

OPERATING & FINANCIAL REVIEW

Key financial highlights in 2012:

- Revenues up 7% year on year to RUB 321.3 billion
- OIBDA¹ up to RUB 118.6 billion
- OIBDA margin of 36.9% compared with 37.5% a year earlier (without taking into account the non-monetary effect on Q4 2011 results due to reduced long-term social obligations, as a result of a new labour contract signed by Rostelecom, its employees and the labour union in December 2011²).
- Net profit of RUB 35.2 billion (RAS net profit is used as a basis for dividend calculation on preferred shares up to RUB 32.7 billion).
- Capital expenditure³ of RUB 91.2 billion, representing 28.4% of consolidated revenues
- Net debt⁴ of RUB 203.1 billion with a net debt / OIBDA⁵ ratio of 1.7x as at December 31, 2012.

Financial summary

| RUB million | FY 2012 | FY 2011 | % change, y-o-y |
|----------------------------------|----------------|----------------|-----------------|
| Revenue | 321,251 | 301,494 | 7% |
| OIBDA | 118,554 | 117,712 | 1% |
| <i>OIBDA margin, %</i> | 36.9% | 39.0% | |
| Operating profit | 53,825 | 60,188 | (11%) |
| <i>Operating margin, %</i> | 16.8% | 20.0% | |
| Net profit | 35,240 | 42,527 | (17%) |
| <i>Net margin, %</i> | 11.0% | 14.1% | |
| Capital expenditures | 91,181 | 83,231 | 10% |
| <i>% of revenue</i> | 28.4% | 27.6% | |
| Net debt | 203,084 | 161,516 | 26% |
| <i>Net debt/annualized OIBDA</i> | 1.7x | 1.4x | |

¹ Here and below, please refer to Attachment 1 to this statement for a full definition of OIBDA

² The non-monetary effect was RUB 4.7 billion on OIBDA margin in Q4 2011 and in total in 2011 without taking into account the non-monetary effect on the result of Q4 2011, due to the reduced long-term social obligations, as a result of the new labour contract signed by Rostelecom, its employees and the labour union in December 2011, which made up 39% .

³ Here and below, capital expenditure ("CAPEX") comprises cash spent on purchase of property, plant and equipment and intangible assets

⁴ Here and below, net debt is calculated as the sum of long-term loans and short-term borrowings minus cash and cash equivalents and short-term investments

⁵ OIBDA for the last 12 months

Operating review

Revenue structure by services⁶

| RUB million | FY 2012 | FY 2011 | % change, y-o-y |
|---|----------------|----------------|-----------------|
| Local telephony services | 85,734 | 88,061 | (3%) |
| Intra-zone telephony services | 18,754 | 21,393 | (12%) |
| DLD/ILD telephony services | 20,390 | 24,070 | (15%) |
| Interconnection and traffic transit services | 21,003 | 19,774 | 6% |
| Broadband Internet | 49,797 | 46,396 | 7% |
| Pay TV | 9,147 | 6,706 | 36% |
| Mobile communication services | 41,161 | 40,660 | 1% |
| Data services (VPN, data centres, wholesale Internet sales) | 20,815 | 18,872 | 10% |
| Rent of channels | 11,269 | 10,365 | 9% |
| Cloud services | 6,625 | 2,764 | 140% |
| Other | 36,556 | 22,442 | 63% |
| Total revenue | 321,251 | 301,494 | 7% |

Revenue structure by customer segments

| RUB million | FY 2012 | FY 2011 | % change, y-o-y |
|------------------------|---------|---------|-----------------|
| Residential customers | 162,493 | 165,634 | (2%) |
| Corporate customers | 69,015 | 69,555 | (1%) |
| Governmental customers | 53,452 | 34,484 | 55% |
| Operators | 36,291 | 31,821 | 14% |

⁶ Effective from April 1, 2011, the methodological changes in the revenue structure include the following: 1) revenue from DLD/ILD traffic transit, which were previously included in the "DLD / ILD telephony services" reporting line, are now included in the "Interconnection and traffic transit services" reporting line; 2) revenue from mobile interconnection services, previously included in the "Interconnection and traffic transit services" reporting line, are now presented under "Mobile Communication Services"; 3) other methodological changes had no significant impact on the reporting structure

| RUB million | FY 2012 | FY 2011 | % change, y-o-y |
|----------------------|----------------|----------------|-----------------|
| Total revenue | 321,251 | 301,494 | 7% |

Rostelecom's revenue in 2012 reached RUB 321.3 billion, a 7% increase over 2011, achieved due to growth in cloud and IT service segments, but also from growth in revenue from providing broadband and pay-TV services.

This growth was partially offset by a decline in revenues from Domestic Long Distance and International Long Distance and intrazonal telephony services, which primarily reflected on-going changes in usage patterns for traditional fixed-line services.

Key operating indicators

| Number of Subscribers (millions): | FY 2012 | FY 2011 | % change, y-o-y |
|--|----------------|----------------|------------------------|
| Household passed | 33.8 | 32.0 | 6% |
| incl FTTx | 16.4 | 12.9 | 27% |
| Local telephony | 27.1 | 28.5 | (5%) |
| Mobile | 13.6 | 13.1 | 4% |
| Broadband Internet access incl. | 9.2 | 8.2 | 12% |
| • Residential | 8.5 | 7.6 | 12% |
| • Corporate | 0.7 | 0.6 | 9% |
| Pay TV incl. | 6.6 | 5.9 | 12% |
| • IPTV | 1.4 | 0.7 | 102% |
| Traffic, generated by residential and corporate subscribers ⁷ (billions of minutes) | | | |
| • Intra-zone | 2.4 | 2.7 | (11%) |
| • DLD | 1.2 | 1.3 | (13%) |
| • ILD | 0.1 | 0.1 | (13%) |

The number of households passed grew 6% year-on-year to 33.8 million⁸, including 16.4 million (or 48%) passed by FTTx technology. The number of broadband subscribers grew 12% compared to the equivalent period last year, rising to 9.2 million subscribers. The subscriber base in the broadband B2C segment grew 12% to 8.5 million, out of which, those connected by FTTx technology grew 1.6 times year-on-year to 2.8 million (that is 33% of the total subscriber

⁷ Excluding traffic, generated by other telecom operators

⁸ Calculated as the sum of total number of households passed by xDSL, FTTx and xPON technologies, excluding technology intersections.

base), representing the highest rate of growth in the Russian market. Rostelecom's share of the B2C broadband market was 40%.

The number of pay-TV subscribers grew 12% compared to the equivalent period last year, comprising 6.6 million subscribers. Of that total, the number of interactive TV subscribers more than doubled to 1.4 million, with the penetration optical networks making up 34%. Rostelecom's share of the Interactive TV market was 49%.

The number of mobile subscribers grew 4% compared with the equivalent period last year, rising to 13.6 million subscribers. The acquisition of SkyLink gave Rostelecom access to 3G licenses in 69 regions across Russia. As of the date of this annual report, 3G+ networks have been built and undergone testing in 24 Russian regions, with commercial launches taken place in 10 areas.

The number of subscribers to fixed-line local telephone services decreased year-on-year, due to changes in client preference in favour of mobile means of communication, although remaining significantly lower than for international peer companies.

Operating Expenses⁹ Structure

| RUB million | FY 2012 | FY 2011 | % change, y-o-y |
|---|----------------|----------------|-----------------|
| Personnel costs | 84,308 | 76,252 | 11% |
| Interconnection charges | 47,312 | 40,736 | 16% |
| Materials, repairs and maintenance, utilities | 27,358 | 27,507 | (1%) |
| Other operating income | (13,868) | (14,711) | (6%) |
| Other operating expenses | 57,587 | 53,998 | 7% |
| Total | 202,697 | 182,782 | 10% |

Operational expenditure, excluding depreciation and amortisation, in 2012 was RUB 202.7 billion, up 10% compared to the equivalent period last year, in the main part, due to:

- 11% growth in personnel expenditure compared to the equivalent period in 2011 to RUB 84.3 billion, due to the effect of the one-off reduction in long-term social obligations, as a result of a new labour contract signed by Rostelecom, its employees and the labour union in December 2011 by RUB 4.8 billion, the recruitment of commercial staff in the mobile segment, but also the creation of reserves for compensation due to employees as part of the 20% optimization of administrative personnel planned for 2013

⁹ Excluding depreciation and amortisation

- Increased expenditure on operator services by 16% year-on-year to RUB 47.3 billion, in connection with the increase in direct expenditure, which relates to the growth of the Company's profits.

The Company reported a FY 2012 OIBDA of RUB 118.6 billion with OIBDA margin 36.9%.

In 2012, depreciation and amortisation expenses rose 13% compared to 2011 to reach RUB 64.7 billion due to the video surveillance project for the Presidential elections and the commissioning of new fixed assets, specifically the construction of 3G+ networks.

In 2012, capital expenditure rose 10% overall compared to 2011, reaching RUB 91.2 billion. The 2012 increase in CAPEX primarily comprised of the maintenance of existing channels and the construction of new channels, to enable the video observation of the Presidential elections. Also, the modernization of broadband networks, the implementation of new IT systems, the launch of new services and the expansion of 3G+ networks required additional investment.

The Company reported an operating profit of RUB 53.8 billion for 2012, with operating margin of 16.8%.

The growth of financial expenditure in connection with the rise in gross debt was in part compensated by the positive effect of the exchange rate.

Profit before tax was RUB 44.0 billion for 2012, representing decreases of 17% on the equivalent period of 2011. This was for the most part due to the increase in amortization, but also as a result of the one-off decrease in expenditure from the pension plan in 4Q 2011.

The Company's rate of income tax in the full year 2012 decreased 18% compared to 2011 to RUB 8.8 billion. This change in income tax related to changes to pre-tax profit. The effective income tax-rate for whole 2012 year remained at 20%, in line with the Tax Code level of 20%.

The Group reported a net profit of RUB 35.2 billion for 2012.

Financial review

Net operating cash flow rose 13% by the end of 2012 to RUB 96.2 billion.

Net cash used for investment activities decreased 24% by the end of 2012 to RUB 87.5 billion. This decrease is linked to the use of investment funds in acquiring 71.8% of the shares in OAO NTK in 1Q 2011.

The decrease in the amount of net cash received from financial activity by the end of 2012 was linked to Rostelecom's acquisition of 3.86% ordinary shares in OOO Mobitel, but also the buyback of 28.2% of shares in OAO NTK.

The Group's total debt rose 24% year-on-year to RUB 214.4 billion. More than 98% of the Company's total debt was ruble-denominated as of 31st December 2012. Rostelecom's net debt, as of December 31, 2012, was RUB 203.1 billion, which is 1.7x and the Group's OIBDA margin as at the end of 2012.

CORPORATE GOVERNANCE

Rostelecom is governed by the Board of Directors and the Management Board. The Board of Directors is responsible for the strategic development, while the Management Board is responsible for implementing such strategies and overall management. There are no service contracts between Rostelecom and the Directors. There are no family relationships between any of the Directors and the members of the Management Board.

BOARD OF DIRECTORS & COMMITTEES

Pursuant to the Joint Stock Companies Law and Rostelecom charter, members of the Board of Directors are elected annually by a general meeting of shareholders. A person elected as a member of the Board of Directors may be re-elected an unlimited number of times. The business address for each of our Directors is 14, 1-st Tverskaya-Yamskaya Street, Moscow 125047, Russian Federation. As at the date of the annual report, the membership of the Board of Directors is set out below:

| Name | Date of Birth | Position | Since |
|-------------------------|----------------------|------------------------------------|--------------|
| Ivan I. Rodionov | November 30, 1953 | Chairman of the Board of Directors | May 2009 |
| Sergey A. Azatyan | May 4, 1979 | Director | June 2012 |
| Vladimir N. Bondarik | November 7, 1957 | Director | May 2009 |
| Anton S. Inshutin | March 20, 1974 | Director | June 2012 |
| Yury A. Kudimov | April 19, 1953 | Director | June 2010 |
| Sergey I. Kuznetsov | December 25, 1953 | Director | June 2011 |
| Mikhail A. Leshenko | March 20, 1975 | Director | June 2012 |
| Anatoly A. Milyukov | April 15, 1972 | Director | June 2011 |
| Alexander Y. Provotorov | November 7, 1974 | Director | May 2009 |
| Vadim V. Semenov | August 21, 1965 | Director | January 2011 |
| Anton A. Zlatopolsky | September 12, 1966 | Director | June 2011 |

All of the Directors were elected or re-elected on June 14, 2012 by the Company's annual general shareholders' meeting. The terms of appointment for each Director expire on the date of the next annual general shareholders' meeting of the Company.