u>	175,694	<u>306,206</u>	<u>(108,892)</u>	197,314
Indefinite-life intangible assets:						
Trademarks	4	-	4	5	-	5
Goodwill	86,858	-	86,858	86,858	-	86,858
Total	\$ <u>405,887</u>	<u>(143,331)</u>	<u>262,556</u>	<u>393,069</u>	<u>(108,892)</u>	<u>284,177</u>

The amortization expense for the years ended December 31, 2010 and 2009 was \$50.4 million and \$27.2 million, respectively.

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Based on market analysis management has revised the estimated useful lives of capitalized software development costs in Intracom Telecom which resulted in an accelerated amortization of \$10.0 million during 2010.

The estimated amortization expense for the finite-life intangible assets existing as of December 31, 2010 for each of the five succeeding fiscal years and thereafter is as follows:

2011	44,392
2012	37,830
2013	33,779
2014	34,160
2015	9,402
Thereafter	16,131
Total	\$ 175,694

The actual amortization expense to be reported in future periods could differ from these estimates as a result of new intangible assets acquisitions, changes in useful lives and other relevant factors.

11. LONG-TERM INVESTMENTS

Long-term investments as of December 31, 2010 and 2009 comprised the following:

	<u>2010</u>	<u>2009</u>
Share in LLC SITRONICS-Nano	220,677	220,980
Share in JSC Intellect Telecom	\$ 7,940	\$ -
Other	2,099	1,404
Total	\$ 230,716	\$ 222,384

LLC SITRONICS-Nano – In October 2009, the Group entered into an agreement to form SITRONICS-Nano, which is owned 49.75% by the Group, 49.75% by RUSNANO and 0.5% by another party. The primary purpose of SITRONICS-Nano is to acquire equipment and licenses necessary to launch 90 nanometer microchip production and to lease them to the Group, and to provide project financing to the Group. The equipment and licenses purchases will be financed through the equity of SITRONICS-Nano and external borrowings.

SITRONICS-Nano is determined to be a variable interest entity where the Group has a variable interest through a lease agreement and is not the primary beneficiary. The Group accounts for the investment under the equity method.

RUSNANO has a put option to sell its shares to Sistema at market price +25% not earlier than in nine years and not later than in 10.5 years from the date of financing (December 2009). Sistema has a call option to acquire at any time RUSNANO's shares at RUB 6,480.0 million plus 18% p.a.

In addition, during the first nine years of operations of SITRONICS-Nano on non-fulfillment of certain criteria, RUSNANO can put its share in SITRONICS-Nano to Sistema at RUB 6,480.0 million plus 18% p.a., less any net profit attributed and paid to RUSNANO during the period from the date of the put option application.

The maximum exposure to a loss is determined as the Group's contribution to SITRONICS-Nano adjusted by the Group's share of distributed results of the investee and is equal to \$220.7 million.

JSC Intellect Telecom – In November 2010, SITRONICS acquired a 24.95% stake of JSC Intellect Telecom, Sistema's R&D innovation centre, for cash consideration of \$8.0 million.

JSC Navigation-Information Systems – In November 2010, SITRONICS sold its 25.5% stake in JSC Navigation-Information Systems to Sistema for consideration of \$8.0 million. The profit from the transaction is included in the consolidated statement of operations as gain on sale of associates.

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12. LONG-TERM TRADE RECEIVABLES

The long-term portion of trade receivables as of December 31, 2010 and 2009 comprised the following:

	Annual interest rate (Actual at December 31, 2010)	Maturity date	2010	2009
Trade receivables from third parties	6 month EURIBOR+1.8%; 6 month EURIBOR+1%; 3 month EURIBOR+1.8%; 1 year EURIBOR+2.5%; 8.85%; 0%	2012-2015	\$ 33,214	\$ 46,075
Trade receivables from Sistema affiliates	3 month EURIBOR+2.75%; 0%	2012	5,511	12,079
Total			\$ 38,725	\$ 58,154

The long-term trade receivables are primarily related to customers of Intracom Telecom.

13. RESTRICTED CASH

As of December 31, 2009 the Group had restricted cash in the amount of \$1.1 million related to collateral issued in favour of customers which was released in the year ended December 31, 2010.

14. ACCRUED EXPENSES AND OTHER CURRENT LIABILITIES

Accrued expenses and other current liabilities as of December 31, 2010 and 2009 comprised the following:

	2010	2009
Customers' prepayments and billings in excess of project costs	\$ 170,627	\$ 67,298
Interest payable on debt	27,089	24,029
Accrued payroll and vacation	21,821	21,650
Accrued expenses and other current liabilities	16,825	13,027
Warranty obligations	3,581	1,969
Current portion of capital lease obligation (Note 17)	2,691	5,098
Provision for uncertain tax positions (Note 20)	1,236	2,576
Phantom option obligation (Note 22)	998	-
Current portion of postretirement benefit obligations (Note 18)	835	832
Total	\$ 245,703	\$ 136,479

Customers' prepayments and billings in excess of project costs as of December 31, 2010 and 2009 included amounts related to transactions with subsidiaries and affiliates of Sistema of \$118.7 million and \$30.8 million, respectively (Note 24).

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15. SHORT-TERM LOANS AND NOTES PAYABLE

At December 31, 2010 and 2009, short-term loans and notes payable comprised the following:

	Annual interest rate (Actual at December 31, 2010)	2010	2009
Revolving credit facilities:			
Including:			
EUR-denominated	3 month EURIBOR+4.0%; 3 month EURIBOR+3.5%	\$ 17,734	\$ 19,225
USD-denominated	9.5%; 1 month LIBOR+8.5%	13,901	3,524
		<u>31,635</u>	<u>22,749</u>
RUB-denominated loans and notes payable to Sistema and subsidiaries:			
Including:			
Notes payable	0.1%	58,360	58,809
Loans payable	20.5%	17,061	25,294
		<u>75,421</u>	<u>84,103</u>
Loans and notes payable to other parties:			
Including:			
EUR-denominated	3 month EURIBOR+4.0%; 3 month EURIBOR+4.8%	21,836	24,388
CZK-denominated	3 month PRIBOR+0.35%	1,726	1,934
USD-denominated	5.25%	995	29,045
RUB-denominated	11.5%	166	31,740
		<u>24,723</u>	<u>87,107</u>
Total		<u>\$ 131,779</u>	<u>\$ 193,959</u>

Revolving Credit Facilities

In December 2005, Intracom Telecom entered into several EUR-denominated revolving loan agreements with a number of financial institutions, including National Bank of Greece S.A., Piraeus Bank S.A. and EFG Eurobank S.A. limited in aggregate to \$82.5 million. As of December 31, 2010 these facilities bear interest rates from three month EURIBOR+3.5% to three month EURIBOR+4.0% per annum. As at December 31, 2010 the outstanding amount under these facilities comprised \$17.7 million.

During the year ended December 31, 2008, SITRONICS Smart Technologies entered into a revolving credit facility agreement with HSBC denominated in USD, limited to \$15.0 million. The credit facility bears an interest rate of one month LIBOR+8.5% per annum. During the year ended December 31, 2010, the credit facility was extended and matures in June 2011. As of December 31, 2010, the outstanding amount under the credit facility with HSBC comprised \$12.0 million.

During the year ended December 31, 2010, SITRONICS Information Technologies Ukraine entered into a USD-denominated revolving loan agreement with BM Bank (subsidiary of the Bank of Moscow in Ukraine). The loan bears an interest of 9.5% per annum and matures in June 2011. The facility is secured by the guarantee of SITRONICS and guarantee of the Bank of Moscow. Land and buildings of SITRONICS IT B.V. subsidiaries with an approximate carrying value of \$0.4 million are pledged as a security under the agreement. The amount outstanding as at December 31, 2010 under this agreement comprised \$1.9 million.

RUB-denominated Loans and Notes Payable to Sistema and subsidiaries

During the year ended December 31, 2009, SITRONICS issued RUB-denominated promissory notes to Sistema. The promissory notes bear an interest rate of 0.1% per annum. During the year ended December 31, 2010, the promissory notes were extended and mature during 2011. The amount outstanding as at December 31, 2010 under this arrangement comprised \$58.4 million.

During the year ended December 31, 2009, SITRONICS issued RUB-denominated promissory notes to Sistema and a subsidiary of Sistema, Sistema Finance. The promissory notes bear an interest rate of 20.5% per annum. During the year ended December 31, 2010, the promissory notes were extended and mature during 2011. The amount outstanding as at December 31, 2010 under this arrangement comprised \$17.1 million.

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Loans and Notes Payable to Other Parties

During the year ended December 31, 2009, Intracom Telecom entered into a USD-denominated unsecured loan agreement with New York Commercial Bank bearing an interest rate of 5.25% per annum. During the year ended December 31, 2010, the loan was extended and matures in December 2011. As of December 31, 2010, the amount outstanding under this agreement comprised \$1.0 million.

During the year ended December 31, 2009, Intracom Telecom entered into a number of EUR-denominated unsecured loan agreements with GENIKI BANK – SOCIETE GENERALE Group and Alphabank. During the year ended December 31, 2010, the loans were extended and mature in March 2011. As of December 31, 2010, the loans bear interest rates of three month EURIBOR+4.0% and three month EURIBOR+4.8% per annum, respectively. The amounts outstanding as at December 31, 2010, under these agreements comprised \$15.2 million and \$6.6 million, respectively.

In 2003, SITRONICS TS CR obtained a CZK-denominated loan of \$2.3 million from BAWAG Bank. The loan bears an interest of three month PRIBOR+0.35% per annum. Land and buildings of SITRONICS TS CR with an approximate carrying value of \$1.7 million are pledged as security under the agreement. The amount outstanding as at December 31, 2010, under this agreement comprised \$1.7 million.

During the year ended December 31, 2010, SITRONICS Information Technologies entered into a RUB-denominated unsecured loan agreement with PROBUSBUSINESSBANK, bearing an interest rate of 11.5% per annum and maturing in January 2011. The amount outstanding as at December 31, 2010, under this agreement comprised \$0.2 million.

16. LONG-TERM DEBT

Long-term debt as of December 31, 2010 and 2009 consisted of the following:

	Currency	Annual interest rate (Actual at December 31, 2010)	2010	2009
GOLDEN GATES B.V. (Bank of Moscow)	USD	3 month LIBOR+8%	\$ 230,000	\$ 230,000
Syndicated loan to Intracom Telecom (2008)	EUR	6 month EURIBOR+1.5%	158,808	193,671
Russian bonds	RUB	22%	-	96,841
Bonds (Series BO-01; Series BO-02)	RUB	11.75%; 10.75%	139,647	-
SITRONICS-Nano	RUB	14%	45,623	5,952
Sberbank	RUB	11.25%	25,954	16,235
Science and Industrial Policy Department of the Moscow Government	RUB	3.0%; 1 month LIBOR+10.5%	7,120	7,175
Other loans	various	3.33%	5,724	2,021
Subtotal			612,876	551,895
Less current portion of long-term debt			(397,552)	(135,596)
Total			\$ 215,324	\$ 416,299

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Borrowing from GOLDEN GATES B.V. (Bank of Moscow) – In November 2009, SITRONICS signed a \$230.0 million two-year loan agreement with Bank of Moscow as Arranger and Agent and GOLDEN GATES B.V. as original lender. The loan bears an interest rate of three months LIBOR+8% per annum and is guaranteed by Sistema. The proceeds of the loan were used to refinance current liabilities of SITRONICS. The loan contains financial performance covenants and triggers, including, but not limited to, compliance with certain performance ratios. The loan also includes a number of conditions, including a cross-default in the case of any default of any member of the Sistema Group on their financial obligations, unless the aggregate amount of the financial indebtedness is less than \$50.0 million for the Sistema Group companies and less than \$10.0 million for the SITRONICS Group companies. As of December 31, 2010, the Group is in compliance with all existing financial covenants. The facility matures in November 2011. As at December 31, 2010 the outstanding amount of \$230 million was included in the current portion of long-term debt.

Syndicated Loan to Intracom Telecom – In June 2008, Intracom Telecom Solutions S.A. entered into a syndicated loan agreement with a number of banks (Alphabank, HSBC Bank plc, Geniki Bank of Greece S.A., National Bank of Greece S.A., Piraeus Bank S.A., EFG Eurobank S.A., FBB-First Business Bank S.A., T-Bank (former Aspis Bank), Millennium Bank S.A.). The loan bears an interest of six month EURIBOR+1.5% to 1.7% per annum and matures in July 2011. Intracom Telecom may request the extension of the final maturity twice for one year at each time. The loan is guaranteed by SITRONICS and Intracom Holding S.A. by 51% and 49%, respectively, and contains certain restrictive covenants, including but not limited to, compliance with certain financial ratios. As of December 31, 2010, Intracom Telecom is in compliance with all existing financial covenants. The amount outstanding as at December 31, 2010, under this agreement comprised \$158.8 million and was included in the current portion of long-term debt.

Bonds Series BO-01 – In June 2010 SITRONICS issued RUB-denominated non-convertible interest-bearing bonds Series BO-01 with a par value of 1,000 Rubles each. The three-year RUB 2 billion issue was priced at face value. The bonds have six coupon periods (the duration of each coupon period is 182 days) and mature in June 2013. The semi-annual coupon payment of 11.75% per annum was determined for the first four semi-annual coupon periods from June 2010 to June 2012. Bonds holders have an early redemption option exercisable on June 26, 2012 when the coupon rate for coupon periods 5-6 will be established. In June 2010, SITRONICS Management (a subsidiary of SITRONICS) repurchased RUB 744.0 million of SITRONICS bonds at nominal value. As of December 31, 2010, the outstanding amount was \$41.2 million.

Bonds Series BO-02 – In October 2010 SITRONICS issued RUB-denominated non-convertible interest-bearing bonds Series BO-02 with a par value of 1,000 Rubles each. The three-year RUB 3 billion issue was priced at face value. The bonds have six coupon periods (the duration of each coupon period is 182 days) and mature in October 2013. The semi-annual coupon payment of 10.75% per annum was determined for the first four semi-annual coupon periods from October 2010 to October 2012. Bond holders have an early redemption option exercisable on October 15, 2012 when the coupon rate for coupon periods 5-6 will be established. As of December 31, 2010, the outstanding amount was \$98.4 million.

Borrowing from Sberbank – During the year ended December 31, 2010, Mikron entered into a credit facility agreement with Sberbank denominated in RUB, limited in aggregate to \$26 million. The drawdown bears an interest rate of 11.25% per annum and matures in 2013. The amount outstanding as at December 31, 2010 under this agreement comprised \$26 million. The facility is secured by the guarantees of Mikron and SITRONICS. Land and buildings of Mikron with an approximate carrying value of \$46.5 million were also pledged as security under the agreement.

Credit agreement with Science and Industrial Policy Department of the Moscow Government – In December 2005, Mikron entered into a credit facility with the Science and Industrial Policy Department of the Moscow Government. The facility is limited to RUB 217.0 million (\$7.12 million as of December 31, 2010) and matures in December 2011. The facility bears an interest determined as one fourth of the official refinancing rate of the Central Bank of Russia (3% as of December 31, 2010). As at December 31, 2010 the outstanding amount of \$7.12 million was included in the current portion of long-term debt.

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Borrowing from SITRONICS-Nano – During the year ended December 31, 2009 and 2010, Mikron entered into a number of credit facility agreements with SITRONICS-Nano denominated in RUB, limited in aggregate to \$45.6 million. The drawdowns bear an interest rate of 14% per annum. The drawdowns mature at the end of 2017. The amount outstanding as at December 31, 2010 under this agreement comprised \$45.6 million.

Credit agreement with Bank of Moscow – In April 2010, SITRONICS Smart Technologies entered into a USD-denominated credit facility with Bank of Moscow. The facility is limited to \$5.0 million and matures on March 31, 2012. The borrowing under the facility bears an interest of one month LIBOR+10.5% per annum. The facility is secured by the guarantees of Mikron and SITRONICS. The amount outstanding as at December 31, 2010 under this agreement comprised \$4.1 million.

The other borrowings outstanding at December 31, 2009, were repaid, refinanced or extended during 2010.

The following table presents the aggregate scheduled maturities of the total debt outstanding as of December 31, 2010:

Year ended December 31,	
2011	397,552
2012	4,100
2013	165,601
2014	-
2015	-
Thereafter	45,623
Total	\$ 612,876

17. CAPITAL LEASE OBLIGATIONS

The capital lease obligations as of December 31, 2010 and 2009 are presented as follows:

	<u>2010</u>	<u>2009</u>
Total minimum lease payments (undiscounted)	\$ 177,903	\$ 181,986
Less: amount representing interest	(6,905)	(9,330)
Present value of net minimum lease obligations	170,998	172,656
Less: current portion of capital lease obligations (Note 14)	(2,691)	(5,098)
Non-current portion of capital lease obligations	\$ 168,307	\$ 167,558

In December 2009 Mikron entered into a lease agreement for equipment and vehicles with SITRONICS-Nano. The lease was classified as a capital lease. The total amount of the minimum lease payments was equal to \$171.9 million and \$170.0 million as at December 31, 2010 and 2009, respectively.

Most of the agreements expire in 2018 and thereafter. Future payments under capital leases in effect as of December 31, 2010, are as follows:

Year ended December 31,	
2011	3,947
2012	44,958
2013	28,656
2014	19,144
2015 and thereafter	81,198
Less: amount representing interest	(6,905)
Total	\$ 170,998

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18. POSTRETIREMENT BENEFITS

The following are the key assumptions used in determining the projected benefit obligation and net periodic expense:

	<u>2010</u>	<u>2009</u>
Discount rate	4.6% p.a.	6.2% p.a.
Annual payroll increase	4.5% p.a.	4.5% p.a.
Long-term inflation	2.0% p.a.	2.0% p.a.
Staff turnover for voluntary resignation (up to 30)	11.0% p.a.	11.0% p.a.
Staff turnover for voluntary resignation (from 31 to 50)	5.5% p.a.	5.5% p.a.
Staff turnover for voluntary resignation (for ages above 51)	2.0% p.a.	2.0% p.a.
Staff turnover for dismissal (for ages below 51)	0.2% p.a.	0.2% p.a.

The change in the projected benefit obligation for the year ended December 31, 2010 and 2009 is presented in the following table:

	<u>2010</u>	<u>2009</u>
Projected benefit obligation, beginning of the year	\$ 7,166	\$ 8,215
Service cost	679	596
Interest cost	394	386
Amendments	2,181	1,104
Benefit payments	(2,679)	(2,935)
Actuarial loss/(gain)	968	(306)
Currency translation effect	(559)	106
Projected benefit obligation, end of the year	\$ 8,150	\$ 7,166
Current portion (Note 14)	835	832
Long-term portion (Note 19)	7,315	6,334

The future payments to employees under the plan are expected as follows:

Year ended December 31,	
2011	835
2012	901
2013	967
2014	1,033
2015 and thereafter	4,414
Total	\$ 8,150

The components of the net periodic costs for the years ended December 31, 2010 and 2009 are as follows:

	<u>2010</u>	<u>2009</u>
Service cost	\$ 679	\$ 596
Interest cost	394	386
Recognized actuarial loss	58	-
Net periodic cost	\$ 1,131	\$ 982

Unrecognised actuarial gains/(losses) recorded in other comprehensive income for the years ended December 31, 2010 and 2009 amounted to \$0.5 million loss and \$0.2 million gain, respectively. Deferred tax effects recognised in respect of these amounts were \$0.1 million gain and \$nil in the years ended December 31, 2010 and 2009, respectively (Note 21).

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19. OTHER LONG-TERM LIABILITIES

As of December 31, 2010 and 2009, other long-term liabilities of the Group comprised the following:

	<u>2010</u>	<u>2009</u>
Postretirement benefit obligation, long-term portion (Note 18)	\$ 7,315	\$ 6,334
Warranty obligations, long-term portion	1,101	1,898
Other	277	1,705
Total	\$ 8,693	\$ 9,937

20. INCOME TAX

Income tax rates effective during the years ended December 31, 2010 and 2009, in countries where the Group primarily operates were as follows:

	<u>2010</u>	<u>2009</u>
Russia	20%	20%
Ukraine	25%	25%
Czech Republic	19%	20%
Greece	24%	25%
Romania	16%	16%

The Group's provision for income taxes for the years ended December 31, 2010 and 2009, was as follows:

	<u>2010</u>	<u>2009</u>
Current tax expense	\$ 15,602	\$ 7,567
Deferred income tax benefit	(4,196)	(21,855)
Total income tax expense/(benefit)	\$ 11,406	\$ (14,288)

The provision for income taxes is different from that which would be obtained by applying the Russian statutory income tax rate of 20% to the loss from continuing operations before income tax.

The items causing this difference are as follows:

	<u>2010</u>	<u>2009</u>
Loss from continuing operations before income tax	\$ (48,264)	\$ (115,095)
Russian statutory tax rate	20%	20%
Income tax benefit	(9,653)	(23,019)
Adjustments due to:		
Expenses not deductible for tax purposes	19,146	15,349
Valuation allowance	486	(557)
Tax (loss)/benefit carried forward	(1,238)	354
Change in liability for uncertain tax positions	(1,300)	(9,296)
Income tax paid in capacity of agent	1,944	2,387
Effect of different tax rates in foreign subsidiaries	1,638	494
Other	383	-
Income tax expense/(benefit)	\$ 11,406	\$ (14,288)

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Temporary differences between the tax and accounting bases of assets and liabilities give rise to the following deferred tax assets and liabilities as at December 31, 2010 and 2009:

	<u>2010</u>	<u>2009</u>
Deferred tax assets		
Property, plant and equipment	\$ 15,125	\$ 22,101
Tax losses carried forward	15,565	5,009
Accounts receivable	14,317	6,202
Accrued expenses	11,882	17,051
Inventories and spare parts	11,869	14,874
Allowance for deferred tax asset	(1,047)	(562)
Other	6,634	4,836
Total deferred tax assets	\$ <u>74,345</u>	\$ <u>69,511</u>
Deferred tax liabilities		
Undistributed untaxed profit	(10,697)	(11,596)
Property, plant and equipment	(13,916)	(14,505)
Intangible assets	(13,497)	(15,044)
Other	(15,666)	(10,069)
Total deferred tax liabilities	\$ <u>(53,776)</u>	\$ <u>(51,214)</u>
Net deferred tax assets, current	\$ 28,020	\$ 30,868
Net deferred tax assets, long-term	28,149	23,855
Net deferred tax liabilities, current	(16,388)	(16,041)
Net deferred tax liabilities, long-term	(19,212)	(20,385)

As of December 31, 2010, deferred tax assets relating to tax losses carried forward are mainly attributable to SITRONICS TS CR and Mikron in the amounts of \$5.7 million and \$9.4 million, respectively. The remaining balance is attributable to Intracom Telecom and SITRONICS TS. These tax losses can be utilized through 2013 in the Czech Republic and through 2020 in Russia.

The Group accounts for uncertain tax positions in accordance with ASC 740. The effect on the consolidated statements of operations for the years ended December 31, 2010 and 2009 was \$1.3 million and \$9.3 million gain, respectively.

A reconciliation of the beginning and ending amount of unrecognized tax benefits is as follows:

	<u>2010</u>	<u>2009</u>
Opening balance	\$ (545)	\$ (3,393)
Decrease due to the change of tax positions during the current year	58	2,848
Closing balance	\$ <u>(487)</u>	\$ <u>(545)</u>

A reconciliation of the beginning and ending balances of interest and penalties related to unrecognized tax benefits are as follows:

	<u>2010</u>	<u>2009</u>
Opening balance	\$ (2,031)	\$ (8,479)
Decrease due to the change of tax positions during the current year	1,282	6,448
Closing balance	\$ <u>(749)</u>	\$ <u>(2,031)</u>

During the years ended December 31, 2010 and 2009, the Group reversed tax positions related to unrecognized tax benefits in the amount of \$1.5 million and \$9.5 million, respectively as the time allowed for claims expired. The Group considers it reasonably possible that approximately \$0.6 million of the unrecognized tax benefit will be reversed within the next twelve months.

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21. SHAREHOLDERS' EQUITY

Common Stock – SITRONICS' share capital comprises of one class of ordinary shares with each share having equal voting rights. Based on Russian law, distributions to shareholders can only be paid out of distributable earnings. The distributable retained earnings of SITRONICS are based on amounts determined in accordance with Russian statutory accounting regulations and may differ significantly from the amounts calculated on the basis of U.S. GAAP.

Treasury Stock – In July 2010, SITRONICS purchased 11,879,011 of its own shares from the management of SITRONICS for a consideration of \$0.3 million within the stock option program. The transaction was recorded as an increase in treasury stock.

Receivable from Shareholder – In March 2010, as per terms of the agreement dated March 2006, a shareholder used his right to return to SITRONICS the unpaid 300,158,550 of common shares amounting to \$10.4 million on the date of the transfer. This transaction was recorded as an increase in treasury stock and as a decrease in a receivable from shareholder.

Accumulated other comprehensive income for the years ended December 31, 2010 and 2009 comprised the following:

	Translation adjustment	Unrecognized actuarial gains/(losses)	Deferred tax	Total accumulated other comprehensive income
Balances at January 1, 2009	\$ 15,920	176	-	16,096
(Debit)/credit for the year	(8,709)	156	-	(8,553)
Balances at December 31, 2009	\$ 7,211	332	-	7,543
(Debit)/credit for the year	(11,552)	(464)	92	(11,924)
Balances at December 31, 2010	\$ (4,341)	(132)	92	(4,381)

Earnings Per Share (EPS) – EPS are computed using the weighted average number of shares outstanding during the years ended December 31, 2010 and 2009. Diluted earnings per share are computed on the basis of the weighted average number of shares outstanding plus any dilutive effect of the outstanding stock options.

22. STOCK OPTIONS

Stock option plan for senior management of the Group 2007–2010 years

In July 2007, the Group established a stock option plan ("Plan") for certain of its employees that provided for the issuance of 627,783,968 shares, representing 6.57% of the share capital. The shares were to be issued from the Group's treasury stock. The options were contingent on the continued employment of the grantees with the Group or, in some cases, with Sistema. According to the terms of the plan, the grantees were entitled to buy option shares in four instalments, representing 16.7% of the total amount due to each person during the years 2007, 2008, 2009, and the remaining amount of 49.9% in 2010. The exercise price was 1 RUB per share. The Group recognizes the expense for stock-based compensation on a straight-line basis over the period represented by each tranche of options. All the participants were restricted from selling their shares until 2010.

In July 2008, 94,636,956 stock options were exercised under the stock option program for consideration of \$4.1 million (representing 1 RUB per share). The Group transferred the equivalent number of treasury shares to the participants. The transaction resulted in a decrease in retained earnings in the amount of \$2.7 million.

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In July 2009, 87,959,254 stock options were exercised under the stock option program for consideration of \$2.8 million (representing 1 RUB per share). The Group transferred the equivalent number of treasury shares to the participants. The transaction resulted in a decrease in retained earnings in the amount of \$3.1 million.

During the year ended December 31, 2010, the remaining 49.9% of granted share options were not exercised by participants and expired.

The compensation cost recorded during the year ended December 31, 2010 and 2009 was \$1.6 million and \$5.2 million, respectively and was included in selling, general and administrative expenses. The offsetting amount was credited to additional paid-in capital.

The activity relating to the stock options for the year ended December 31, 2010 was as follows:

	<u>Number of shares</u>
Outstanding at December 31, 2009	262,824,369
Options granted	-
Options exercised	-
Options expired	(262,824,369)
Outstanding at December 31, 2010	<u>-</u>

Phantom stock option plan for senior and middle management of the Group 2010–2012 years

In January 2010, SITRONICS' Board of Directors established a three-year stock option plan for senior and middle management of the Group. The participants are granted phantom shares, contingent on continued employment with the Group and other conditions. The plan consists of 3 options each starting in the beginning of years 2010, 2011, 2012. All the distributions to participants are performed in cash with amounts determined as a price equal to the average price of 1 GDR at the London Stock Exchange ("LSE") 60 days prior to the end of the year multiplied by a respective quantity of phantom shares.

In the beginning of 2010, SITRONICS' Board of Directors established all the key provisions of the first part of the stock option plan with the quantity of phantom shares granted equal to 5,288,470 ("Option 1"). Option 1 vests in equal parts for 3 years. The Group recognizes compensation cost on a straight-line basis over the requisite service period for each separately vesting portion of the award.

In the year ended December 31, 2010, the first part of Option 1 vested at \$0.78 per phantom share. The number of vested phantom options was 1,282,529.

The Lattice model is used to calculate the present value of the expected option value at the end of the vesting periods, based on the variability of outcomes with relevant probability allocated to each one.

The compensation cost recorded during the year ended December 31, 2010 was \$1.0 million and is included in selling, general and administrative expenses. The offsetting amount was credited to accrued expenses and other current liabilities (Note 14).

The activity relating to the stock options for the year ended December 31, 2010 was as follows:

	<u>Number of shares</u>
Outstanding at December 31, 2009	-
Options granted	5,288,470
Options exercised	-
Options forfeited	(1,440,883)
Outstanding at December 31, 2010	<u>3,847,587</u>

As of December 31, 2010, there was \$1.4 million of total unrecognized compensation cost related to non-vested share-based compensation arrangements granted under Option 1. That cost is expected to be recognized over a 2-year period.

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23. SEGMENT INFORMATION

The FASB ASC No. 280 "Segment Reporting" establishes standards for reporting information about operating segments in the financial statements. Operating segments are defined as components of an enterprise engaging in business activities for which separate financial information is available that is evaluated regularly by the chief operating decision maker or group in deciding how to allocate resources and in assessing performance.

The Group has three operating segments, namely the Telecommunication Solutions segment, Information Technologies Solutions segment and the Microelectronic Solutions segment. These operating segments have differing production processes and product specification. The Group's management evaluates performance of the segments based on their operating income.

The intercompany eliminations presented below consist primarily of intercompany sales transactions, intercompany investments and loans and other intercompany transactions and balances conducted in the normal course of operations.

An analysis and reconciliation of the Group's business segment information to the respective information in the consolidated financial statements for the years ended December 31, 2010 and 2009 is as follows:

For the year ended December 31, 2010	Telecom- munication Solutions	Information Technologies Solutions	Micro- electronic Solutions	All other	Corporate	Total
Sales to external customers	\$ 525,929	\$ 323,640	\$ 255,447	\$ 61,912	\$ -	\$ 1,166,928
Intersegment sales	3	2,637	11,935	1,053	-	15,628
Depreciation and amortization	(48,945)	(7,213)	(30,773)	(3,305)	(609)	(90,845)
Operating income/(loss)	627	15,215	11,050	7,738	(19,854)	14,776

For the year ended December 31, 2009	Telecom- munication Solutions	Information Technologies Solutions	Micro- electronic Solutions	All other	Corporate	Total
Sales to external customers	\$ 579,021	\$ 221,512	\$ 208,109	\$ 15,577	\$ -	\$ 1,024,219
Intersegment sales	1,313	1,368	173	463	-	3,317
Depreciation and amortization	(39,762)	(1,306)	(14,128)	(2,467)	(349)	(58,012)
Operating (loss)/income	(17,193)	21,128	(8,262)	(16,799)	(30,183)	(51,309)

The reconciliation of segment operating income/(loss) to loss from continuing operations before income tax is as follows:

	2010	2009
Telecommunication Solutions	\$ 627	\$ (17,193)
Information Technologies Solutions	15,215	21,128
Microelectronic Solutions	11,050	(8,262)
Total segment operating income/(loss) for reportable segments	26,892	(4,327)
All other	7,738	(16,799)
Corporate	(19,854)	(30,183)
Interest expense, net	(71,442)	(51,873)
Foreign currency transactions losses	(890)	(3,167)
Gain on sale of associates	7,885	-
Equity in net income of investees	1,389	536
Other non-operating gains/(losses)	18	(9,282)
Consolidated loss from continuing operations before income tax	\$ (48,264)	\$ (115,095)

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As of December 31, 2010 and 2009, the total assets of reportable segments comprised the following:

	<u>2010</u>	<u>2009</u>
Telecommunication Solutions	\$ 811,389	\$ 909,279
Information Technologies Solutions	414,600	279,865
Microelectronic Solutions	739,448	711,430
Total for reportable segments	<u>1,965,437</u>	<u>1,900,574</u>
All Other	53,209	36,271
Corporate	561,989	562,812
Intersegment eliminations	(570,566)	(572,830)
Total assets	<u>\$ 2,010,069</u>	<u>\$ 1,926,827</u>

For the years ended December 31, 2010 and 2009, the Group's additions to property, plant and equipment and intangible assets, comprised the following:

	<u>2010</u>	<u>2009</u>
Telecommunication Solutions	\$ 18,747	\$ 54,708
Information Technologies Solutions	14,126	1,455
Microelectronic Solutions	37,577	45,139
Total for reportable segments	<u>70,450</u>	<u>101,302</u>
All Other	541	3,909
Corporate	1,131	1,564
Total additions to property, plant and equipment and intangible assets	<u>\$ 72,122</u>	<u>\$ 106,775</u>

Information about the Group's revenues attributed to different geographic areas for the years ended December 31, 2010 and 2009 is shown below. The revenue is attributed by the location of the registered office of the customer.

	<u>2010</u>	<u>2009</u>
Russia and CIS, except for Ukraine	\$ 671,593	\$ 450,716
Central and Eastern Europe	154,149	168,591
Greece	121,320	163,747
Ukraine	89,558	93,387
Middle East and Africa	56,997	37,643
Asia-Pacific region	55,567	79,795
Others	17,744	30,340
Total sales to external customers	<u>\$ 1,166,928</u>	<u>\$ 1,024,219</u>

As of December 31, 2010 and 2009, the Group's property, plant and equipment and intangible assets, net of accumulated depreciation and amortization plus goodwill, in respect of their geographical location were as follows:

	<u>2010</u>	<u>2009</u>
Russia and CIS, except for Ukraine	\$ 368,046	\$ 399,155
Ukraine	150,675	146,688
Greece	110,045	140,581
Czech Republic	52,420	37,334
Romania	12,161	14,913
Other	8,285	2,477
Total property, plant and equipment and intangible assets, net of accumulated depreciation and amortization plus goodwill	<u>\$ 701,632</u>	<u>\$ 741,148</u>

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24. RELATED PARTY TRANSACTIONS

The Group enters into related party transactions, such as for the sale of software and telecommunications equipment, sale of smart cards, and providing of services for implementation of systems integration with entities affiliated with the Group through common ownership. A majority of these transactions are executed in the normal course of business at customary rates established with third parties.

During the years ended December 31, 2010 and 2009, the Group entered into transactions with related parties as follows:

	2010	2009
Sales of software and telecommunication equipment	\$ 187,574	\$ 144,451
Systems integration	233,635	146,363
Sales of smart cards	46,720	34,250
Interest income	2,016	1,271
Interest expense	(14,623)	(24,239)
Operating services consumed	(3,090)	(4,827)
Other income	8,670	1,423

Sales of Software and Telecommunication Equipment

Mobile TeleSystems (“MTS”) – During the years ended December 31, 2010 and 2009, SITRONICS TS CR and SITRONICS TS entered into transactions with MTS, a subsidiary of Sistema, and its affiliates Mobile TeleSystems Belarus (“MTS Belarus”), Uzdurobita (“MTS Uzbekistan”) and MTS Ukraine (previously named “UMC”) for sales of communications software support systems and telecommunication equipment. Pursuant to these contracts, SITRONICS TS CR and SITRONICS TS sold software, equipment and related services for approximately \$119.9 million and \$112.4 million during the years ended December 31, 2010 and 2009, respectively. During the years ended December 31, 2010 and 2009, Intracom Telecom sold telecommunication equipment and provided installation services to MTS and its subsidiary K-Telecom for approximately \$29.0 million and \$10.4 million, respectively. During the year ended December 31, 2010 and 2009, Network Systems sold software products to MTS for approximately \$8.7 million and \$0.7 million respectively.

Comstar UTS – During the years ended December 31, 2010 and 2009, the Telecommunication Solutions segment companies entered into transactions with subsidiaries of Sistema currently comprising Comstar UTS. Pursuant to these contracts, the Telecommunication Solutions segment companies sold telecommunication equipment and rendered system maintenance services for approximately \$7.3 million and \$2.9 million during the years ended December 31, 2010 and 2009, respectively.

During the year ended December 31, 2010, Network Systems rendered system maintenance services to Comstar UTS for approximately \$3.5 million.

Other Subsidiaries of Sistema – During the years ended December 31, 2010 and 2009, the Telecommunication Solutions segment companies sold telecommunication equipment and rendered system maintenance services to Sistema Shyam TeleServices Ltd (subsidiary of Sistema) for approximately \$16.4 million and \$17.5 million, respectively.

Systems integration

During the years ended December 31, 2010 and 2009, the Telecommunication Solutions segment companies provided systems integration services to MTS and other Sistema subsidiaries and affiliates for \$202.7 million and \$141.9 million, respectively. Starting from 2010 SITRONICS Bashkortostan extensively expanded its business activity to the "Oil and energy" Business Unit of Sistema. System integration services provided by SITRONICS Bashkortostan to this unit in the year ended December 31, 2010 amounted to \$29.3 million.

Sales of Smart Cards

During the year ended December 31, 2010 and 2009, SITRONICS Smart Technologies sold smart cards to MTS for \$46.5 million and \$33.7 million, respectively.

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Interest Income

During the year ended December 31, 2010, the Group has earned \$0.4 million from deposits placed at MBRD. For the year ended December 31, 2010 the interest income on the loan provided to K-Telecom amounted to \$0.6 million. The remainder of the interest income was earned from different transactions with Sistema and its subsidiaries.

Interest Expense

During the years ended December 31, 2010 and 2009, the Group had several short-term and long-term loans outstanding with Sistema and its subsidiaries, including MBRD (Note 15). Interest expenses on these loans amounted to \$11.5 million and \$24.2 million for the years ended December 31, 2010 and 2009, respectively.

During the year ended December 31, 2010, Mikron received several long-term loans from SITRONICS-Nano (Note 16). Interest expense on these loans amounted to \$1.9 million in the year ended December 31, 2010.

During the years ended December 31, 2010 and 2009, Mikron entered into a capital lease agreement for equipment and vehicles with SITRONICS-Nano (Note 17). Interest expense in respect of the lease obligation for the years ended December 31, 2010 and 2009 amounted to \$1.3 million and \$nil, respectively.

Transactions and Balances with Intracom Holdings S. A.

During the year ended December 31, 2010, Intracom Telecom entered into transactions with subsidiaries and affiliates of Intracom Holdings S.A., its non-controlling shareholder. For the years ended December 31, 2010 and 2009, revenues from these transactions amounted to \$78.8 million and \$124.8 million, respectively. The corresponding balances of accounts receivable as of December 31, 2010 and 2009 comprised \$93.7 million and \$87.9 million, respectively. As of December 31, 2010 and 2009, the balances of advances received comprised \$0.1 million and \$1.1 million, respectively. In addition, Intracom Telecom's expenses for services consumed and inventories purchased from these entities amounted to \$16.3 million and \$20.2 million in the years ended December 31, 2010 and 2009, respectively. As of December 31, 2010 and 2009, trade and other payables to subsidiaries and affiliates of Intracom Holdings S.A. amounted to \$27.0 million and \$36.8 million, respectively.

25. COMMITMENTS AND CONTINGENCIES

Operating Leases

The Group leases land, buildings and vehicles from other parties through contracts, which expire in various years through 2019. Rental expenses under these leases were \$10.2 million and \$11.6 million for the years ended December 31, 2010 and 2009, respectively, and were included in operating expenses in the consolidated statements of operations and comprehensive loss.

Future minimum rental payments under operating leases in effect as of December 31, 2010, were as follows:

Year ended December 31,	
2011	7,121
2012	5,871
2013	1,593
2014	1,206
2015	1,020
Thereafter	6,000
Total	\$ <u>22,811</u>

Legal Proceedings

In the ordinary course of business, the Group may be party to various legal and tax proceedings, and be subject to claims. In the opinion of the management, the Group's liability, if any, in all pending litigation, other legal proceedings or other matters, will not have a material effect upon the financial condition, results of operations or liquidity of the Group.

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Import of Goods

The Telecommunication Solutions segment companies utilize third parties to import goods into the CIS countries. There is a risk that the third parties' import transactions may be challenged by regulatory authorities and would be determined as inappropriate. The impact that this determination may potentially have on the Group's net income and financial position cannot be quantified at this stage due to the lack of precedent for such determinations. No contingent liabilities have been recorded in the Group's financial statements in relation to these transactions.

Guarantees

SITRONICS did not issue any guaranties to third parties in 2010.

26. CONCENTRATIONS OF RISK

Credit Risks

During the years ended December 31, 2010 and 2009, the Group's sales to subsidiaries of Sistema and affiliates amounted to \$468.7 million and \$321.6 million, respectively, or 40.2% and 31.4% of the Group's consolidated revenues for the respective periods. The Group's trade receivables from subsidiaries of Sistema and affiliates as of December 31, 2010 and 2009 are disclosed in Note 6; the Group's cash and cash equivalents, short-term deposits and loans balances with subsidiaries of Sistema and affiliates are disclosed in Notes 4 and 5, respectively.

Intracom Telecom encounters a concentration of revenue and receivables among a few significant customers. Five customers in this entity accounted for revenues of \$152.3 million in the year ended December 31, 2010, which is 13.1% of the Group's consolidated revenues for this year.

Trade receivables from these customers amounted to \$72.7 million as of December 31, 2010.

Industry Risks

The industries in which the Group operates are characterized by rapid technological changes, competitive pricing pressures and cyclical market patterns. The Group's financial results are affected by a wide variety of factors, including the general economic conditions in the countries where the Group's entities operate, industry-specific economic conditions, the timely implementation of new manufacturing technologies, the ability to safeguard patents and intellectual property in rapidly evolving markets and reliance on vendors and independent distributors. The Group is exposed to the risk of obsolescence of its inventory depending on the mix of future business. As a result, the Group may experience significant period-to-period fluctuations in future operating results due to the factors mentioned above, or other factors.

Tax Risk

The Russian and Ukrainian economies, while deemed to be of market status, continue to display certain traits consistent with that of emerging markets. These characteristics have in the past included higher than normal inflation, insufficient liquidity of the capital markets, and the existence of currency controls. The continued success and stability of the Russian and Ukrainian economies will be subject to their respective governments' continued actions with regard to legal and economic reforms.

Russia and Ukraine currently have a number of laws related to various taxes imposed by governmental authorities. Applicable taxes include VAT, corporate income tax, and payroll taxes, together with others. The policies on implementation of these regulations are often inconsistent or nonexistent. Accordingly, few precedents with regard to tax rulings have been established. Tax declarations, together with other legal compliance areas (for example, customs and currency control matters), are subject to review and investigation by a number of authorities, which are enabled by law to impose extremely severe fines, penalties and interest charges. These facts create tax risks in Russia and Ukraine that are more significant than typically found in countries with more developed tax systems.

Management believes that it has adequately provided for tax liabilities in the Group's consolidated financial statements; however, the risk remains that relevant authorities could take a different position with regard to interpretive issues.

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Operating Environment and Financial Risks

From 2008 through 2009, the markets where the Group offers its products and services have been affected by the global economic crisis and the recession. The world economy returned to growth in 2010 but growth remains subdued and renewed stresses in the Eurozone area periphery are contributing to downside risks. In many emerging economies, activity remains buoyant, inflation pressures are emerging, and there are some signs of overheating, driven in part by strong capital inflows. The Group, as a leading provider of telecommunication solutions, including software, equipment and systems integration, IT solutions and microelectronic solutions in Russia and the CIS with a presence in Central and Eastern Europe, the Middle East and Africa will continue to be affected by the global economic trends. These changes may adversely affect the Group's access to capital and cost of capital, its business, results of operations, value of its assets, financial condition and prospects. Debtors of the Group may be affected by the lower liquidity situation which could in turn impact their ability to repay the amounts owed. Deteriorating operating conditions for debtors may also have an impact on management's cash flow forecasts and assessment of the impairment of financial and non-financial assets. An exposure to the risk of obsolescence of inventory may increase due to lower business activity, and reduced capital expenditures of clients. Change in the currency exchange rates may affect Group's consolidated financial position and results of operations.

As shown in the accompanying consolidated financial statements, the Group has incurred net losses of \$59.7 million and \$127.0 million in 2010 and 2009, respectively. The devaluation of currencies against the US dollar resulted in \$1 million and \$3 million of exchange losses in 2010 and 2009, respectively while the impact of the impairment of assets, bad debt expenses and other reserves amounted to \$16.5 million and \$94.4 million in 2010 and 2009, respectively. The primary components of these costs relate to the provision for bad debts in the Telecommunication Solutions and the Microelectronic Solutions segments and the impairment of inventory in the Telecommunication Solutions and the Microelectronic Solutions segments. The provisions for bad debts reflect the current estimation of collectability of the Group's outstanding receivables based on the impact of the economic downturn on the Group's customers. The management will continue to make efforts to collect the amounts which have been provided for.

The financing receivables portfolio, excluding trade receivables, as of December 31, 2010, is considered by management to be insignificant in amount, and therefore no specific analysis for credit quality was performed.

The impairment losses and reserves are presented in a separate line in the consolidated statements of operations and comprise as follows:

	<u>2010</u>	<u>2009</u>
Bad debt expense	\$ 9,447	\$ 54,627
Impairment of inventory	5,956	18,882
Impairment of property, plant and equipments	510	6,823
Impairment of short-term deposits, loans and other assets	562	14,055
Total	\$ <u>16,475</u>	\$ <u>94,387</u>

Management believes that the amount of provisions and reserves adequately reflects the future uncertainties related to the recoverability of Group assets and they believe they have taken all necessary steps to overcome the challenging market conditions. However, in the context of the current global economic environment, the degree of volatility could be very different from management's expectation. This may affect the financial position and results of operations of the Group.

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27. SUBSEQUENT EVENTS

Phantom stock options plan – In January 2011, SITRONICS' Board of Directors approved the key terms of the three-year stock option plan for senior and middle management of the Group in respect of the second part of the plan which starts from the beginning of 2011 (see Note 22). The participants are granted phantom shares, contingent on continued employment with the Group and other conditions. The quantity of phantom shares granted for 2011 equals to 8,993,479 phantom shares. The participants have a right to require the Group to purchase a certain amount of phantom shares at specific dates at a price equal to the average price of 1 GDR at the LSE 60 days prior to the end of the year multiplied by a respective quantity of phantom shares. In February 2011, the participants exercised 1,042,685 of phantom shares granted in 2010 with price equal to \$0.78 per phantom share (see also Note 22).

Contribution to the equity of SITRONICS-ZTE Ltd. – In January 2011, SITRONICS made cash contribution of \$3.1 million to the equity of its subsidiary, SITRONICS-ZTE Ltd. Ownership interest of SITRONICS did not change due to respective contribution of non-controlling shareholder. Total increase in equity of SITRONICS-ZTE Ltd. was \$6 million.

Borrowing from PROBUSBUSINESSBANK – In January 2011, SITRONICS Information Technologies refinanced the RUB-denominated unsecured loan agreement with PROBUSBUSINESSBANK (amount outstanding as of December 31, 2010 - \$0.2 million). The facility is limited to \$1.0 million, bears an interest rate of 11.5% per annum and matures in July 2011.

Bank of Moscow – In January 2011, SITRONICS increased the credit limit up to \$17.5 million on an existing RUB-denominated revolving credit facility agreement with Bank of Moscow bearing an interest rate of 3 month MOSPRIME+5% per annum (amount outstanding as of December 31, 2010 - \$nil). In April 2011, the amount withdrawn on the loan was \$10.5 million. The funds were borrowed for working capital financing. The facility is secured by the guarantees of Mikron, SITRONICS TS and SITRONICS Information Technologies and matures in November 2011.

Additional share issue of Mikron – In February and March 2011, Mikron issued 2,436,372 ordinary shares with a nominal value RUB 0.025. SITRONICS acquired 1,987,120 shares (81.6%) of the issued shares resulting in an ownership of 77.9%, for a consideration of \$40.9 million. The rest of the issue was purchased by a number of investors including state authorities.

Borrowing from SITRONICS-Nano – In February and March 2011, Mikron entered into a number of credit facility agreements with SITRONICS-Nano denominated in RUB, limited in aggregate to \$6.0 million. The drawdowns bear an interest rate of 14% per annum. The drawdowns mature at the end of 2017. The funds were borrowed to finance the construction and installation of the equipment necessary to launch 90 nanometer microchip production. As of March 2011, the outstanding amount under these agreements is unsecured and comprised \$6.0 million.

Approval of sale of Sistema's stake in SITRONICS to RTI Systems Concern – In March 2011, JSFC Sistema's Board of Directors approved the sale of Sistema's stake of approximately 63% in SITRONICS to JSC RTI Systems Concern, a subsidiary of Sistema, for \$0.9228 per GDR (based on the three-month weighted average price for GDR of SITRONICS on the LSE).

Letter of credit – In March 2011, Bank of Moscow and SITRONICS-Nano signed an agreement for issuance of a secured irrevocable letter of credit (L.C.) with post-financing in favor of STMicroelectronic N.V. for license and technology transfer to SITRONICS-Nano in the amount of EUR 27 million. The L.C. rate is EURIBOR+5% per annum and the term of contract is 3 years with potential extension for another 3 years. SITRONICS and Mikron acted as L.C. guarantors.

JSC Technological Centre Geoinformatica – In March 2011, SITRONICS sold its 1% stake in equity of JSC Technological Centre Geoinformatica to JSC RTI Systems Concern for a total cash consideration of \$2.6 thousand.

Borrowing from MBRD – In March 2011, JSC SITRONICS CAMS (former JSC SITRONICS-PARAVAN) entered into a RUB-denominated credit facility agreement with MBRD bearing an interest rate of 10.8% per annum and maturing on May 15, 2011. The amount withdrawn on the loan was \$11.0 million. The funds were borrowed to open a good performance deposit as required by government tender procedure. The facility is secured by the guarantee of SITRONICS.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEARS ENDED DECEMBER 31, 2010 AND 2009

(Amounts in thousands of U.S. dollars, except share amounts or if otherwise stated)

Borrowing from GENIKI BANK – SOCIETE GENERALE Group – In March 2011, Intracom Telecom repaid and refinanced the EUR-denominated unsecured loan agreement with GENIKI BANK – SOCIETE GENERALE Group (amount outstanding as of December 31, 2010 - \$15.2 million). The repayment was made in amount of \$0.7 million, and the rest of the loan was refinanced bearing an interest rate of three month EURIBOR+4.5% per annum and maturing in June 2011.

Borrowing from Alphabank – In March 2011, Intracom Telecom refinanced the EUR-denominated unsecured loan agreement with Alphabank amounting to \$6.6 million as of December 31, 2010. The facility matures in June 2011 and bears an interest rate of three month EURIBOR+4.8% per annum.

Interest Payment to Bondholders – In April 2011, SITRONICS made its first interest payment on the Bonds Series BO-02. The coupon rate comprised 10.75% per annum. The total amount of interest paid was RUB 160.7 million (\$5.7 million).

Management of the Group has evaluated subsequent events through April 12, 2011, the date when its financial statements were issued.