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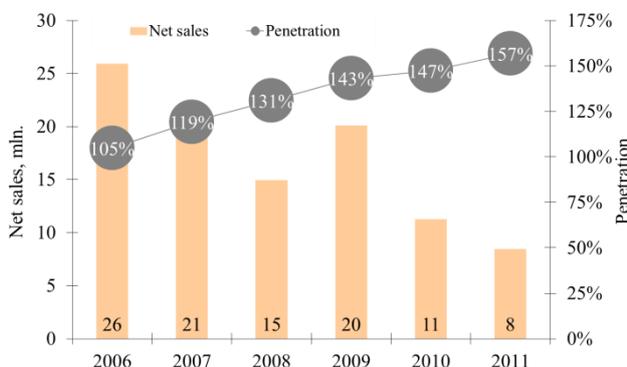
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RUSSIAN MOBILE SEGMENT: RECENT DEVELOPMENTS

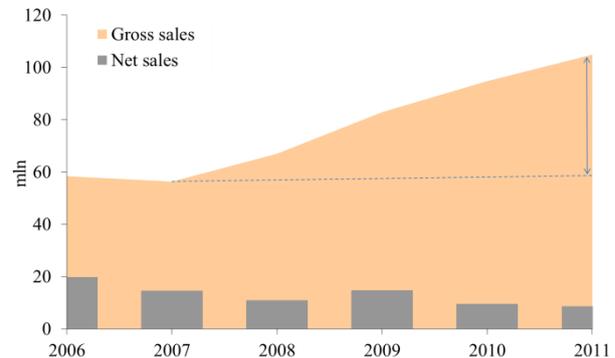
Russian telecom market appears to have exhausted its growth potential – after a quick recovery in 2009-2010, the total telecom service revenue in Russia entered stagnation phase with y-o-y growth rate below consumer price index (CPI) for the first time since 2008. And what is more discouraging – even in mobile industry the real revenue growth is only marginal – just about 1% y-o-y (assuming CPI in 2011 at 6.1%). Neither massive 3G roll-out, nor proliferation of wireless mobile internet produced any tangible positive effect on the combined revenue of the largest MNOs of Russia.

As stagnation becomes a reality for most of MNOs, there is a growing concern over enormous gap between net additions and gross sales. In 2011 Russian market expanded by 8 mln mobile accounts (in 2010 the increment was 11 mln, while in 2009 – 20 mln). In the same time combined gross sales of Russian mobile operators in 2011 exceeded 110 mln subscriptions, what implies a total annual churn of over 50%. Although there are fewer net subscriber additions on the Russian market, gross sales increased dramatically over the last 3-4 years.

Total net additions

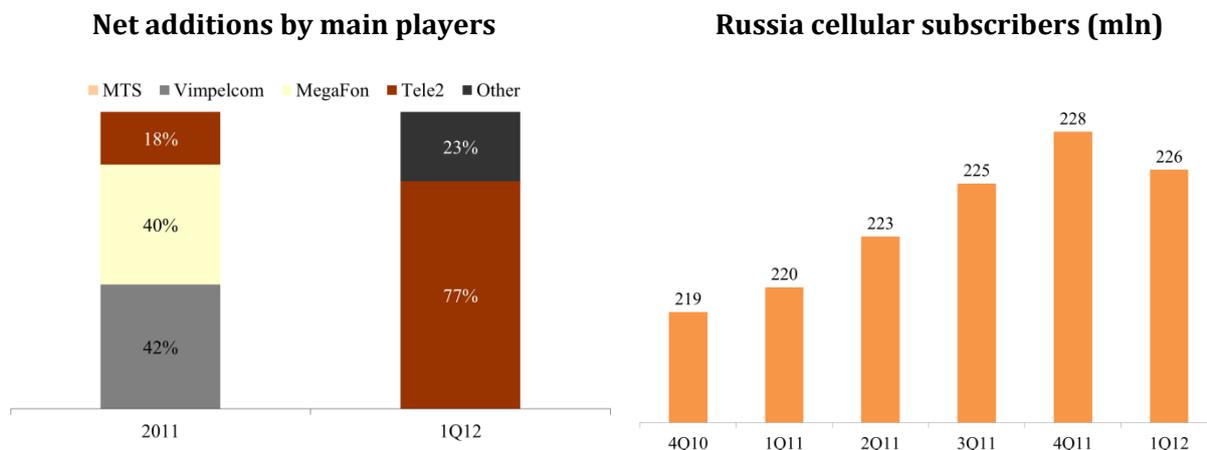


Net and gross additions

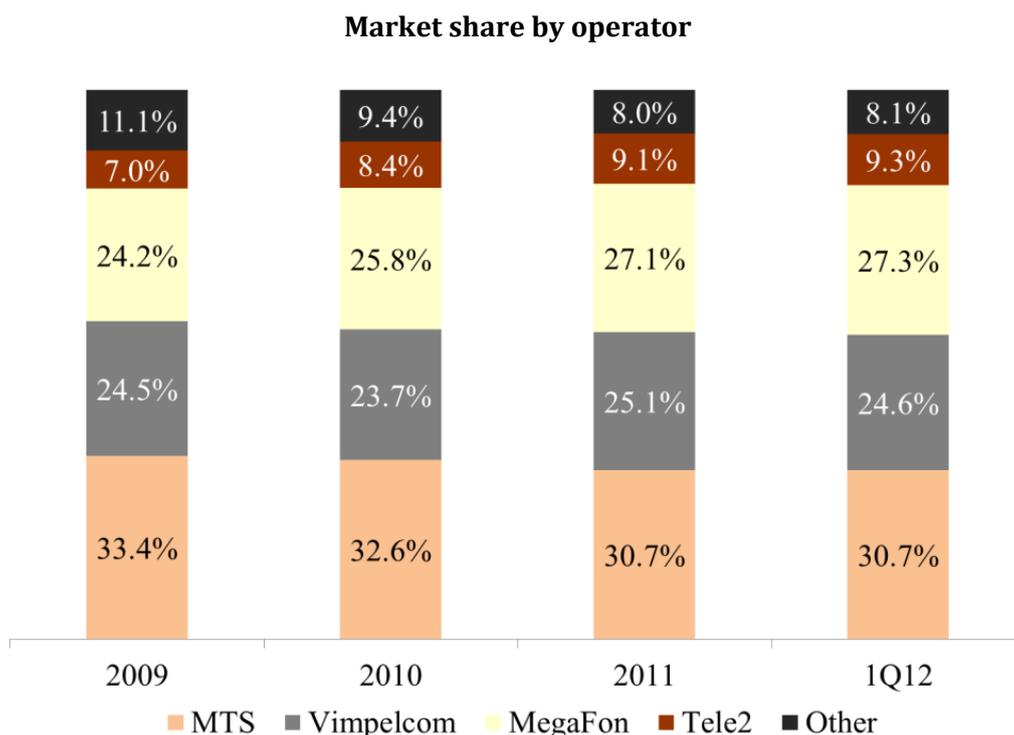


Obviously, the frantic subscriber acquisition process translates into zero incremental revenue and implies significant cost of sales to MNOs. Towards the end of 2011 Big Three operators undertook unprecedented measures to improve the “quality” of new sales – for example, they abandoned a one-off commission to indirect distribution channels such as independent mobile retail chains.

Instead, the resellers of SIM cards are now getting a share of the actual ARPU generated by newly-added subscribers during the first 6 months of their lifecycle.

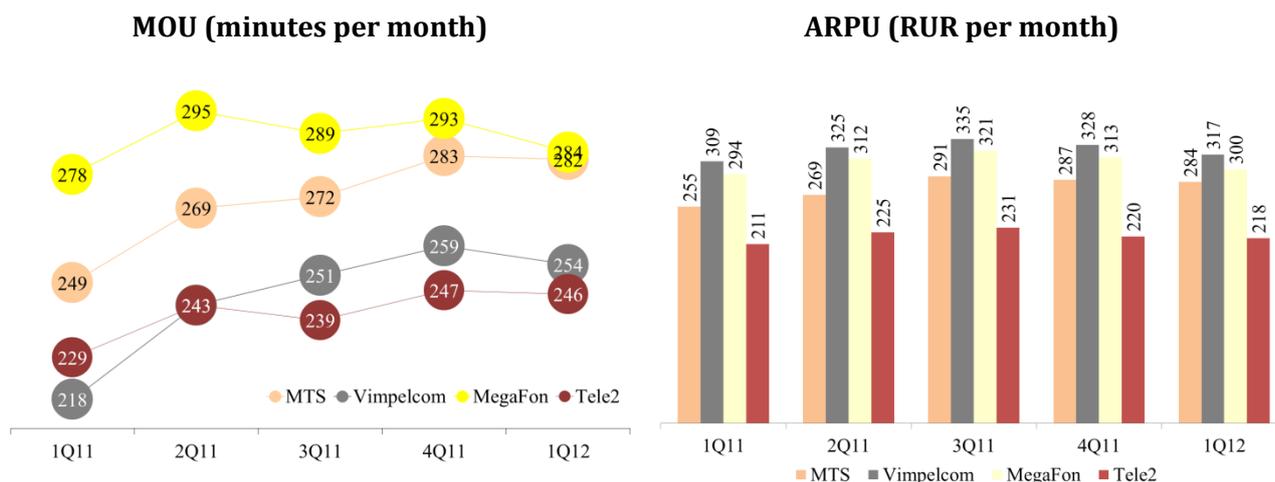


As a result of that action, **for the first time in the entire Russian cellular market history the overall reported cellular subscriber base decreased in 1Q2012.** The significant contraction of customers was observed in MTS, Vimpelcom and MegaFon networks while Tele2 and other regional players managed to demonstrate some positive intake.



Market shares in terms of subscribers remain rather stable without any significant dynamics: since 2009 MTS' market share contracted, Vimpelcom's – remained virtually unchanged while MegaFon and Tele2, being the most aggressive players on the market, expanded their shares a bit.

Russian mobile market continues to demonstrate some, albeit very marginal, increase in MOU. Overall the **increase in MOU illustrates an important trend – the shift towards tariff plans with free or heavily subsidized on-net voice traffic.**

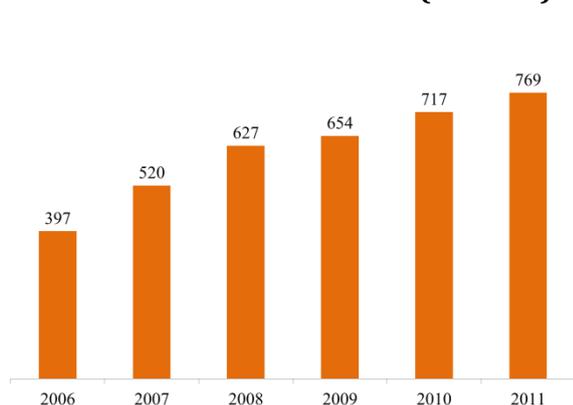


However, the demand for voice services reveals a relative inelasticity. The promotion of on-net offerings with a low (but cost-effective for operators) price per minute does not generate enough incremental usage able to offset the less cost-effective traffic and, consequently, improve operators' margins. So far the resulting effect of the "tariff rebalancing" is negative for "voice" (non-VAS) ARPU.

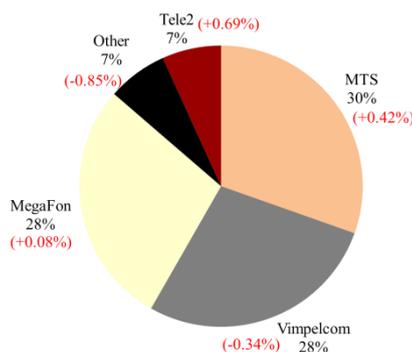
The observed decline in voice ARPU is compensated by a visible increase in mobile data usage and, therefore, growing data-related ARPU. The compound ARPU remains flat and the overall mobile service increment in 2011 was about 7% (in RUR terms) and 11% (in US\$).

MegaFon remains ahead of Vimpelcom in terms of mobile service revenue but only by a small margin. MTS managed to slightly improve its position revenue-wise. Tele2 is winning a market share thanks to aggressive geographic expansion. The combined share of other operators shrank mainly because one of the largest independent players, New Telephone Company, was acquired by Vimpelcom in 2011.

Russian Mobile Revenues (bln RUR)



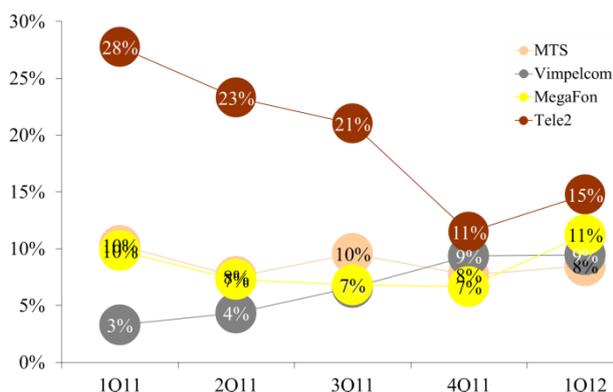
Market decomposition by revenue (2011)*



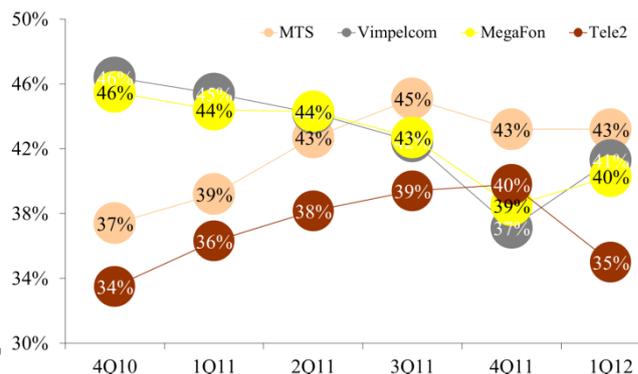
* excluding end-user equipment sales; (y-o-y growth)

All four largest MNOs demonstrated positive top-line trend in 2011. Nevertheless, one can identify difference in the growth rates displayed by MNOs: MegaFon's competitive advantage is fading away as MTS is catching up in 3G services – during 2011 MTS was persistent in expanding the coverage and building an equally impressive 3G footprint. Tele2 is leading in revenue growth rates: although in 4Q2011 the growth slowed down a bit to a figures close to the Big Three, in 1Q2012 Tele2 managed to achieve its y-o-y revenue growth rate visibly above the competition.

Service revenue growth y-o-y (RUR)



EBITDA margin*



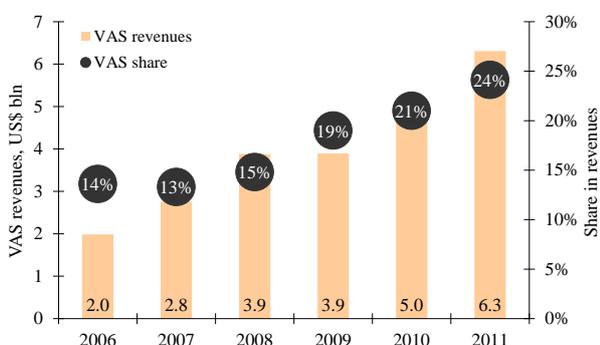
Note: consolidated EBITDA margin for MTS, Vimpelcom and MegaFon

After an abrupt decline in marginality (apparently because of consolidated “retail” business with very low margin as opposed to “service” part of business) MTS managed to improve EBITDA within the space of last four quarters. It was seemingly achieved at the expense of less aggressive sales and tighter churn policy. At the same time, Vimpelcom and MegaFon saw margin declining for 6 consecutive quarters (from 43% to 37% and from 44% to 39% respectively) and managed to recover in 1Q2012 only. Nevertheless, it is unlikely that capital market and shareholders will see EBITDA margin decline below 40% in the longer run. It is important to mention that Tele2 has been catching up with Big Three in terms of EBITDA margin. In the context of double digit revenue growth and active geographic expansion it is an outstanding case of high efficiency and dedication.

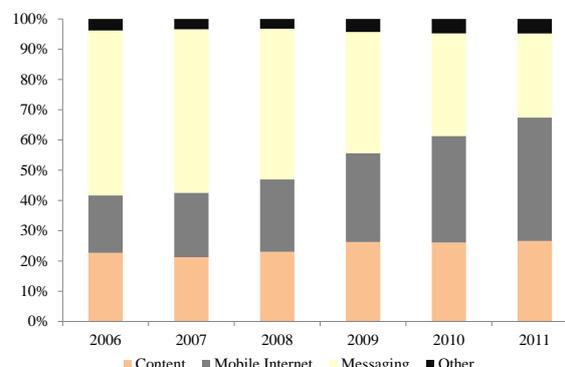
As the voice market “flattens-out”, the hopes of MNOs are associated mainly with the progress in value-added services and, particularly, mobile data. In 2011 VAS market expanded even faster than a year ago (23% y-o-y growth as opposed to 21% in 2010/2011). VAS contribution to the total revenue has increased to 24.1%.

The fastest growing VAS segment is mobile internet. In fact mobile internet remains one of the very few segments within the telecom industry where expansion of the customer base (about 15% y-o-y) takes place at the same time as average revenue per user also increases.

VAS revenue in Russia



VAS revenue decomposition in Russia



In absolute figures the mobile Internet access market in Russia exceeded RUR 75 bln in 2011 (about US\$ 2.5 bln) and literally almost came on par with the total residential broadband access market (between RUR 77 and 80 bln in 201, depending on revenue recognition standards).

Monthly audience of mobile Internet users reached 60 mln as of the end of 2011 (every fourth mobile service account or "SIM card in service"), while around 11 mln customers access Internet through USB-compatible portable modems, apparently for "large-screen" applications.

Interestingly enough, Tele2 is on par with the Big Three in terms of share of subscribers who use mobile Internet on a regular basis. Despite the fact that Tele2 does not possess UMTS license and, consequently, is unable to provide 3G access speed, around 40% of its subs are active users of the service.

There is hardly any doubt that MegaFon managed to become a dominant mobile Internet operator, thanks to the handicap in 3G coverage between themselves and the competition. In terms of traffic throughput it accounts for roughly half of the total mobile Internet traffic in Russia. Revenue-wise it has almost 40% of the market. Having stated this, MTS undertakes an unprecedented effort to try and abridge the gap.