



## Extraordinary General Meeting of Magyar Telekom Telekommunikations Public Limited Company's

21 December 2006. at 11.00 a.m.  
Headquarters of Magyar Telekom  
Budapest I., Krisztina krt. 55.

**Written documents of Magyar Telekom Plc's  
Extraordinary General Meeting of December 21<sup>st</sup>, 2006**

	Page
1. Report of the Board of Directors on the management of the Company, the business policy of Magyar Telekom Group and report on the business operations and the financial situation of Magyar Telekom Group in 2005 according to the requirements of the Accounting Act	3
2. Report of the Board of Directors on the business operations of the Company in 2005	19
3. Decision on the approval of the 2005 financial statements of the Company and on the release from liability of the members of the Board of Directors	31
4. Proposal of the Board of Directors for the use of the profit after tax earned in 2005	35
5. Election of the Company's Auditor and determination of its remuneration	39
6. Modification of the Articles of Association of Magyar Telekom Plc.	43
7. Report of the Supervisory Board about the 2005 operations of the Company and the Group	47

# Magyar Telekom Telecommunications Public Limited Company

## Submission for Magyar Telekom Plc.'s General Meeting

**Subject:** Report of the Board of Directors on the management of the Company, the business policy of Magyar Telekom Group and report on the business operations and the financial situation of Magyar Telekom Group in 2005 according to the requirements of the Accounting Act.

Budapest, december, 2006

Magyar Telekom Telecommunications  
Public Limited Company

# Consolidated Financial Statements

FOR THE YEAR ENDED DECEMBER 31, 2005

Prepared in accordance with  
International Financial Reporting Standards (IFRS)

**MAGYAR TELEKOM**  
**CONSOLIDATED BALANCE SHEETS**

	Notes	At December 31,		
		HUF		USD
		2004	2005	2005
		(in HUF millions)		(million USD) (unaudited) (note 2)
<b>ASSETS</b>				
<b>Current assets</b>				
Cash and cash equivalents .....	6	36,879	46,060	216
Other financial assets .....	7	576	1,817	9
Trade and other receivables .....	8	83,440	97,183	455
Current income tax receivable .....		3,549	452	2
Inventories .....	9	7,669	8,414	39
Assets held for disposal .....	10	3,063	2,302	11
<b>Total current assets</b> .....		<u>135,176</u>	<u>156,228</u>	<u>732</u>
<b>Non current assets</b>				
Property, plant and equipment – net .....	11	571,090	580,736	2,719
Intangible assets – net .....	12	298,351	319,797	1,497
Associates .....	14	5,750	5,020	23
Deferred taxes .....	26	12,527	14,966	70
Other non current assets .....	15	6,664	6,201	29
<b>Total non current assets</b> .....		<u>894,382</u>	<u>926,720</u>	<u>4,338</u>
<b>Total assets</b> .....		<u>1,029,558</u>	<u>1,082,948</u>	<u>5,070</u>
<b>LIABILITIES</b>				
<b>Current liabilities</b>				
Loans from related parties .....	17	60,000	74,648	350
Loans and other borrowings – third party .....	17	34,538	43,602	204
Trade and other payables .....	18	109,921	119,464	559
Current income tax payable .....		52	1,472	7
Deferred revenue .....	19	1,502	918	4
Provision for liabilities and charges .....	20	15,537	6,817	32
<b>Total current liabilities</b> .....		<u>221,550</u>	<u>246,921</u>	<u>1,156</u>
<b>Non current liabilities</b>				
Loans from related parties .....	17	177,675	212,000	993
Loans and other borrowings – third party .....	17	48,395	14,215	67
Deferred revenue .....	19	1,186	267	1
Deferred taxes .....	26	1,280	3,189	15
Provision for liabilities and charges .....	20	2,761	3,141	15
Other non current liabilities .....	18	47	5,521	26
<b>Total non current liabilities</b> .....		<u>231,344</u>	<u>238,333</u>	<u>1,117</u>
<b>Total liabilities</b> .....		452,894	485,254	2,273
<b>EQUITY</b>				
<b>Shareholders' equity</b>				
Common stock .....		104,281	104,281	488
Additional paid in capital .....		27,382	27,382	128
Treasury stock .....		(3,842)	(1,926)	(9)
Cumulative translation adjustment .....		(3,026)	(420)	(2)
Retained earnings .....		391,772	398,250	1,864
<b>Total shareholders' equity</b> .....		<u>516,567</u>	<u>527,567</u>	<u>2,469</u>
Minority interests .....		60,097	70,127	328
<b>Total equity</b> .....		<u>576,664</u>	<u>597,694</u>	<u>2,797</u>
<b>Total liabilities and equity</b> .....		<u>1,029,558</u>	<u>1,082,948</u>	<u>5,070</u>

These consolidated financial statements were authorized for issue by the Board of Directors on December 5, 2006 and signed on their behalf by:

Elek Straub  
Chairman and Chief Executive Officer

Thilo Kusch  
Chief Financial Officer

The accompanying notes form an integral part of these consolidated financial statements.

**MAGYAR TELEKOM**

**CONSOLIDATED INCOME STATEMENTS**

	Notes	For the year ended December 31,			
		HUF			USD
		2003	2004	2005	2005
		(in HUF millions, except per share amounts)			(million USD) (unaudited) (note 2)
Fixed line services .....	21	358,655	334,174	331,062	1,550
Mobile services .....	22	248,597	267,264	289,635	1,356
<b>Total revenues</b> .....		<u>607,252</u>	<u>601,438</u>	<u>620,697</u>	<u>2,906</u>
Employee related expenses .....	23	(87,920)	(109,497)	(92,783)	(434)
Depreciation and amortization .....		(128,334)	(137,666)	(114,686)	(537)
Payments to other network operators .....		(84,449)	(87,580)	(89,097)	(417)
Cost of telecommunications equipment sales .....		(40,811)	(40,971)	(37,221)	(174)
Other operating expenses – net .....	24	(143,674)	(140,460)	(153,522)	(720)
<b>Total operating expenses</b> .....		<u>(485,188)</u>	<u>(516,174)</u>	<u>(487,309)</u>	<u>(2,282)</u>
<b>Operating profit</b> .....		122,064	85,264	133,388	624
Net financial expenses .....	25	(40,002)	(36,146)	(31,288)	(146)
Share of associates' profits/losses after tax .....	14	795	1,896	330	1
<b>Profit before income tax</b> .....		82,857	51,014	102,430	479
Income tax .....	26	(13,517)	(7,687)	(13,511)	(63)
<b>Profit for the year</b> .....		<u>69,340</u>	<u>43,327</u>	<u>88,919</u>	<u>416</u>
<b>Attributable to:</b>					
Equity holders of the Company (Net income) .....		57,475	34,641	78,564	368
Minority interests .....		11,865	8,686	10,355	48
		<u>69,340</u>	<u>43,327</u>	<u>88,919</u>	<u>416</u>
<b>Earnings per share (EPS) information:</b>					
Profit attributable to the equity holders of the Company		57,475	34,641	78,564	368
Weighted average number of common stock outstanding (thousands) used for basic EPS .....		1,037,912	1,037,912	1,038,803	
Average number of dilutive share options (thousands) .....		122	318	417	
Weighted average number of common stock outstanding (thousands) used for diluted EPS .....		1,038,034	1,038,230	1,039,220	
Basic earnings per share (HUF and USD) .....		55.38	33.38	75.63	0.35
Diluted earnings per share (HUF and USD) .....		55.37	33.37	75.60	0.35

The accompanying notes form an integral part of these consolidated financial statements.

**MAGYAR TELEKOM**

**CONSOLIDATED CASHFLOW STATEMENTS**

		<b>For the year ended December 31,</b>			
		<b>HUF</b>			<b>USD</b>
Notes	2003	2004	2005	2005	
		(in HUF millions)			(million USD) (unaudited) (note 2)
<b>Cashflows from operating activities</b>					
	27	240,497	234,681	236,937	1,110
		(30,063)	(34,030)	(31,078)	(146)
		(12,318)	(10,900)	(4,523)	(21)
		<b>198,116</b>	<b>189,751</b>	<b>201,336</b>	<b>943</b>
<b>Cashflows from investing activities</b>					
	13	(90,788)	(91,748)	(103,587)	(485)
	5	(7,992)	(17,273)	(35,927)	(168)
	5	61	16	1,866	9
		908	1,452	2,195	10
		575	2,633	1,729	8
		266	43	(371)	(2)
		2,269	4,090	2,529	12
		<b>(94,701)</b>	<b>(100,787)</b>	<b>(131,566)</b>	<b>(616)</b>
<b>Cashflows from financing activities</b>					
		(23,507)	(78,294)	(84,551)	(396)
		192,057	338,680	263,329	1,233
		(260,583)	(332,481)	(242,595)	(1,136)
		(3,842)	-	-	-
		3,842	-	1,969	9
		(2)	-	-	-
		<b>(92,035)</b>	<b>(72,095)</b>	<b>(61,848)</b>	<b>(290)</b>
		1,901	(2,122)	1,259	6
		<b>13,281</b>	<b>14,747</b>	<b>9,181</b>	<b>43</b>
		8,851	22,132	36,879	173
	6	22,132	36,879	46,060	216

The accompanying notes form an integral part of these consolidated financial statements.

**MAGYAR TELEKOM**

**CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY**

Attributable to the equity holders of the Company

	Shares of common stock (a)	Common stock	Additional paid in capital	Treasury stock	Cumulative translation adjustment	Retained earnings (i)	Minority interest	Total equity
<b>Balance at December 31, 2002</b>	1,042,811,600	104,281	27,382	(4,488)	(4,348)	393,317	59,436	575,580
.....								
Dividend (g) .....						(18,682)		(18,682)
Dividend declared to minority interest (h) .....							(4,796)	(4,796)
Business combinations (b) .....							(2,424)	(2,424)
Sale of treasury stock (c) .....				4,488		(646)		3,842
Purchase of treasury stock (c) ...				(3,842)				(3,842)
Cumulative Translation Adjustment					5,173		6,193	11,366
Profit for the year .....						57,475	11,865	69,340
<b>Balance at December 31, 2003</b>	1,042,811,600	104,281	27,382	(3,842)	825	431,464	70,274	630,384
.....								
Dividend (g) .....						(72,654)		(72,654)
Dividend declared to minority interest (h) .....							(5,651)	(5,651)
Business combinations (b) .....							(9,109)	(9,109)
Purchase of investment in T-Systems Hungary (d) .....						(1,679)		(1,679)
Cumulative Translation Adjustment					(3,851)		(4,103)	(7,954)
Profit for the year .....						34,641	8,686	43,327
<b>Balance at December 31, 2004 as reported</b>	1,042,811,600	104,281	27,382	(3,842)	(3,026)	391,772	60,097	576,664
.....								
Effect of adoption of changes in IAS 39 – net of tax (note 2(e)) .....						(733)		(733)
<b>Balance at December 31, 2004 as restated</b>	1,042,811,600	104,281	27,382	(3,842)	(3,026)	391,039	60,097	575,931
.....								
Dividend (g) .....						(72,654)		(72,654)
Dividend declared to minority interest (h) .....							(11,913)	(11,913)
Business combinations (b) .....							9,447	9,447
Sale of Telit to DeTe Immobilien (d) .....						495		495
TSP's capital injection in TSH (d)						669		669
Sale of treasury stock (e) .....				1,916		53		1,969
Effect of fair value of share based payments (f) .....						84		84
Cumulative Translation Adjustment					2,606		2,141	4,747
Profit for the year .....						78,564	10,355	88,919
<b>Balance at December 31, 2005</b>	1,042,811,600	104,281	27,382	(1,926)	(420)	398,250	70,127	597,694
.....								
Of which treasury stock .....	(2,456,659)							
<b>Shares of common stock outstanding at December 31, 2005</b>	1,040,354,941							

The accompanying notes form an integral part of these consolidated financial statements.



## MAGYAR TELEKOM

### CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY (notes)

- (a) In addition to the 1,042,811,600 issued shares of common stock (nominal value of HUF 100), total shareholders' equity includes one Series "B" preference share at the nominal value of HUF 10,000 at December 31, 2005. This Series "B" share is held by the Ministry of Informatics and Communications, and bestows certain rights on its owner, including access to information, and the appointment of a Director. This share may only be held by the Government or its nominee. The number of authorized shares on December 31, 2005 is 1,054,911,600.
- (b) Business combinations include the change in minority interests due to acquisitions. In case of new acquisitions where Magyar Telekom acquires a less than 100 percent stake, minority interests increase. Minority interests decrease where Magyar Telekom acquires further share of ownership in subsidiaries already consolidated.
- (c) Due to statutory requirements the Company sold and repurchased its 4,900,000 shares of common stock in 2003 for HUF 3,842 million, which resulted in a loss of HUF 646 million recognized in retained earnings.
- (d) Related party transactions

In 2004 Magyar Telekom acquired a 49% share of ownership in T-Systems Hungary (TSH), since which time TSH is an associate of Magyar Telekom Group. As both Magyar Telekom and TSH belong to the Deutsche Telekom group, the ultimate parent of Magyar Telekom, the transaction is considered as being between entities under common control. As a result, the difference between the carrying value of this investment in T-Systems International's books (HUF 1,751 million) and the purchase price (HUF 3,430 million) was accounted for directly against the retained earnings of the Group.

In 2005 Magyar Telekom sold its investment in Telit Rt., the real estate outsourcing company of Magyar Telekom to DeTe Immobilien, a Deutsche Telekom group member. As the transaction took place between entities under common control, the gain on the sale of the investment was recognized directly in retained earnings.

In 2005 T-Systems International (TSI) forgave a loan given to T-Systems Hungary (TSH) in an amount of HUF 1,366 million of which HUF 669 appears as an increase in Magyar Telekom's share of TSH's net assets on equity consolidation as TSH is an associated company of the Group. As all three parties are part of the Deutsche Telekom group and the transaction took place between entities under common control, the increase in Magyar Telekom's investment in TSH was recognized directly in retained earnings.

- (e) In 2005 Magyar Telekom's CEO and other managers exercised some of their share options, and the Company used its treasury shares reserved for the option programs. As a result of these transactions, the Company sold 2,443,341 of its treasury shares to the CEO and other managers at the fixed option prices. On the sale of the treasury shares the Company recognized a gain of HUF 53 million, which was recognized in retained earnings. For more details on the programs see note 28.
- (f) In 2005 Magyar Telekom adopted IFRS 2 – Share-based payment, which requires the Company to recognize the cost of the equity-settled share-based payments against retained earnings. In 2005 the Company accounted for HUF 84 million of such expenses. For more details see note 28.
- (g) In 2005 Magyar Telekom Plc. declared and paid HUF 70 dividend per share (HUF 70 in 2004, HUF 18 in 2003).
- (h) The dividend declared to minority interest almost entirely reflects the dividend declared by Maktel, Magyar Telekom's Macedonian subsidiary to its minority shareholders.
- (i) The distributable reserves of the Company under Hungarian law at December 31, 2005 amounted to approximately HUF 282,000 million (HUF 283,000 million at December 31, 2004).

The accompanying notes form an integral part of these consolidated financial statements.

## **Investigation into certain consultancy contracts**

On February 13, 2006, the Company announced that it was investigating certain contracts to determine whether they were entered into in violation of Company policy or applicable law or regulation. Concerns regarding two consultancy contracts entered into by one of the Company's subsidiaries were initially raised by the Company's auditors. As a result of the investigation, two additional consultancy contracts, which were entered into by the Company, have been called into question. The total amount of the four contracts under investigation is around HUF 2 billion. Concerns have also arisen regarding destruction by certain employees of electronic documents obstructing the investigation. As a consequence of the investigation, the Company had suspended a number of employees who have since resigned. The investigation, which is being conducted by an independent law firm and supervised by the Audit Committee, is still ongoing.

Although the investigation has not been finalized, based on the independent investigators' findings and conclusions to date, these contracts were entered into without full compliance with internal company procedures regarding the entry of such contracts. Moreover, sufficient evidence could not be obtained that adequate value was received under these contracts. In its 2005 preliminary results announcement the Company had capitalized the HUF 1.12 billion payment made related to two of these contracts. As a result of the findings of the investigation, the Company has expensed the total amount of the HUF 2 billion paid under these four contracts, and discloses these expenses under the caption "Other operating expenses – net." See Note 23. This has resulted in a commensurate effect on, among others, taxes, minority interest and net income when compared to what was reported in the Company's 2005 preliminary results announcement.

The Company has already implemented certain remedial measures designed to enhance its control procedures with respect to the entry into consultancy contracts, including the introduction of a new governance model and replacement of the Board of Directors at Crnogorski Telekom and termination of work contracts with employees initiating data deletions interfering with the investigation.

The Company's Board of Directors also approved on November 8, 2006 a more extensive program of remedial actions, which it expects to implement in the near future. These decisions include structural and procedural changes in relation to mergers and acquisitions and procurement as well as a new internal control regime. The Company's Board of Directors also decided on December 5, 2006 on certain additional enhancements of internal controls and the implementation thereof.

As a result of the delays in finalizing its 2005 financial statements as a result of the investigation, the Company and some of its subsidiaries have failed and may fail to meet certain deadlines prescribed by the Hungarian and other applicable laws and regulations for preparing and filing audited annual results and holding annual general meetings. The Company has already been fined HUF 12 million as a consequence of such delays. The Company has notified the Hungarian Financial Supervisory Authority, the U.S. Securities and Exchange Commission and the U.S. Department of Justice of the investigation and is in contact with these authorities regarding the investigation and has responded to a number of inquiries these authorities have raised.

**Magyar Telekom Telecommunications Company Plc.**

**Submission  
for Magyar Telekom Plc.'s General Meeting**

**Subject:** Report of the Board of Directors on the business operations of the Company in 2005

Budapest, December, 2006

Magyar Telekom Plc.

MAGYAR TELEKOM TELECOMMUNICATIONS  
PUBLIC LIMITED COMPANY

BALANCE SHEET AND PROFIT AND LOSS STATEMENT  
TO THE 2005 ANNUAL REPORT

(All amounts in millions of HUF)

ASSETS

	Note	December 31, 2004	Self-revision	December 31, 2005
<b>A. FIXED ASSETS AND FINANCIAL INVESTMENTS</b>		<b>816 037</b>	<b>-8</b>	<b>842 373</b>
<b>I. Intangible assets</b>	4	<b>185 679</b>	<b>-3</b>	<b>180 411</b>
Capitalised costs of foundation and restructuring		0	0	0
Capitalised costs of research and development		0	0	0
Rights		1 138	0	18 238
Intellectual property		13 837	-3	1 558
Goodwill		170 704	0	160 615
Advance payments on intangible assets		0	0	0
<b>II. Tangible assets</b>	5	<b>357 632</b>	<b>-5</b>	<b>338 114</b>
Land and buildings and related rights		207 039	39	204 716
- Land		2 404	27	2 298
- Buildings		40 968	5	39 334
- Telecommunication network		153 829	3	153 969
- Other properties		8 385	3	8 108
- Real estate related rights		1 453	1	1 007
Technical equipment, machinery and vehicles		134 085	133	117 730
- Telecommunication equipment and machinery		133 112	133	116 718
- Other technical equipment, machinery and vehicles		973	0	1 012
Other equipment and vehicles		8 042	49	6 290
Construction-in-progress, renovation		8 466	-226	9 378
Advance payments on construction-in-progress		0	0	0
<b>III. Financial investments</b>		<b>272 726</b>	<b>0</b>	<b>323 848</b>
Non current investments in affiliated companies	6	188 994	0	230 147
Non current loans granted to affiliated companies	7	79 000	0	89 141
Other investments	8	20	0	0
Other non current loans granted	9	4 712	0	4 560
Non current bonds and other securities		0	0	0
<b>B. CURRENT ASSETS</b>		<b>83 100</b>	<b>175</b>	<b>70 773</b>
<b>I. Inventories</b>	10	<b>2 235</b>	<b>-8</b>	<b>2 862</b>
Raw materials		1 291	0	884
Work in progress and semi-finished products		0	0	0
Finished products		0	0	0
Goods available for sale		944	-8	1 978
Advance payments on inventories		0	0	0
<b>II. Receivables</b>		<b>76 137</b>	<b>183</b>	<b>64 312</b>
Accounts receivable	11	18 671	82	22 225
Receivables from affiliated companies	12	50 208	0	36 410
Bills receivable		0	0	0
Receivables from other related companies		30	98	36
Other receivables	13	7 228	3	5 641
<b>III. Securities</b>	14	<b>3 842</b>	<b>0</b>	<b>1 926</b>
Investments in affiliated companies		0	0	0
Other investments		0	0	0
Treasury stock, quotas		3 842	0	1 926
Marketable securities		0	0	0
<b>IV. Liquid assets</b>		<b>886</b>	<b>0</b>	<b>1 673</b>
Cash and cheques		3	0	5
Bank deposits		883		1 668
<b>C. PREPAYMENTS</b>	15	<b>11 163</b>	<b>-14</b>	<b>10 320</b>
Accrued income		10 754	-14	9 960
Prepayments for costs and expenses		409	0	360
Deferred expenses		0	0	0
<b>TOTAL ASSETS</b>		<b>910 300</b>	<b>153</b>	<b>923 466</b>

Budapest, December 5, 2006

Straub Elek  
Chairman and Chief Executive Officer

Thilo Kusch  
Chief Financial Officer

## BALANCE SHEET AS OF DECEMBER 31, 2005

(All amounts in millions of HUF)

LIABILITIES AND OWNER'S EQUITY

	Note	December 31, 2004	Self-revision	December 31, 2005
<b>D. SHAREHOLDER'S EQUITY</b>	16	<b>371 724</b>	<b>186</b>	<b>440 000</b>
I. Common stock		104 281	0	104 281
- of this treasury stock at par value		490	0	246
II. Unpaid share capital (-)		0	0	0
III. Capital reserves		52 837	0	52 837
IV. Retained earnings		210 764	0	212 866
V. Restricted reserves		3 842	0	1 926
VI. Valuation reserves		0	0	0
VII. Net income		0	186	68 090
<b>E. PROVISIONS</b>	17	<b>13 516</b>	<b>0</b>	<b>4 307</b>
Provision for expected obligations		13 345	0	4 183
Provision for expected expenses		165	0	124
Other provisions		6	0	0
<b>F. LIABILITIES</b>		<b>498 406</b>	<b>184</b>	<b>454 331</b>
I. Subordinated liabilities		0	0	0
II. Non current liabilities		<b>225 068</b>	<b>0</b>	<b>230 605</b>
Non current credits		0	0	0
Convertible bonds		0	0	0
Debt from issuance of bonds		127	0	124
Investment and development loans	18	47 266	0	13 125
Other non current loans		0	0	0
Non current liabilities to affiliated companies		0	0	0
Non current liabilities to other affiliated companies	19	177 675	0	212 000
Other non current liabilities		0	0	5 356
III. Current liabilities		<b>273 338</b>	<b>184</b>	<b>223 726</b>
Current loans		72	0	71
- of this convertible bonds		0	0	0
Current credits	20	34 156	0	41 913
Advances received		708	22	606
Accounts payable		20 372	0	19 499
Bills of exchange payable		0	0	0
Current liabilities to affiliated companies	21	74 598	0	73 399
Current liabilities to other affiliated companies	22	60 000	0	74 678
Other current liabilities	23	83 432	162	13 560
- of this dividends payable		72 654	0	0
<b>G. ACCRUED EXPENSES</b>	24	<b>26 654</b>	<b>-217</b>	<b>24 828</b>
Deferred income		2 072	0	2 502
Accrued expenses		24 295	-217	21 804
Other deferred revenue		287	0	522
<b>TOTAL LIABILITIES AND SHAREHOLDER'S EQUITY</b>		<b>910 300</b>	<b>153</b>	<b>923 466</b>

Budapest, December 5, 2006

Straub Elek  
Chairman and Chief Executive Officer

Thilo Kusch  
Chief Financial Officer

Magyar Telekom Plc.  
INCOME STATEMENT FOR THE PERIOD ENDED 31 DECEMBER, 2005  
(All amounts in millions of HUF)

	Note	2004	Self-revision	2005
1. Domestic sales	25	253 878	76	237 079
2. Export sales	26	12 368	50	12 060
<b>I. Sales revenues</b>		<b>266 246</b>	<b>126</b>	<b>249 139</b>
3. Change in self-manufactured inventories		0	0	0
4. Capitalised value of self-manufactured assets		11 315	0	12 915
<b>II. Own work capitalized</b>		<b>11 315</b>	<b>0</b>	<b>12 915</b>
<b>III. Other revenues</b>	27	<b>7 198</b>	<b>9</b>	23 184
of which: reversal of write-down for assets		573	0	388
5. Costs of raw material		14 132	-2	15 858
6. Costs of services	29	53 960	-207	59 593
7. Costs of other services		2 271	-4	2 151
8. Cost of goods sold		4 005	-3	4 271
9. Costs of services sold (intermediated)	30	52 929	-8	41 813
<b>IV. Material-type expenditures</b>		<b>127 297</b>	<b>-224</b>	<b>123 686</b>
10. Salaries and wages	31	35 722	0	32 552
11. Other payroll related costs	31	11 668	22	12 942
12. Payroll related contributions		14 280	-6	13 733
<b>V. Payroll and related expenditures</b>		<b>61 670</b>	<b>16</b>	<b>59 227</b>
<b>VI. Depreciation</b>		<b>66 812</b>	<b>13</b>	64 097
<b>VII. Other expenditures</b>	33	<b>31 847</b>	<b>140</b>	16 914
of which: write-down for assets		8 365	0	2 769
<b>A. PROFIT FROM OPERATING ACTIVITIES</b>		<b>-2 867</b>	<b>190</b>	<b>21 314</b>
13. Dividends and profit sharing (received or due)		70 770	0	68 429
of which: received from affiliated companies		70 770	0	68 429
14. Foreign exchange gains on sale of investments		150	0	497
of which: received from affiliated companies		0	0	0
15. Interest income and f/x gains on financial investments		10 813	0	7 051
of which: received from affiliated companies		10 805	0	7 044
16. Other interest income received		4 174	0	3 171
of which: received from affiliated companies		3 779	0	3 015
17. Other revenues on financial activities		659	0	4 476
<b>VIII. Revenues from financial transactions</b>		<b>86 566</b>	<b>0</b>	<b>83 624</b>
18. Foreign exchange loss on the sale of financial investments		78	0	0
of which: related to affiliated companies		0	0	0
19. Interest expense		35 150	0	31 702
of which: related to affiliated companies		694	0	643
related to other affiliated company		23 271	0	24 793
20. Write-down for investments, securities and bank deposits		0	0	0
21. Other expenses on financial activities		6 289	0	576
<b>IX. Expenditures from financial transactions</b>		<b>41 517</b>	<b>0</b>	<b>32 278</b>
<b>B. FINANCIAL RESULTS</b>	34	<b>45 049</b>	<b>0</b>	<b>51 346</b>
<b>C. INCOME FROM ORDINARY ACTIVITIES</b>		<b>42 182</b>	<b>190</b>	<b>72 660</b>
<b>X. Extraordinary revenues</b>	35	<b>3 476</b>	<b>1</b>	2 013
<b>XI. Extraordinary expenditures</b>	36	<b>6 630</b>	<b>5</b>	6 583
<b>D. NET INCOME ON EXTRAORDINARY ACTIVITIES</b>		<b>-3 154</b>	<b>-4</b>	<b>-4 570</b>
<b>E. NET INCOME BEFORE TAXES</b>		<b>39 028</b>	<b>186</b>	<b>68 090</b>
<b>XII. Corporate income tax</b>	37	<b>0</b>	<b>0</b>	0
<b>F. NET INCOME</b>		<b>39 028</b>	<b>186</b>	<b>68 090</b>
22. Use of retained earnings for dividends		33 626	0	0
23. Dividend paid (approved)	38	72 654	0	0
<b>G. BALANCE SHEET NET PROFIT FIGURE</b>		<b>0</b>	<b>186</b>	<b>68 090</b>

Budapest, December 5, 2006

Straub Elek  
Chairman and Chief Executive Officer

Thilo Kusch  
Chief Financial Officer

## **Investigation into certain consultancy contracts**

On February 13, 2006, the Company announced that it was investigating certain contracts to determine whether they were entered into in violation of Company policy or applicable law or regulation. Concerns regarding two consultancy contracts entered into by one of the Company's subsidiaries were initially raised by the Company's auditors. As a result of the investigation, two additional consultancy contracts, which were entered into by the Company, have been called into question. The total amount of the four contracts under investigation at the Group is around HUF 2 billion, of which HUF 1,120 million relates to the two contracts entered into by the Company. Concerns have also arisen regarding destruction by certain employees of electronic documents obstructing the investigation. As a consequence of the investigation, the Company had suspended a number of employees who have since resigned. The investigation, which is being conducted by an independent law firm and supervised by the Audit Committee, is still ongoing.

Although the investigation has not been finalized, based on the independent investigators' findings and conclusions to date, these contracts were entered into without full compliance with internal company procedures regarding the entry of such contracts. Moreover, sufficient evidence could not be obtained that adequate value was received under these contracts. Accordingly, although the Company had originally capitalized the amounts paid under these contracts, as a result of the findings of the investigation, the Company has ultimately expensed the HUF 1,120 million paid under these two contracts, and discloses these expenses under the caption "Extraordinary expenditures." See Note 36

The Company has already implemented certain remedial measures designed to enhance its control procedures with respect to the entry into consultancy contracts, including the introduction of a new governance model and replacement of the Board of Directors at Crngorski Telekom and termination of work contracts with employees initiating data deletions interfering with the investigation.

The Company's Board of Directors also approved on 8 November, 2006 a more extensive program of remedial actions, which it expects to implement in the near future. These decisions include structural and procedural changes in relation to mergers and acquisitions, and procurement, as well as a new internal control regime. The Company's Board of Directors also decided on 5 December, 2006 on certain additional enhancements of internal controls and the implementation thereof.

As a result of the delays in finalizing its 2005 financial statements as a result of the investigation, the Company has failed to meet certain deadlines prescribed by the Hungarian and other applicable laws and regulations for preparing and filing audited annual results and holding annual general meetings. The Company has already been fined HUF 12 million as a consequence of such delays. The Company has notified the Hungarian Financial Supervisory Authority, the U.S. Securities and Exchange Commission and the U.S. Department of Justice of the investigation and is in contact with these authorities regarding the investigation and has responded to a number of inquiries these authorities have raised.



# Magyar Telekom Telecommunications Public Limited Company

## Submission for Magyar Telekom Plc.'s General Meeting

**Subject:** Decision on the approval of the 2005 financial statements of the Company and on the release from liability of the members of the Board of Directors

Budapest, December, 2006

**Resolutions proposal:**

- 1. The General Meeting approves the 2005 Consolidated Financial Statements of Magyar Telekom Group prepared according to the International Financial Reporting Standards, including**

**Balance Sheet Total Assets of HUF 1,082,948 million and  
Profit after tax for year 2005: HUF 88,919 million (before the deduction of HUF 10,355 million attributable to minority interests).**

- 2. The General Meeting approves the Y2005 Annual Report of the Company prepared according to the Hungarian Accounting Regulations (HAR), including**

**Balance Sheet Total Assets of HUF 923,466 million and  
After-tax Net Income of HUF 68,090 million.**

- 3. The General Meeting hereby evaluates the work of the board members of the Company and decides on granting the relief from liability for the board members of the Company with respect to the 2005 business year in accordance with Section 30 (5) of the Companies Act. The evaluation and the relief from liability granted by this resolution shall not apply to the liability of the board members arising from their gross negligence or wilful misconduct.**

# **Magyar Telekom Telecommunications Public Limited Company**

## **Submission for Magyar Telekom Plc.'s General Meeting**

**Subject:** Proposal of the Board of Directors for the use of the profit after tax earned in 2005

Budapest, December, 2006

**Resolution proposal:**

**A dividend of HUF 73 per ordinary share (with a face value of HUF 100) and dividend of HUF 7 300 per preference share (with a face value of HUF 10 000) shall be paid to the shareholders from the profit of 2005.**

**The Company uses HUF 8,031,646,223 from profit reserves to pay the total dividend of HUF 76,122,086,995 because profit after tax before dividend is HUF 68,090,440,772 based on HAR figures.**

**January 12<sup>th</sup>, 2007 shall be the first day of dividend disbursement.**

**On December 22<sup>nd</sup>, 2006, the Management Committee of Magyar Telekom Plc. shall publish a detailed announcement on the order of dividend disbursement in Magyar Tőkepiac, as well as on the homepage of the Company and the Budapest Stock Exchange.**

**In compliance with Magyar Telekom's assignment, KELER Ltd. shall disburse dividends.**

**Magyar Telekom Telecommunications Public Limited Company**

**Submission  
for Magyar Telekom Plc.'s General Meeting**

**Subject:** Election of the Company's Auditor and determination of its remuneration

Budapest, December, 2006

Resolution proposal:

The General Meeting elects:

PricewaterhouseCoopers Kft. (1077 Budapest, Wesselényi u. 16 Registration no.: 001464)

Name of the private person to perform audit services as registered auditor:

Szilvia Szabados

Chamber membership number: 005314

Address: 1031 Budapest, Amfiteátrum u. 25. VI. 53.

Mother's maiden name: Terézia Bukó

as Auditor of the Company for the two year period ending with the Annual General Meeting closing the 2007 financial year.

In the event that Szilvia Szabados is incapacitated, the GM elects Márta Hegedűsné Szűcs (chamber membership number: 006838, mother's maiden name: Julianna Hliva, address: 2071 Páty, Várhegyi u. 6.) to act as responsible auditor.

The General Meeting approves the payment of HUF 81,000,000 - not including the audit of internal controls as required by the Sarbanes-Oxley Act of 2002 - (+ a maximum of 5% for related costs) + VAT per year, covering the audit of the annual financial statements of Magyar Telekom Plc. (Company) prepared in accordance with the Hungarian Accounting Act and also the audit of the annual consolidated financial statements of the Magyar Telekom Group prepared in accordance with International Financial Reporting Standards (IFRS).

**Magyar Telekom Telecommunications Public Limited Company**

**Submission  
for Magyar Telekom Plc.'s General Meeting**

**Subject:** Modification of the Articles of Association of Magyar Telekom Plc.

Budapest, December, 2006

The reasons for the amendment of the Articles of Magyar Telekom Plc. are as follows:

1. A gas-engine is operated in the headquarters of Magyar Telekom that requires a small-power-station licence from the Hungarian Energy Office („MEH”). MEH concluded in its answer letter that the Articles of the Company does not contain the activity of producing electric energy and heat, therefore it is problematic to operate the heating system of the headquarters and to sell / charge for electricity. Consequently, it is expedient to include such activity into the scope of activities of the Company.

The (TEÁOR) registry No. of the activity is: TEÁOR 40.11 Production of electricity.

2. Magyar Telekom wishes to manage the provision of insurance policies – in packages or individually – for its customers as an important future business development issue. During the revision of the possible scenarios the business area concluded that in order to realize such cooperations and product concepts it is necessary to include the relevant TEÁOR activity into the scope of activities of the Company.

The (TEÁOR) registry No. of the activity is: TEÁOR 67.20 Other insurance activities.

3. The name of the Budapest Stock Exchange is amended with respect to the form of operation and is changed to Budapest Stock Exchange **Closed Limited** Company („Budapesti Értéktőzsde Zártkörűen Működő Részvénytársaság”). Therefore the name contained in Section 15.2. is to be amended.

#### **Resolution proposal:**

**The General Meeting approves the modifications of the Articles of Associations as follows:**

#### **1.6.2. Other activities**

**40.11'03 Production of electricity**

**67.20'03 Other insurance activities**

#### **15.2. Notices**

Notices and advertisements of the Company shall be published in the nationwide, official journal of the Budapest Stock Exchange and in the official publication space of the Budapest Stock Exchange **Closed Limited** Company (i.e. home page of the Stock Exchange) and the Official Gazette ("Cégek Közlöny") in cases required by applicable law.

**All other provisions of the Articles of Association remain unchanged**



# **Magyar Telekom Telecommunications Public Limited Company**

## **Submission for Magyar Telekom Plc.'s General Meeting**

**Subject:** Report of the Supervisory Board about the 2005 operations of the Company and the Group

Budapest, December, 2006

The Supervisory Board has reviewed the Report of the Company Management in respect of the performance, financial status, prospects and environmental uncertainties of the Company and the Group.

The Supervisory Board focused on the following priorities:

1. the compliance of the operation of the Company with the legal requirements and obligations;
2. the compliance of the applied accounting practices with the HAR (Hungarian Accounting Rules) and with the IFRS (International Financial Reporting Standards);
3. whether the operation and decisions of the Board of Directors served the best interest of the shareholders.

The Supervisory Board summarizes its position as follows:

- I. The business operations of the Company and the Group met the expectations of the shareholders in the 2005 business year. The Management successfully managed the Company in a dynamically changing market environment. Cost management is considered efficient.
- II. The Supervisory Board hereby states that the Net Profit after Tax of the Company for the 2005 business year was HUF 68 090 million (say: sixty-eight billion and ninety million Forints) and the total Assets and Liabilities of the Company for the 2005 business year was HUF 923 466 million (say: nine hundred and twenty-three billion four hundred and sixty-six million Forints). The Company Report has been prepared in line with the Hungarian Accounting Rules (HAR). The consolidated earnings of Magyar Telekom Group after tax in year 2005 according to IFRS (before subtracting HUF 10 355 million earnings on minority shares) is HUF 88 919 million (say: eighty-eight billion nine hundred and nineteen million Forints); the balance sheet total is HUF 1 082 948 million (say: one thousand and eighty-two billion nine hundred and forty-eight million Forints). The Supervisory Board states that the report of the Company and the Group includes the necessary information concerning the independent investigation. The Supervisory Board acknowledges that the dividend on profits, payable to the shareholders is established at HUF 76 122 million (say: seventy six billion one hundred and twenty-two million Forints).
- III. The Supervisory Board continuously monitored the Management's decisions by having the Management report on its most important business decisions, on the financial stand of the Group at every Supervisory Board Meeting. The Supervisory Board also monitored the control activity of the Management.
- IV. The Supervisory Board approved the Annual Audit Plan of the independent Internal Audit organization for year 2005. The Supervisory Board requested and received regular reports about each and every audit finding, recommended audit measure and about the status of the implementation of these measures. The Internal Audit Branch completed the audits requested by the Supervisory Board and reported to them about the results. The Director of the Internal Audit is a permanent invitee of Supervisory Board Meetings where she regularly responded to the further issues raised in connection with certain audits.

- V. The Supervisory Board paid special attention in year 2005 to the following audit topics: compliance with SOX 404 requirements, integrity of the financial statements, security of assets and IT systems, revenue assurance, CRM, business solutions.
- VI. The Supervisory Board elected an Audit Committee (AC) from its own members and regulated the work of the AC by approving the Code of Procedures. The AC regularly checked the compliance with the rules assuring the independence of the Book Auditor and performed continuous control over the contracts that do not fall under the scope of book auditing.
- VII. The Supervisory Board continuously monitored the compliance of the Group with the rules assuring the fulfillment of the stock exchange requirements. A Directive has been issued on the "Procedures for treatments of complains/comments regarding accounting matters". Beyond that, the technical conditions of making such reports have also been established. The Supervisory Board had all the anonymous reports investigated and reports were made about them. The Group has made the necessary preventive measures in all cases to prevent repeated occurrence.
- VIII. The Supervisory Board put major focus on the strengthening of the corporate control processes and compliance with the SOX requirements. They asked regular reports on this issue from Internal Audit, in many cases from the Management and asked information also from the external Book Auditor.
- IX. The Supervisory Board highly appreciates the efforts of the Group to exploit the synergy opportunities with DT on group level. In this framework the Company continuously monitored the fulfillment of the shareholders' expectations and the optimization of resources. The Supervisory Board strongly supports the introduction of the principles of the standardized internal audit procedures.
- X. The Supervisory Board continuously monitored the independent investigation on the year-2005 operations of the Company and the Group and made recommendations on the corrective measures. The Board of Directors has decided the implementation of those measures.

Based on its findings in the course of the continuous monitoring of the business operations of the Company and Magyar Telekom Group the Supervisory Board - provided that the Company's Auditor issues its Report with the content according to the proposal of the Board of Directors until the date of the General Meeting – recommends that the General Meeting should:

- accept the Annual Report of the Company and the Group on the 2005 business year,
- accept the financial reports of the Company and the Group with the balance sheet earnings proposed by the Board of Directors,
- accept the proposal of the Board of Directors on the dividend payment,
- accept the Auditor's report.

**MAGYAR TELEKOM PLC.**

**MAGYAR TELEKOM TELECOMMUNICATIONS PUBLIC  
LIMITED COMPANY**

**Business Report of 2005**

December 2006

## **Introduction**

The annual report of the Magyar Telekom Telecommunications Public Limited Company (“Magyar Telekom Plc.” or “the Company”) has been prepared pursuant to the Hungarian Accounting Law.

Magyar Telekom Plc. is the principal provider of fixed line telecommunications services in Hungary, with approximately 2.7 million fixed access lines at December 31, 2005.

Magyar Telekom Plc. is listed in the Budapest and the New York Stock Exchanges. Key shareholders of Magyar Telekom as of December 31, 2005 include MagyarCom Holding GmbH (59.21 percent), owned by Deutsche Telekom AG. The remainder, 40.79 percent is publicly traded.

Magyar Telekom Plc.'s headquarters are located at 55 Krisztina krt., 1013 Budapest, Hungary.

### *Investigation into certain consultancy contracts*

On February 13, 2006, the Company announced that it was investigating certain contracts to determine whether they were entered into in violation of Company policy or applicable law or regulation. Concerns regarding two consultancy contracts entered into by one of the Company's subsidiaries were initially raised by the Company's auditors. As a result of the investigation, two additional consultancy contracts, which were entered into by the Company, have been called into question. The total amount of the four contracts under investigation at the Group is around HUF 2 billion, of which HUF 1,120 million relates to the two contracts entered into by the Company. Concerns have also arisen regarding destruction by certain employees of electronic documents obstructing the investigation. As a consequence of the investigation, the Company had suspended a number of employees who have since resigned. The investigation, which is being conducted by an independent law firm and supervised by the Audit Committee, is still ongoing.

Although the investigation has not been finalized, based on the independent investigators' findings and conclusions to date, these contracts were entered into without full compliance with internal company procedures regarding the entry of such contracts. Moreover, sufficient evidence could not be obtained that adequate value was received under these contracts. Accordingly, although the Company had originally capitalized the amounts paid under these contracts, as a result of the findings of the investigation, the Company has ultimately expensed the HUF 1,120 million paid under these two contracts, and discloses these expenses under the caption “Extraordinary expenditures.” See Note 36 in the ‘Supplement to the Annual report.’

The Company has already implemented certain remedial measures designed to enhance its control procedures with respect to the entry into consultancy contracts, including the introduction of a new governance model and replacement of the Board of Directors at Crngorski Telekom and termination of work contracts with employees initiating data deletions interfering with the investigation.

The Company's Board of Directors also approved on November 8, 2006 a more extensive program of remedial actions, which it expects to implement in the near future. These decisions include structural and procedural changes in relation to mergers and acquisitions, and procurement, as well as a new internal control regime. The Company's Board of Directors also decided on December 5, 2006 on certain additional enhancements of internal controls and the implementation thereof.

As a result of the delays in finalizing its 2005 financial statements as a result of the investigation, the Company has failed to meet certain deadlines prescribed by the Hungarian and other applicable laws and regulations for preparing and filing audited annual results and holding annual general meetings. The Company has already been fined HUF 12 million as a consequence of such delays. The Company has notified the Hungarian Financial Supervisory Authority, the U.S. Securities and Exchange Commission and the U.S. Department of Justice of the investigation and is in contact with these authorities regarding the investigation and

has responded to a number of inquiries these authorities have raised.

## **Analysis of results**

*Revenues.* Our sales revenues decreased by 6.4 percent from HUF 266,246 million in 2004 to HUF 249,139 million in 2005. The decrease is primarily due to lower revenues from outgoing domestic and international traffic resulting from lower per minute rates included in our various tariff packages and lower amount of outgoing traffic. These decreases were partly offset by higher leased lines and data transmission revenues.

Other revenues increased significantly mainly as a result of the compensation received from Deutsche Telekom for the costs of rebranding. The increase is also attributable to higher amount of released provisions for severance payments.

*Expenditures.* Material-type expenditures decreased by 2.8 percent primarily owing to lower mobile outpayments by Magyar Telekom Plc. due to strong decrease in traffic and lower fixed to mobile termination rates. This decrease was partly compensated by higher expenditures relating to rebranding.

Payroll and related expenditures decreased by 4.0 percent in 2005. The main driver of the decrease is the significant decrease in severance expenditures as well as lower average headcount at Magyar Telekom Plc. The closing headcount figure fell from 7,740 on December 31, 2004 to 5,478 on December 31, 2005. As a result of decreased headcount, the number of lines per fixed line employee at Magyar Telekom Plc. increased to 489 at the end of December 2005 compared to 365 a year earlier.

Other expenditures declined due to lower severance provisions and due lower extraordinary depreciation of certain fixed assets because of scrapping and impairments in 2004.

*Financial results.* Financial results increased by 14.0 percent, from 45,049 million in 2004 to 51,346 million in 2005. The increase resulted from lower HUF interest expenses in line with lower average HUF interest rates of HUF denominated loans as well as lower amount of foreign exchange loss. In 2004, HUF 5.6 bn foreign exchange loss was recorded on foreign exchange investments, while in 2005 HUF 3.5 bn foreign exchange gain was booked as the revaluation of investments.

## **Overview of Magyar Telekom Plc.'s Services**

### ***Domestic Services***

#### *Products and Services*

*Public Switched Telephone Network ("PSTN").* Due to the fierce competition and mobile substitution, the number of our PSTN lines decreased from 2,299,314 as of December 31, 2004 to 2,182,905 as of December 31, 2005.

*Integrated Services Digital Network ("ISDN").* ISDN allows a single access line to be used simultaneously for a number of purposes, including voice, data, facsimile and video transmission. ISDN also provides higher quality and faster transmission of signals while increasing the bandwidth capacity of the network. The coverage of ISDN is 100 percent of our network. We offer both basic ISDN access lines with two channels and multiplex ISDN access lines with 30 channels. As of December 31, 2005, we had installed 175,058 ISDN access lines with two channels and 4,856 ISDN access lines with 30 channels, amounting to the total of 495,796 ISDN channels. We intend to extend the life cycle of the ISDN product by offering various discounts to our customers.

*Digifon Services.* At the end of 2005, our network was 100 percent digitalized, which enable us to provide value added service in our whole service area. We offer a number of value added services, such as call forwarding, call waiting and call conference, to a significant number of our fixed line telephony subscribers.

These services help increase fixed line usage as they make busy signals and unanswered calls less common. We also offer bundled packages of digifon services. The most popular of these packages is the Összhang, which contains five services at a discount price. Összhang package was introduced in May 2001 and had approximately 278,000 customers by the end of 2005.

*Shared Cost/Toll Free Numbers.* To enable business customers to better meet the needs of their clients, we have introduced a wide range of “blue” numbers, which are shared cost numbers, and “green” numbers, which are toll free access numbers.

*Voice-mail.* We offer a voice-mail service including call return and call capture. We also offer a voice-mail Short Message Service (“SMS”), which provides an SMS alert to the mobile handset of the customer each time he or she receives a voice-mail message. These services allow better usage of the network, more comfort in using the phone and decrease the ratio of uncompleted calls.

*Directory Assistance.* We offer directory inquiry services. The domestic directory assistance database includes all fixed line and postpaid mobile subscribers' data in Hungary. We offer a call completion option to subscribers, whereby calls may be connected automatically. We also offer increasingly popular Directory Assistance-Plus (“DA-Plus”) service. DA-Plus offers a wide range of information including Yellow Pages, residential classified advertisements, encyclopedia, dictionary-based information, recipes, poems, as well as telephone numbers, postal, e-mail and website addresses without any quantity restrictions. The requested information is not only provided verbally, but by e-mail or fax. The tariff of the service is based on per minute usage. In 2005, we won the Best European Directory Assistance Service award.

#### *Subscribers*

The following table sets forth information regarding total fixed access lines and penetration rates in our service areas:

	<b>At December 31,</b>		
	<b>2003</b>	<b>2004</b>	<b>2005</b>
Lines in service in Magyar Telekom Plc.'s service areas			
Residential lines .....	2,012,672	2,015,934	1,919,434
Business lines .....	261,642	256,321	241,875
Public payphones .....	28,799	27,059	21,596
Total .....	2,303,113	2,299,314	2,182,905
ISDN channels .....	527,728	525,346	495,796
Total .....	<u>2,830,841</u>	<u>2,824,660</u>	<u>2,678,701</u>
Lines installed per 100 inhabitants			
in Magyar Telekom Plc.'s service areas .....	37.5	37.5	35.6
Digital exchange capacity as % of Magyar Telekom Plc.'s			
total exchange capacity .....	89.9	92.9	100

Our domestic fixed line telephony subscribers can be classified into two categories: residential customers and business customers, which include our customers in the public sector. As of December 31, 2005, 74 percent of our access lines was utilized by our residential customers and 25 percent by our business customers. The remaining one percent of access lines was used for public payphones.

#### *Tariffs*

We charge fixed line subscribers a one-time connection fee, monthly subscription charges and call charges based on usage. A call charge contains two elements: a call set-up charge and a traffic charge measured in seconds based on the call's duration.

In 2005, we increased the number of tariff packages to allow customers in different market segments to choose plans that best suit their calling patterns. These tariff packages also served as a tool to maintain our customer base in the fully liberalized market as those customers who select us as the operator for every traffic direction (local, long distance and international) receive the highest discounts. In 2005, we introduced flat rate packages that offer free of charge calls to customers during the flat-rate period for an additional monthly fee. We also introduced tariff packages specially developed for LTO areas, such as Teleperc, a call-by-call tariff package. At the end of December 2005, approximately 66 percent of Magyar Telekom Plc.'s customers chose customized tariff packages, the most popular of which is the Felező (Halving) package with over 530,000 subscribers and the flat rate Favorit packages with approximately 325,000 customers.

### *Public Telephones*

As of December 31, 2005, Magyar Telekom Plc. operated 21,596 public payphones, representing a penetration rate of approximately 2.9 per 1,000 inhabitants in Magyar Telekom Plc.'s service areas. The Act on Electronic Communications modified the requirement to provide public telephone stations from one pay station per 500 inhabitants to one pay station per 1,000 inhabitants. The traffic tariffs charged for calls from public payphones are at a premium to those charged to fixed line subscribers.

### *International Telephone Services*

International telephone services consist of outgoing and incoming international telephony traffic, including voice and switched transit traffic through Hungary.

We provide international calling access to our fixed line telephony subscribers and to subscribers of other local telephone operators and mobile service providers. Our Hungary Direct and Country Direct services permit customers to charge calls made from 50 countries abroad to their home phone numbers.

International toll free service was launched in 1998. This service enables the caller to make international calls free of charge, while the call charges are covered by the subscriber of the toll free number. Universal international toll free service was launched in 2003. This service is available from 22 countries and enables the subscribers to be called on a unique universal number free of charge from abroad.

In June 2000, we introduced the international prepaid calling card, "Barangoló", which allows customers to make phone calls, including IP-based calls. This service enables customers to call from touch-tone payphones in Hungary and abroad.

### *Tariffs*

The call charge for an international call contains two elements: a call set-up charge and a traffic charge measured in seconds based on the call's duration. Although the list prices of our international tariffs did not change in 2005, the average per minute rates decreased as a result of discounts given in various optional tariff packages.

*Settlement Arrangements.* Under bilateral settlement arrangements, we pay other carriers for the use of their networks for outgoing international calls and receive payments from other carriers for the use of our network for incoming international calls. In Europe, such settlement arrangements fall under the general auspices of the International Telecommunications Union. Settlement payments, which are generally denominated in Special Drawing Rights ("SDR"), are calculated using a currency basket in which U.S. dollar has the greatest weight. Due to the large exchange rate fluctuations of the SDR caused by the recent volatility of the U.S. dollar, we started to shift our accounting rate agreements to euro-based arrangements. As our important European and North-American partners supported this change, we will continue these efforts in 2006 as well. New international carrier partners prefer to use the euro as a settlement currency.



### *International Telecommunications Hub*

We believe that Hungary is geographically well positioned to serve as a telecommunications gateway between Eastern and Western Europe. We have two state-of-the-art international gateways as well as fiber optic cable connections serving 12 border crossings. These fiber optic cable connections use synchronous digital hierarchy transmission facilities. We have X.25 links, which are used for packet switched data transmission with 83 international networks. We also have ISDN connections with more than 50 international networks. To increase the utilization of our transmission network, we offer attractive price schedules for dedicated transit services through Hungary. We have launched our own Dense Wavelength-Division Multiplexing (“DWDM”) backbone network and are DT’s partner in Delivery of Advanced Network Technology to Europe (“DANTE”), which provides 10 Gbit/s transmission path interconnecting Budapest and Vienna and connection to the European research and educational network, GEANT.

To seize the opportunities presented by the liberalization of the telecommunications market in Romania, we established interconnection arrangements with major Romanian alternative service operators and network service providers to offer transit services towards Western Europe. In addition, we use our own point of presence in Austria, which enables us to engage in telephone and Internet business with alternative telecommunications carriers located in Vienna. We are present at the Vienna Internet Exchange (with dedicated circuit for Internet data exchange) and have peering arrangements with approximately 60 Internet Service Providers (“ISPs”) there. We have direct Internet peering connections with Serbia and Slovakia and provide high-capacity international Internet transit service ISPs in Ukraine, Bosnia-Herzegovina and Macedonia.

### *Leased Lines*

Magyar Telekom Plc. is the principal provider of leased lines in Hungary.

Leased line service establishes a permanent connection for transmission of voice and data traffic between two geographically separate points (point-to-point connection) or between a point and several other points (point-to-multipoint connection). These points can be either all within Hungary or some in Hungary and others abroad.

We lease lines to other local telephone operators and mobile service providers, who use such lines as part of their networks. We also lease lines to providers of data services. In addition, we lease lines to multi-site business customers who use leased lines to transmit internal voice and data traffic.

We offer a broad variety of standard analog and digital lines for lease, including two-wire and four-wire analog lines and digital lines with capacities from 64 Kbit/s to 155 Mbit/s. We also offer high capacity customized digital lines to other telecommunications providers.

*Flex-Com.* Since 1996, we have offered Flex-Com, domestic and international digital leased lines with managed back-up systems that are dedicated to data transmission. The number of Flex-Com connections decreased from 10,467 as of December 31, 2004 to 9,842 lines as of December 31, 2005. However, during the same period the aggregate sum of the bandwidths of the connections has increased by 14.6 percent from 3.02 Gbit/s to 3.46 Gbit/s resulting in higher revenues.

*Frame-Flex.* We also use our managed leased line network to offer Frame-Flex, a public frame relay service that is particularly suited to customers who transmit data in bursts, such as connections between local area networks. In 2000, we introduced LANConnect, a frame relay based managed router service. LANConnect is primarily targeted at small and medium size enterprises allowing them to seamlessly interconnect their Local Area Networks (“LANs”). As of December 31, 2005, we had 344 Frame-Flex connections.

*High Speed Leased Line (“HSSL”).* The HSSL service provides permanent, digital, transparent, point-to-point leased line service between service access points (“SAPs”). The connections are established by a service

provider according to the needs of its customers. Transmission rates provided by the HSSL service are 2, 34 and 140 Mbit/s. In 2001, we enlarged our HSSL services portfolio by offering new rates of 45 and 155 Mbit/s.

As an addition to the High Speed Leased Line portfolio, we introduced a Wavelength Division Multiplexing (“WDM”) technology based premium service, Gigalink, which provides an even higher speed (622 Mbit/s) leased line service to business customers and to other service providers. In 2004, we expanded the speed of Gigalink from 2.5 Gbit/s to 10 Gbit/s for the Campus backbone network (a link between universities and academic institutions).

### ***Data Transmission and Related Services***

Data transmission and related services consist primarily of data transmission and network services for business customers, such as financial institutions and insurance companies, and, to a lesser extent, residential customers. The market for data transmission and related services in Hungary is highly competitive. We are the leading supplier of data transmission and related services in Hungary.

Our revenues from data transmission have grown significantly as a result of both the development of the Hungarian economy and our increasingly sophisticated services. We expect the market for these services to grow with the proliferation of personal computers and increasing consumer demand. We believe that the ability to offer new data products and services will be critical to competing effectively in the future, particularly with respect to business customers.

*Datex-P.* We offer Datex-P, a packet-switched data transmission service based on the X.25 protocol. The service provides low to medium speed domestic switched data communications services with international connectivity to business customers. As a result of the proliferation of new technologies, growth in the number of subscribers has stopped. Between 2003 and 2005, our major objectives were to extend the lifecycle of the product, maintain profitability, optimize the network and reduce costs. In 2005, we assessed and commenced migration of customers to other data transmission services. Full service withdrawal is planned for 2008-2009.

*ADSL.* ADSL is a continuous, high-speed Internet access service based on the Asymmetric Digital Subscriber Line (“DSL”) technology. The service offers cost efficient broadband Internet access together with telephony service over existing copper wires. We sell these services mainly on a wholesale basis to ISPs, which in turn distribute the services to residential and small business customers. In 2005, this service had significant growth with the number of ADSL connections reaching 321,416 by December 31, 2005 from 203,654 at December 31, 2004.

In 2005, we implemented a major infrastructure expansion project to accomplish our Internet market goals. A large amount of investment was used for the roll out of broadband Internet. As a result of these steps, over 450 additional settlements were connected to the service in 2005.

To better satisfy customer demand, we increased the maximum download speed of our ADSL accesses at no extra charge in May 2005. As a result, the maximum download bit-rate was increased by one third for the cheapest tariff package and doubled for all other tariff packages at the same prices, terms and conditions. The higher bandwidth contributes to the faster roll out of ADSL and also encourages customers to download enriched broadband content. We also introduced a new low-end bandwidth to provide entry-level ADSL with a favorable monthly subscription fee.

*International data products.* We provide signaling links for mobile operators to facilitate international roaming. We also sell international leased lines, including international managed leased lines, international ISDN, X.400, X.25 and telegraph services. The sales of international leased lines are steadily growing, partly due to the introduction of one-stop-shopping agreements, whereby customers can order from and pay for the service at one end-point of the connection, which eliminate the need to deal with multiple service providers. International Internet connectivity was enhanced in 2004 to provide services for Internet service providers. By the end of 2004, the capacity of international Internet connections reached 3 Gbit/s. Since the end of 2003, we

no longer provide international telex services.

### ***Fixed Line Telecommunications Equipment Sales***

Magyar Telekom Plc. distributes an extensive range of telecommunications equipment, from individual telephone sets to facsimile terminals and complete network systems, through a network of customer service centers. In addition to stand-alone phoneset sales, Magyar Telekom Plc. sells various packages combining telephone sets with telephone lines or tariff packages.

The telecommunications equipment sector is highly competitive and characterized by rapid technological innovation. Magyar Telekom Plc. believes that the supply and service of telecommunications equipment are integral parts of being a full service telecommunications provider and are necessary for the expansion of its customer base. In addition, these activities permit Magyar Telekom Plc. to ensure that technologically advanced equipment required for new services is available in the Hungarian market.

### ***Other Revenues***

Other revenues include construction and maintenance services as well as other miscellaneous revenues.

We construct fixed telecommunications networks and offers network maintenance services to other telecommunications operators in Hungary. These construction and maintenance services are ancillary to the construction and maintenance of Magyar Telekom Plc.'s networks.

We carry out our construction mainly through subcontractors. The majority of construction revenue is derived from optical network construction, network construction related to subscriber connections and project planning.

### **Research and development**

Magyar Telekom Plc. has a separate organization called PKI Telecommunications Development Institute for performance of research and development ("R&D") projects to meet the demands of the rapidly changing market, such as development of our telecommunications networks and service platforms. The institute works in close cooperation with educational institutions (such as Budapest University of Technical and Economic Sciences, Technical College of Budapest, etc.), strategic investors and suppliers and domestic and international development organizations. According to the Act XC of 2003 on Research and Technological Innovation Fund, simultaneously with our accession to the European Union, several funds aimed to encourage research and development activities became available for us as well; this encouraged us to intensify our participation in national and international consortiums engaged in R&D.

The harmonization projects between DT and the DT Group members (Maktel, Slovak Telekom, Croatian Telekom, T-Systems International) play an important role in our development cooperation relations.

In 2005, in order to maintain or expand our competitive positions – in line with our short and medium term strategy with the international trends and market expectations – we laid down the technical background through the R&D activities for the introduction of new VoIP and multimedia based services, utilizing the capabilities of next generation ("NGN") IP/Ethernet based core and broadband fixed (ADSL, xDSL) and wireless (WLAN, WiFi) accesses.

Significant resources are devoted to the upgrading of our digital backbone network. The DWDM technology was introduced to satisfy the backbone network demands that arose in connection with broadband services, such as fast Internet access and broadband IP-VPN.

We are continuously developing our data communications and IP network and services to meet broadband demands. We developed the concept of a national, high-speed IP network built on DWDM and Gigabit Ethernet. Under this program the components of our IPv6 protocol pilot network were identified. In 2006, we plan an interconnection test with DT's network.

In the last years we rolled out a wide range of broadband access technologies (e.g., ADSL, optical access network and managed leased line technologies) to satisfy the increased bandwidth demand. To widen the choice of broadband services, we examined the possibilities of implementing triple-play solutions. In 2005, multimedia services, including Digital Rights Management ("DRM") system, were tested in Ethernet and DSLAM environment.

In 2005, we studied the usability of World Interoperability for Microwave Access ("WiMAX") technology. WiMAX can provide wireless broadband access with effective radius of up to several kilometers with up to 75 Mbit/s radio throughput. WiMAX is in a standardization phase, so commercialized WiMAX devices will only be available in 2006. We also plan to implement the new generation xDSL technologies (ADSL2, ADSL2+) in the access network to extend the ADSL coverage and provide higher bit-rate.

The GRID mass-computing platform prototype has been further developed providing quota management in order to enhance its security and to ensure resilience against data flooding attacks.

In 2005, we laid down the basics for product developments promoting the convergence of fixed and mobile networks ("FMC"). A Bluetooth based intelligent solution has been tested in our laboratory. Our next step in this field will be investigating the FMC possibilities in IP Multimedia System ("IMS") environment, and WiFi/UMTS handsets. A study has been launched on the potential interconnection of the Next Generation fixed and mobile networks, based on the ETSI TISPAN IMS architecture.

## **Environment protection**

To strengthen our commitment for sustainable development and to identify the ways of development in field of sustainability, the management committee of Magyar Telekom Plc. approved the Sustainability Strategy of the Company in January 2005.

As a part of sustainability communication we developed the sustainability web page on the web portal of Magyar Telekom Plc. This web page includes our reports, news, the introduction of our approach, and an opportunity for open communication on sustainability issues.

Our commitment for environmental protection first led to our signing of the Environmental Charter of the ETNO (European Public Telecommunications Network Operators' Association) in 1998, which was replaced by a more extensive commitment, Sustainability Charter, in 2004. As a member of ETNO Sustainability Working Group, we report about our sustainability-related aspects. In 2005, ETNO started a co-operation together with WWF on information and communication technology combating climate change, where Magyar Telekom Plc. leads the project representing ETNO.

To inform interested parties, we have been publishing Annual Environmental Reports since 2000. We have been publishing our Annual Sustainability Report including economic, social and environmental procedures and results since 2004. These reports are prepared using the Global Reporting Initiative ("GRI") sustainability reporting guidelines, and have been verified by an independent body. These reports can be accessed on our website. In 2005, our sustainability report relating to 2004 won the second prize in the Central European Environmental Reporting Award.

Due to the nature of our business, our operations do not adversely affect the environment to any significant degree, however, we are paying close attention to environmental protection. To mitigate or minimize adverse effects to the environment and to improve the environmental performance on a continual basis in areas of operations with the greatest risk, ISO 14001 environmental management systems were implemented in the

following areas: network management, network services, telecommunications development, procurement and transportation. In 2005, we implemented the ISO 9001-14001 system, which integrates the network management, network services, telecommunications development, and further organizational areas of the fixed line of business.

One of the main adverse environmental effects of our operations is our electricity consumption primarily for the operation of telecommunications equipment, and to a lesser extent, for the operation of buildings. To reduce consumption, we launched pilot programs modeling the best practices of other European telecommunications companies.

We have also taken considerable steps to reduce fuel consumption of vehicles, for example, by making employees aware of alternative communication methods (such as audio and video conferences) to reduce the number of business trips for internal purposes.

In addition to our commitment to reduce paper consumption, we started to use recycled paper in our offices.

Underground fuel tanks for diesel generators, which ensure the continuity of our services, pose a potential risk to the soil and the underground waters. To mitigate this risk, we have set up a program to double-wall those tanks to ensure compliance with applicable laws and to prevent possible pollution.

Magyar Telekom Plc., like other telecommunications service providers, collects and administers wastes in compliance with relevant regulations. We then transfer them to licensed companies for further handling and destruction, while making an effort to reutilize (recycle) as much of these wastes as possible.

## **Real estate**

Based on a five-year contract, we outsourced our real estate operations from February 1, 2005, thus real estate development, investment, area and property management services are now provided by DeTe Immobilien-Hungary Zrt. for Magyar Telekom Plc. In order to exercise strategic management and control, we established the Real Estate Management Office.

We have more than 2,000 premises in use exceeding 670,000 m<sup>2</sup>. These are freehold, leased, jointly owned and used properties as well as realties used under right of common.

Real estate holdings have the following functions:

- Technical building
- Warehouse
- Garage
- Holiday resort
- Tower
- Office
- Other social building
- Preferential office
- Apartment
- Land

Most of the properties are under 100 m<sup>2</sup>. Technical functions have the highest weight - the area of technical buildings constitutes 40 percent within the total space available. From the 50 largest properties 20 are located in the capital. The largest real estate with 35,000 m<sup>2</sup> is situated at 55 Krisztina Krt., Budapest.

More than one thousand properties are leased by us, from which the majority is rented for technical buildings, towers and antennas; the rest serves other functions (office, business premises, garage, warehouse, apartment, land).

According to our proprietary needs, the aim of the Real Estate Management Office is to optimize the utilization of the real estate portfolio, while selling or otherwise making use of the surplus properties on favorable terms.

### **Liquidity, financial instruments**

We carry indebtedness at a level we consider appropriate based on a number of factors, including cash flow expectations (i.e., cash requirements for ongoing operation, investment plans), expectations of investors, analysts, rating agencies and the overall cost of capital. We announced a definite dividend policy in 2003, according to which the group level net debt ratio is to be kept between 30 to 40 percent. According to the dividend policy, we paid an amount of HUF 70 dividend per share in 2004 and 2005 (based on the results of financial years 2003 and 2004 respectively) to maintain the net debt ratio in the target range. Future dividend payment will be determined by the dividend policy but will depend on the profit and cash-flow generation and potential acquisition opportunities of the company.

The majority of our operating revenues and expenses are denominated in Hungarian forints. Accounts payable to and receivable from international carriers, which are denominated in a basket of currencies known as SDRs, are netted against one another and settled primarily in U.S. dollars and Euros. Capital expenditures are denominated partly in foreign currencies, principally U.S. dollars and euros.

We reduced foreign exchange and interest rate risks associated with our loan portfolio. At December 31, 2005, the loans were 100 percent denominated in HUF, thus the foreign exchange risk of the loan portfolio is naturally hedged by the HUF-denominated revenues.

In 2005, the high HUF interest rates started to decline gradually from a very high basis. The volatility and the risk of the Hungarian currency are still relatively high, and we expect them to become higher in the near future due to unfavourable macroeconomic conditions.

In order to avoid potential negative effects of the exchange rate movements, in case of remarkable foreign exchange denominated cash-flow (e.g. acquisition of TCG or foreign exchange denominated dividend payment) after the decision on the payment, prior to the execution of the transaction we open an appropriate hedge (mainly forward) transaction. We do not have any other material derivative transactions.

### **Risk management policies**

It is our policy that all disclosures made by us to our security holders and the investment community be accurate and complete, and fairly present our financial condition and results of operations in all material respects. Such disclosures should be made on a timely basis as required by applicable laws, rules and regulations, including by-laws of the Budapest Stock Exchange and rules adopted by the U.S. Securities and Exchange Commission ("SEC"). To achieve these objectives, we formed a Disclosure Committee and developed and have continuously enhanced our risk management policies.

In 1999, we established a formal risk management system. In 2000, we established a department to coordinate all risk management tasks. This system was integrated into the risk management system of Deutsche Telekom in 2002.

All risks related to material internal and external operations, financial and legal compliance and certain other risks are evaluated and managed by a well-defined internal mechanism. A risk management handbook and a Chief Executive Officer ("CEO") directive on risk management were published. A risk management course was developed for employees responsible for risk management in all organizational areas. Risk items affecting our operations are reviewed quarterly. All of our departments are obliged to identify and report their operational risks on a quarterly basis. After evaluation of these risks, results are reported to our management and to Deutsche Telekom.

Following the enactment of the Sarbanes-Oxley Act, we decided to enhance our risk management procedures. As this new law requires prompt disclosure of all risk items influencing investors' decisions, we complemented our quarterly risk reporting system with a continuous reporting procedure which requires all of our departments to report on a real-time basis any new material fact, information or risk that comes to their knowledge. Information thus submitted is monitored daily by the risk management department and the Chief Financial Officer ("CFO") is notified when a new material risk or information is identified.

A CEO directive has been issued to define responsibilities of each employee in risk monitoring and management. In addition, an e-learning course was created to train our employees on requirements of the Sarbanes-Oxley Act, our enhanced reporting and corporate governance obligations and the enhanced risk reporting procedures. Completion of this course has been made compulsory for all of our employees.

We established a Disclosure Committee on July 31, 2003. The Disclosure Committee acts both in plenary meetings and through its members acting individually. It supports CEO and CFO in fulfilling their responsibility to oversee processes designed to ensure accuracy and timeliness of our disclosures.

### **Human policy**

„Professional and committed employees, who are able to act on their own initiative, are the most important success factor of the business effectiveness of Magyar Telekom Plc.”—this is the HR vision the company has articulated in line with its mission and strategy. The most important goal is to achieve that our company possesses the most professional human resources organization in Hungary and in international terms as well, regarded by its clients as their internal partner and consultant, which other firms also approach with confidence whenever they need to obtain experience.

Magyar Telekom Plc.'s human resources strategy for the years 2003-2006 is grouped around five focal points in line with Deutsche Telekom's HR strategy. The focal points are as follows:

- Managing diversity: we endeavour to leverage group level synergies in order to achieve highest best business returns.
- Management of personnel expenses: Our aim is to achieve a cost effective personnel management based on market information and best international practice.
- Total compensation: Our aim is to ensure performance-based and market-competitive compensation.
- Management of skills and competences: we focus on identifying and managing knowledge and skill, and on promoting talent.
- HR efficiency and quality: Our aim is to deliver high-level human resource services meeting the needs of our business partners.

Out of the nine core elements of SA8000 (Social Accountability) standard, our human resources strategy highlights the one dealing with the absence of discrimination. As far as other core elements are concerned, our company's practice is adapted to Hungarian legislative norms (among others the Constitution of the Hungarian Republic, provisions set out in the Labour Code, as well as the Universal Declaration of Human Rights). The principles of justice and equal opportunities are set out in the basic standards articulated in our Code of Ethics published in 1997, which complies with the S-OX (Sarbanes-Oxley) act. Alternative forms of employment like telework, part-time work, flex-work, employment of disabled persons provide possibilities for the practical implementation of equal opportunities.

Magyar Telekom Plc. continuously cooperates with trade unions and the Works Council to represent employees' interests: wage and compensation elements are reviewed once a year and their upward correction is set out in a contract along with headcount efficiency measures.

The company's wage tariff system regulated by way of the Collective Agreement complies with Article 23 of the Universal Declaration of Human Rights, which says: „Everybody is entitled to equal wage for equal work without any kind of discrimination.”

Magyar Telekom Plc.'s welfare and social benefits constitute an exceedingly wide-ranging pool. A part of them is granted to every employee, while others are available on certain conditions or are of an insurance nature, the basis of which is the employees' collective contribution. The way social benefits and discretionary benefits are granted is set out in the Collective Agreement and related regulations.

Both in its selection processes and during the career of its employees at the company, Magyar Telekom Plc. is committed to ensure for its employees equal opportunities independently from age, gender, ethnicity, religious or political conviction, and sexual orientation. In hiring labour a special attention is paid to granting possibilities to its own employees in the first place, through either horizontal or vertical advancement: this is the FreeJob system (a data base of vacant positions accessible only to Magyar Telekom Plc. employees) accompanied by a regulation for 30 days being reserved for an exclusively internal search. The company operates and Induction Program to effectively help the accommodation of colleagues selected for the position.

Magyar Telekom Plc. pays special attention to young graduates through the „Starting-Block” trainee program, which grants employment and training to 15-20 graduates each year.

The company introduced in 1997 and has continuously developed since then its knowledge management system, which is being used for the measurement of competence and knowledge, for the definition of development areas and the review of individual tasks. Development needs are identified with the help of the Personnel Round Table for middle and top management. Development is available in the following forms:

- traditional „classroom” training within the company and outside,
- skills development training (individual and group programs administered by trainers, e.g. team building, self-awareness training)
- e-learning, i.e. distant training through an individual training „net” (e.g. media training).

Both management succession and development of professionals are key aims in the area of advancement and talent management, for which Magyar Telekom Plc. operates several, target-specific talent management programs.

Magyar Telekom Plc. is committed to excellence: the results of regular surveys among employees and customers are used as a basis for the improvement of our internal operation. In addition, the company takes advantage of the possibilities rendered by modern technologies to achieve excellence: through the enhancement and use of advanced IT systems it improves operating efficiency.

The HR area operates its web-based IT services and, through eHR solutions, it continuously broadens the range of its cost saving, efficiency improving and customer friendly services.

Magyar Telekom Plc. pays special attention to the high level of the employees' occupational safety and provides them the conditions of safe work and a working environment, which does not harm health. A special organizational unit is engaged in occupational health and safety of work issues, and develops the company's safety of work strategy and set of objectives.

Magyar Telekom Plc. puts a major emphasis on taking care of departing employees: several solutions have been developed to provide for benevolent outplacement and to reduce the number of one-sided terminations. Using the wealth of alternative forms of employment is accompanied by an outplacement system called Chance program to help departing employees find a new employment. The program provides training and helps departing employees' reintegration in the labour market.



## Outlook

Since becoming a listed company in 1997, we have maintained our dominant positions both in fixed line, mobile, Internet and data businesses. We have successfully expanded into international operations through acquisitions, and continuously produced solid results.

The telecommunications industry currently undergoes a major change globally and in Hungary as well. We have observed several long-term trends which are changing the structure of the Hungarian telecommunications market. Key drivers of the long-term trends include changes in technology (i.e., IP-based broadband products / solutions, emerging wireless broadband technologies), customer requirements (i.e., mobility and ease of use, always-on broadband Internet access), competition and regulation (i.e., low entry barriers, new business models). These long-term trends and the changing competitive dynamics in the Hungarian market imply the need for Magyar Telekom to change its traditional traffic-based revenue structure to an access-based structure through substituting declining traffic revenues with content, entertainment and bundled access.

Accordingly, we have redefined the focus areas of our corporate strategy in order to better exploit Magyar Telekom Group's being the only integrated telecommunications operator with full scale of services, and ensure the Group's long-term competitiveness and value creation potential. The building blocks of our strategy enable the Group to exploit and develop its extended customer base, significantly improve efficiency and capture growth opportunities. The key focus areas are defined as follows:

- Strengthen integrated telecommunications approach through leveraging all Magyar Telekom Group assets and capabilities with major focus on our extended customer base
- Ensure superior customer care through customer value driven service delivery, service assurance and customer servicing
- Sustain mobile competitiveness and maintain leading mobile position by preserving T-Mobile Hungary's market share
- Build the next-generation broadband services provider by gradually migrating the customer base to seamless IP solutions with appropriate content and value-added services
- Reposition our corporate market approach and position us as full scale IT/telecommunications solution provider
- Capture complementary growth opportunities through an extended reach and scope of our acquisition activities

To ensure our continuous success in the long run, we continue to implement our Value Creation Program launched in mid 2004. According to the key focus areas of our corporate strategy we have redefined the set of initiatives within the Program. Management believes the successful implementation of this Program is critical to enable Magyar Telekom Group to exploit new growth opportunities as the telecommunications market rapidly develops in new directions.

In revenues, at group level we expect to achieve at least 3 percent compounded average growth rate over 2006-2007. We aim to grow our EBITDA in 2007 in forint terms over 2005 performance.

On December 20, 2005, Magyar Telekom's Extraordinary General Meeting approved the decision on the merger of Magyar Telekom Plc. and T-Mobile Hungary. The court registration of the merger took place on February 28, 2006. From March 1, 2006, Magyar Telekom is the legal successor of T-Mobile Hungary. At the same time, T-Mobile Hungary will continue its operations within Magyar Telekom under an independent brand and as an independent line of business.

## Significant events happened in 2006

On November 11, 2005 Magyar Telekom Plc. together with T-Mobile Magyarország Rt. decided to establish Pro-M Professzionális Mobilrádió Zártkörűen Működő Részvénytársaság (PRO-M Zrt.). The company's share capital is HUF 200 million, cash contribution in full, consisting of 200,000 registered ordinary shares with face value of HUF 1,000 apiece. Following the merger of Magyar Telekom Plc. and T-Mobile Hungary (on February 28, 2006), Magyar Telekom Plc. gained direct ownership of 100% of PRO-M Zrt. shares. The Court of Registry had registered Pro-M Zrt. on January 31, 2006, thus it is not shown in investments in 2005.

On November 29, 2005 Magyar Telekom Plc. concluded an agreement on the acquisition of 100% stake in Orbitel for EUR 8 million. Orbitel is Bulgaria's one of the leading alternative wireline telecommunications and Internet service providers, offering country-wide voice and data services based on the IP technology to the business segment. In 2005 the company generated EUR 11.5 million in revenues (unaudited). On February 3, 2006 Magyar Telekom Plc. closed the transaction and gained indirect ownership of 100% in the company.

On December 12, 2005, Magyar Telekom Plc. signed an agreement on purchasing 100% ownership share of Dataplex Kft. for HUF 5.1 billion, based on the net debt position of the company at the time of the agreement. Dataplex is operating in the Hungarian information technology services market. In 2005, the company's revenues reached HUF 1.3 billion (unaudited). The closing of the transaction was carried out on April 5, 2006 after having obtained the approval of the regulatory authority (Hungarian Competition Authority).

On June 16, 2006 Magyar Telekom Plc. signed an agreement on purchasing 100% ownership share of KFKI Group, one of Hungary's leading IT service provider. The purchase price is HUF 8.17 billion, an additional HUF 1.5 billion depends on the financial performance of the Group in 2006. Following the approval of the regulatory authority (Hungarian Competition Authority), Magyar Telekom Plc. has completed the transaction on September 15, 2006.

On August 30, 2006 Magyar Telekom Plc. signed an agreement on selling its 72% stake in Cardnet Zrt. for a purchase price of above HUF 300 million plus the proportionate dividend for 2006. The disposal of this stake is in line with Magyar Telekom's efforts to focus on its core businesses.

On January 12, 2006 Magyar Telekom Plc. signed an agreement with the European Investment Bank (EIB) for a long-term loan, granted through Deutsche Telekom International Finance B.V. as a financial intermediary, in the amount of HUF 47.4 billion that will be used to finance its broadband investment projects. The loan matures in January 2013, and will be repaid in five equal installments starting in 2009 after two years grace period.

The Board of the Hungarian National Regulatory Authority (NRA) has published its draft resolution regarding the Hungarian mobile voice termination fees, based on which the proposed reduction to the average mobile voice termination fee for Magyar Telekom/T-Mobile for the next three years is 14.74% per annum. The new fees could be applicable from early 2007.

Magyar Telekom Plc.'s receivables related to ETTA (Egyetemes Távközlési Támogatási Alap – Universal Telecommunication Support Fund) were HUF 1,468 million at the end of 2004, from which HUF 619 million were recovered during 2005. We recorded impairment on the remaining part (HUF 849 million) of the receivables in 2005. With its review decision of April 25, 2006 (delivered on May 29, 2006) the Supreme Court upheld the resolution that T-Mobile Magyarország Rt. had to pay HUF 1.1 billion to the fund. Resulting from the above-mentioned decision, Magyar Telekom Plc.'s uncertainty of the return concerning the ETTA receivables partly ceased.

Budapest, December 5, 2006

Magyar Telekom Nyrt.

MAGYAR TELEKOM TELECOMMUNICATIONS  
PUBLIC LIMITED COMPANY

BALANCE SHEET AND PROFIT AND LOSS STATEMENT  
TO THE 2005 ANNUAL REPORT

(All amounts in millions of HUF)

ASSETS

	Note	December 31, 2004	Self-revision	December 31, 2005
<b>A. FIXED ASSETS AND FINANCIAL INVESTMENTS</b>		<b>816 037</b>	<b>-8</b>	<b>842 373</b>
<b>I. Intangible assets</b>	4	<b>185 679</b>	<b>-3</b>	<b>180 411</b>
Capitalised costs of foundation and restructuring		0	0	0
Capitalised costs of research and development		0	0	0
Rights		1 138	0	18 238
Intellectual property		13 837	-3	1 558
Goodwill		170 704	0	160 615
Advance payments on intangible assets		0	0	0
<b>II. Tangible assets</b>	5	<b>357 632</b>	<b>-5</b>	<b>338 114</b>
Land and buildings and related rights		207 039	39	204 716
- Land		2 404	27	2 298
- Buildings		40 968	5	39 334
- Telecommunication network		153 829	3	153 969
- Other properties		8 385	3	8 108
- Real estate related rights		1 453	1	1 007
Technical equipment, machinery and vehicles		134 085	133	117 730
- Telecommunication equipment and machinery		133 112	133	116 718
- Other technical equipment, machinery and vehicles		973	0	1 012
Other equipment and vehicles		8 042	49	6 290
Construction-in-progress, renovation		8 466	-226	9 378
Advance payments on construction-in-progress		0	0	0
<b>III. Financial investments</b>		<b>272 726</b>	<b>0</b>	<b>323 848</b>
Non current investments in affiliated companies	6	188 994	0	230 147
Non current loans granted to affiliated companies	7	79 000	0	89 141
Other investments	8	20	0	0
Other non current loans granted	9	4 712	0	4 560
Non current bonds and other securities		0	0	0
<b>B. CURRENT ASSETS</b>		<b>83 100</b>	<b>175</b>	<b>70 773</b>
<b>I. Inventories</b>	10	<b>2 235</b>	<b>-8</b>	<b>2 862</b>
Raw materials		1 291	0	884
Work in progress and semi-finished products		0	0	0
Finished products		0	0	0
Goods available for sale		944	-8	1 978
Advance payments on inventories		0	0	0
<b>II. Receivables</b>		<b>76 137</b>	<b>183</b>	<b>64 312</b>
Accounts receivable	11	18 671	82	22 225
Receivables from affiliated companies	12	50 208	0	36 410
Bills receivable		0	0	0
Receivables from other related companies		30	98	36
Other receivables	13	7 228	3	5 641
<b>III. Securities</b>	14	<b>3 842</b>	<b>0</b>	<b>1 926</b>
Investments in affiliated companies		0	0	0
Other investments		0	0	0
Treasury stock, quotas		3 842	0	1 926
Marketable securities		0	0	0
<b>IV. Liquid assets</b>		<b>886</b>	<b>0</b>	<b>1 673</b>
Cash and cheques		3	0	5
Bank deposits		883		1 668
<b>C. PREPAYMENTS</b>	15	<b>11 163</b>	<b>-14</b>	<b>10 320</b>
Accrued income		10 754	-14	9 960
Prepayments for costs and expenses		409	0	360
Deferred expenses		0	0	0
<b>TOTAL ASSETS</b>		<b>910 300</b>	<b>153</b>	<b>923 466</b>

Budapest, December 5, 2006

Straub Elek  
Chairman and Chief Executive Officer

Thilo Kusch  
Chief Financial Officer

## BALANCE SHEET AS OF DECEMBER 31, 2005

(All amounts in millions of HUF)

LIABILITIES AND OWNER'S EQUITY

	Note	December 31, 2004	Self-revision	December 31, 2005
<b>D. SHAREHOLDER'S EQUITY</b>	16	<b>371 724</b>	<b>186</b>	<b>440 000</b>
I. Common stock		104 281	0	104 281
- of this treasury stock at par value		490	0	246
II. Unpaid share capital (-)		0	0	0
III. Capital reserves		52 837	0	52 837
IV. Retained earnings		210 764	0	212 866
V. Restricted reserves		3 842	0	1 926
VI. Valuation reserves		0	0	0
VII. Net income		0	186	68 090
<b>E. PROVISIONS</b>	17	<b>13 516</b>	<b>0</b>	<b>4 307</b>
Provision for expected obligations		13 345	0	4 183
Provision for expected expenses		165	0	124
Other provisions		6	0	0
<b>F. LIABILITIES</b>		<b>498 406</b>	<b>184</b>	<b>454 331</b>
I. Subordinated liabilities		0	0	0
II. Non current liabilities		<b>225 068</b>	<b>0</b>	<b>230 605</b>
Non current credits		0	0	0
Convertible bonds		0	0	0
Debt from issuance of bonds		127	0	124
Investment and development loans	18	47 266	0	13 125
Other non current loans		0	0	0
Non current liabilities to affiliated companies		0	0	0
Non current liabilities to other affiliated companies	19	177 675	0	212 000
Other non current liabilities		0	0	5 356
III. Current liabilities		<b>273 338</b>	<b>184</b>	<b>223 726</b>
Current loans		72	0	71
- of this convertible bonds		0	0	0
Current credits	20	34 156	0	41 913
Advances received		708	22	606
Accounts payable		20 372	0	19 499
Bills of exchange payable		0	0	0
Current liabilities to affiliated companies	21	74 598	0	73 399
Current liabilities to other affiliated companies	22	60 000	0	74 678
Other current liabilities	23	83 432	162	13 560
- of this dividends payable		72 654	0	0
<b>G. ACCRUED EXPENSES</b>	24	<b>26 654</b>	<b>-217</b>	<b>24 828</b>
Deferred income		2 072	0	2 502
Accrued expenses		24 295	-217	21 804
Other deferred revenue		287	0	522
<b>TOTAL LIABILITIES AND SHAREHOLDER'S EQUITY</b>		<b>910 300</b>	<b>153</b>	<b>923 466</b>

Budapest, December 5, 2006

Straub Elek  
Chairman and Chief Executive Officer

Thilo Kusch  
Chief Financial Officer

Magyar Telekom Nyrt.  
INCOME STATEMENT FOR THE PERIOD ENDED 31 DECEMBER, 2005  
(All amounts in millions of HUF)

	Note	2004	Self-revision	2005
1. Domestic sales	25	253 878	76	237 079
2. Export sales	26	12 368	50	12 060
<b>I. Sales revenues</b>		<b>266 246</b>	<b>126</b>	<b>249 139</b>
3. Change in self-manufactured inventories		0	0	0
4. Capitalised value of self-manufactured assets		11 315	0	12 915
<b>II. Own work capitalized</b>		<b>11 315</b>	<b>0</b>	<b>12 915</b>
<b>III. Other revenues</b>	27	<b>7 198</b>	<b>9</b>	23 184
of which: reversal of write-down for assets		573	0	388
5. Costs of raw material		14 132	-2	15 858
6. Costs of services	29	53 960	-207	59 593
7. Costs of other services		2 271	-4	2 151
8. Cost of goods sold		4 005	-3	4 271
9. Costs of services sold (intermediated)	30	52 929	-8	41 813
<b>IV. Material-type expenditures</b>		<b>127 297</b>	<b>-224</b>	<b>123 686</b>
10. Salaries and wages	31	35 722	0	32 552
11. Other payroll related costs	31	11 668	22	12 942
12. Payroll related contributions		14 280	-6	13 733
<b>V. Payroll and related expenditures</b>		<b>61 670</b>	<b>16</b>	<b>59 227</b>
<b>VI. Depreciation</b>		<b>66 812</b>	<b>13</b>	64 097
<b>VII. Other expenditures</b>	33	<b>31 847</b>	<b>140</b>	16 914
of which: write-down for assets		8 365	0	2 769
<b>A. PROFIT FROM OPERATING ACTIVITIES</b>		<b>-2 867</b>	<b>190</b>	<b>21 314</b>
13. Dividends and profit sharing (received or due)		70 770	0	68 429
of which: received from affiliated companies		70 770	0	68 429
14. Foreign exchange gains on sale of investments		150	0	497
of which: received from affiliated companies		0	0	0
15. Interest income and f/x gains on financial investments		10 813	0	7 051
of which: received from affiliated companies		10 805	0	7 044
16. Other interest income received		4 174	0	3 171
of which: received from affiliated companies		3 779	0	3 015
17. Other revenues on financial activities		659	0	4 476
<b>VIII. Revenues from financial transactions</b>		<b>86 566</b>	<b>0</b>	<b>83 624</b>
18. Foreign exchange loss on the sale of financial investments		78	0	0
of which: related to affiliated companies		0	0	0
19. Interest expense		35 150	0	31 702
of which: related to affiliated companies		694	0	643
related to other affiliated company		23 271	0	24 793
20. Write-down for investments, securities and bank deposits		0	0	0
21. Other expenses on financial activities		6 289	0	576
<b>IX. Expenditures from financial transactions</b>		<b>41 517</b>	<b>0</b>	<b>32 278</b>
<b>B. FINANCIAL RESULTS</b>	34	<b>45 049</b>	<b>0</b>	<b>51 346</b>
<b>C. INCOME FROM ORDINARY ACTIVITIES</b>		<b>42 182</b>	<b>190</b>	<b>72 660</b>
<b>X. Extraordinary revenues</b>	35	<b>3 476</b>	<b>1</b>	2 013
<b>XI. Extraordinary expenditures</b>	36	<b>6 630</b>	<b>5</b>	6 583
<b>D. NET INCOME ON EXTRAORDINARY ACTIVITIES</b>		<b>-3 154</b>	<b>-4</b>	<b>-4 570</b>
<b>E. NET INCOME BEFORE TAXES</b>		<b>39 028</b>	<b>186</b>	<b>68 090</b>
<b>XII. Corporate income tax</b>	37	<b>0</b>	<b>0</b>	0
<b>F. NET INCOME</b>		<b>39 028</b>	<b>186</b>	<b>68 090</b>
22. Use of retained earnings for dividends		33 626	0	0
23. Dividend paid (approved)	38	72 654	0	0
<b>G. BALANCE SHEET NET PROFIT FIGURE</b>		<b>0</b>	<b>186</b>	<b>68 090</b>

Budapest, December 5, 2006

Straub Elek  
Chairman and Chief Executive Officer

Thilo Kusch  
Chief Financial Officer

Magyar Telekom Nyrt.

MAGYAR TELEKOM TELECOMMUNICATIONS  
PUBLIC LIMITED COMPANY

SUPPLEMENT  
TO THE 2005 ANNUAL REPORT

**Magyar Telekom Plc.**  
Notes to the Financial Statements prepared  
in accordance with the Hungarian Act on Accounting  
As of December 31, 2005  
(All amounts in millions of HUF, unless otherwise indicated)

**0. Note Added For Translation**

This annual report for December 31, 2005 is the English translation of the annual report issued in Hungarian language and prepared in accordance with Act C/2000 on accounting and with generally accepted accounting principles in Hungary.

These principles may be different from International Financial Reporting Standards or accounting principles of any other country. No adjustments have been made to conform the annual report with any accounting principles other than Hungarian.

The auditors' report is a translation of the auditors' report issued in Hungarian language on the Hungarian annual report as outlined above.

In the event of any discrepancy, whether in the auditors' report or in the annual report, the Hungarian original version prevails.



**Magyar Telekom Plc.**  
Notes to the Financial Statements prepared  
in accordance with the Hungarian Act on Accounting  
As of December 31, 2005  
(All amounts in millions of HUF, unless otherwise indicated)

**1. Background and General Information**

Official name of the Company: Magyar Telekom Telecommunications Public Limited Company

Short name of the Company: Magyar Telekom Plc.

Headquarter of the Company: 1013 Budapest, Krisztina krt. 55.

The Company's main activity is telecommunication.

The Hungarian Telecommunications Company ("Matáv Rt."), the legal predecessor of Magyar Telekom Telecommunications Public Limited Company ("Magyar Telekom Plc." or the "Company") was founded by the Ministry of Transport, Communications and Construction on January 1, 1990. The Company was transformed by the board of directors of State Asset Holding Ltd. into a wholly owned company limited by shares as of December 31, 1991.

The Company was privatized on December 22, 1993, when MagyarCom consortium acquired a 30.1 per cent stake in the Company. At the second stage of the privatization, which took place in December 1995, MagyarCom became the majority owner.

On November 14, 1997 the Company was the first in the Central-Eastern European region to be listed on both the Budapest and the New York Stock Exchanges.

In June 1999, the State Privatization and Holding Company sold its remaining stake (5.75 per cent) through a secondary offering. After this transaction, the proportion of publicly traded shares increased to 40.47 per cent. MagyarCom's share in the Company decreased to 59.53 per cent.

In 2000, the Company increased its common stock through issuing new shares in the amount of HUF 63 million, which were held mainly within the Matáv Group. As a result of this transaction, the proportion of publicly traded shares increased to 40.51 per cent and MagyarCom's ownership changed to 59.49 per cent.

In 2002, the Company carried out an additional increase in common stock in the amount of HUF 490 million, which shares had been repurchased. As a result of this transaction, the proportion of publicly traded shares changed to 40.32 per cent, the proportion of repurchased treasury stock to 0.47 per cent and MagyarCom's ownership decreased to 59.21 per cent.

The extraordinary general meeting of the Company held on February 22, 2005 approved the decision of the Board of Directors to change the official name of Magyar Telecommunications Company Ltd. into Magyar Telekom Telecommunications Company Ltd., with short name of Magyar Telekom Rt. The change was registered at Court of Registry on May 6, 2005. On February 28, 2006 the name of Magyar Telekom Telecommunications Company Ltd. has changed to Magyar Telekom Telecommunications Public Limited Company, with short name of Magyar Telekom Plc. ("Magyar Telekom Plc." or the "Company"). The change was registered at Court of Registry on February 28, 2006.

**Investigation into certain consultancy contracts**

On February 13, 2006, the Company announced that it was investigating certain contracts to determine whether they were entered into in violation of Company policy or applicable law or regulation. Concerns regarding two consultancy contracts entered into by one of the Company's subsidiaries were initially raised by the Company's auditors. As a result of the investigation, two additional consultancy contracts, which were entered into by the Company, have been called into question. The total amount of the four contracts under investigation at the Group is around HUF 2 billion, of which HUF 1,120 million relates to the two contracts entered into by the Company. Concerns have also arisen regarding destruction by certain employees of electronic documents obstructing the investigation. As a consequence of the investigation, the Company had suspended a number of employees who have since resigned. The investigation, which is being conducted by an independent law firm and supervised by the Audit Committee, is still ongoing.

**Magyar Telekom Plc.**

Notes to the Financial Statements prepared  
in accordance with the Hungarian Act on Accounting  
As of December 31, 2005  
(All amounts in millions of HUF, unless otherwise indicated)

Although the investigation has not been finalized, based on the independent investigators' findings and conclusions to date, these contracts were entered into without full compliance with internal company procedures regarding the entry of such contracts. Moreover, sufficient evidence could not be obtained that adequate value was received under these contracts. Accordingly, although the Company had originally capitalized the amounts paid under these contracts, as a result of the findings of the investigation, the Company has ultimately expensed the HUF 1,120 million paid under these two contracts, and discloses these expenses under the caption "Extraordinary expenditures." See Note 36

The Company has already implemented certain remedial measures designed to enhance its control procedures with respect to the entry into consultancy contracts, including the introduction of a new governance model and replacement of the Board of Directors at Crngorski Telekom and termination of work contracts with employees initiating data deletions interfering with the investigation.

The Company's Board of Directors also approved on November 8, 2006 a more extensive program of remedial actions, which it expects to implement in the near future. These decisions include structural and procedural changes in relation to mergers and acquisitions, and procurement, as well as a new internal control regime. The Company's Board of Directors also decided on December 5, 2006 on certain additional enhancements of internal controls and the implementation thereof.

As a result of the delays in finalizing its 2005 financial statements as a result of the investigation, the Company has failed to meet certain deadlines prescribed by the Hungarian and other applicable laws and regulations for preparing and filing audited annual results and holding annual general meetings. The Company has already been fined HUF 12 million as a consequence of such delays. The Company has notified the Hungarian Financial Supervisory Authority, the U.S. Securities and Exchange Commission and the U.S. Department of Justice of the investigation and is in contact with these authorities regarding the investigation and has responded to a number of inquiries these authorities have raised.

Persons authorised to sign the annual report:

Elek Straub - Chairman and Chief Executive Officer (residence: Budapest)

Thilo Kusch - Chief Financial Officer (residence: Budapest)

The Company's bookkeeping services are provided by EurAccount Pénzügyi és Számviteli Szolgáltató Kft.

The company register number of EurAccount Kft. is 01-09-737269, its taxation number is 13477541-2-42.

The accounting services provided by EurAccount Kft. are supervised by Beáta Bálintné Pál Executive Director.

Certificate number: 132224. Area of speciality: entrepreneurial activity. State: registered. Residence: Budapest

The Company is subject to compulsory audit. The Company's auditor is PricewaterhouseCoopers Ltd. – Szilvia Szabados.

Magyar Telekom Plc.'s homepage address: [www.magyartelekom.hu](http://www.magyartelekom.hu)

**Magyar Telekom Plc.**  
Notes to the Financial Statements prepared  
in accordance with the Hungarian Act on Accounting  
As of December 31, 2005  
(All amounts in millions of HUF, unless otherwise indicated)

**2. Accounting policies**

The accounting policies of Magyar Telekom Plc. include basic accounting principles, measurement methods and procedures as well as methods and tools used for enforcing the provisions of the Hungarian Accounting Regulations.

Magyar Telekom Plc. maintains its records both in accordance with the Hungarian Accounting Regulations (HAR) and International Financial Reporting Standards (IFRS). The differences between the two reports are solely due to differences in the respective accounting principles.

The closing day in the Company's business year is December 31. The balance sheet preparation date is the 2nd working day of the year.

Magyar Telekom Plc. uses version "A" of the balance sheet and version "A" of the income statement (total cost method) when preparing its annual report in accordance with the Hungarian Accounting Regulations. Amounts in the annual report are stated in HUF millions.

The Hungarian Act on Accounting allows for certain captions in the balance sheet to be broken-down or omitted, what is adopted by the Company both in case of the balance sheet and the income statement, as well.

Since January 1, 2005 the Company has complied with its obligation to prepare consolidated annual report in such a way that it prepares its consolidated annual report in accordance with the International Financial Reporting Standards (as accepted by EU).

Based on the above, in contrast to previous practice, information regarding the consolidation level of affiliated companies – for the year 2005 and for comparative periods as well – is no longer provided either in the income statement or in the balance sheet, only in the Notes.

Deutsche Telekom Group's consolidated annual report prepared by Deutsche Telekom AG (Friedrich-Ebert-Alle 140, 53113 Bonn, Germany) includes Magyar Telekom Plc. as a subsidiary of Deutsche Telekom AG.

*Definition of the accounting principles, guidelines and methods*

Classification of accounting matters:

Magyar Telekom Plc. applies the materiality and significance guidelines for limits set forth in the Hungarian Accounting Regulations in preparing its annual report.

Material error:

An error revealed must be treated as a material error in every case it results in at least 20 per cent change in prior year's shareholder's equity.

Significant error:

Items must be considered as significant in every case if in the year the error was discovered the cumulative absolute amount of the errors and their effects on net income and shareholder's equity exceeds the lower of 2 per cent of total assets of the year they relate to or HUF 500 million.

If the Company reveals a significant error through self-revision, then modifications relating to prior years are presented next to the prior years' figures for each balance sheet and income statement item.

**Magyar Telekom Plc.**  
Notes to the Financial Statements prepared  
in accordance with the Hungarian Act on Accounting  
As of December 31, 2005  
(All amounts in millions of HUF, unless otherwise indicated)

The Company has set up regulations for valuation of assets and liabilities, scrapping, cost calculation, stocktaking, cash management, and system of documentation as required by the Hungarian Accounting Regulations.

Until further decision the Company does not use the allowed alternative treatment in the Hungarian Accounting Regulations for the valuation of fixed assets on market value and valuation of certain financial instruments on fair value.

The Company qualifies every foreign exchange rate difference resulting from foreign exchange translation as significant, therefore all realized and unrealized foreign exchange gains and losses are recorded in the subledger as well as in the general ledger.

*Measurement methods used at the preparation of the Balance Sheet*

**ASSETS**

Recognition and measurement of non current assets

*Intangible and tangible fixed assets*

Magyar Telekom Plc. carries intangible and tangible fixed assets at historical cost less accumulated depreciation. Property, plant and equipment includes the capitalized value of those improvements and refurbishment, which extend the useful life of the asset, increase its capacity and/or modify its functionality. Borrowing costs are capitalized up to the date the assets are put into use. Foreign exchange differences arising from foreign currency capital expenditure loans are capitalized in case they are significant. These items are considered to be significant if they exceed 1 per cent of the annual capital expenditure.

*Depreciation policy*

The depreciation of tangible fixed assets is determined using the straight-line method on the basis of the useful life of the assets taking into consideration their residual value. The Company determines residual values for those groups of assets where the residual values are considered to be significant. Residual value is considered to be significant if the expected realizable value exceeds the expected scrap value when the asset is taken out of service.

The Company determines residual value for buildings and vehicles. Residual value is not considered to be significant for intangible fixed assets and other groups of the tangible fixed assets.

The Company applies residual values only for assets capitalized after January 1, 2001. No residual value is calculated for additional capitalization on assets purchased before January 1, 2001.

Determination of residual value:

Buildings: Determined individually based on location of the building as well as expected future useful life and usage of the building.

Vehicles: personal cars for personal use: 40 per cent of the acquisition cost  
personal cars for business use: 30 per cent of the acquisition cost  
trucks under 3.5 tons: 30 per cent of the acquisition cost  
trucks above 3.5 tons: 20 per cent of the acquisition cost  
transport vehicles: 10 per cent of the acquisition cost.

**Magyar Telekom Plc.**  
Notes to the Financial Statements prepared  
in accordance with the Hungarian Act on Accounting  
As of December 31, 2005  
(All amounts in millions of HUF, unless otherwise indicated)

Since January 1, 2005 residual value of personal cars for personal use has changed from 30 per cent to 40 per cent. The reason for this is the change of the policy for personal used cars defining their replacement after 3 years and so their useful life became shorter.

Useful lives are determined based on generally accepted international telecommunication industry practices and development potentials. Magyar Telekom Plc. regularly reviews the useful lives of fixed assets and modifies them if necessary. The Company records the value of all tangible fixed assets below HUF 50,000 immediately as depreciation expense, excepted for network assets under HUF 50,000 that were installed at customers.

The Company records extraordinary depreciation in cases where the value of the assets permanently decreased due to the fact that it is no longer needed, is spoiled or destroyed, or if the book value is permanently and significantly in excess of the market value. In the absence of other reliable estimates the market value of the asset is determined using discounted cashflow analysis.

In case the market value of the individual asset significantly exceeds its carrying value, the Company records a reversal of extraordinary depreciation and classifies the related income as other revenue.

*Capitalized value of foundation and restructuring*

The Company does not capitalize foundation and restructuring costs.

*Capitalized value of research and development*

The Company does not capitalize research and development costs.

*Goodwill*

The excess of the cost of an acquisition over the Company's share of the net assets of a directly controlled subsidiary (more than 75 per cent ownership) is recorded as goodwill. The Company determines the expected useful life of the goodwill between 5 and 20 years on an individual basis.

The Company does not record depreciation on goodwill realized after January 1, 2005 unless impairment required. The Company practices the straight-line method for goodwill recorded earlier.

*Intellectual property*

Since 2005 only those assets have been recorded as intellectual property which are in the ownership of the Company. The useful life of the intellectual property is mainly 5 years.

Those intellectual properties where the Company has only the rights of use are recorded as Rights. Their useful life is similar to that of intellectual property.

*Own work capitalized*

Direct expenses incurred in construction of property, plant and equipment manufactured by the Company are capitalized. This includes direct production costs and all other direct costs. The Company records materials supplied to subcontractors at delivery as construction in progress.

*Financial investments*

Long term investments in affiliated companies are recorded at cost when established or at original purchase price less goodwill when acquired. At the end of the year, the Company's investments are impaired if the market value of the equity investment is permanently and significantly lower than its book value. The impairment review is carried out on an individual basis.

## Magyar Telekom Plc.

Notes to the Financial Statements prepared  
in accordance with the Hungarian Act on Accounting  
As of December 31, 2005  
(All amounts in millions of HUF, unless otherwise indicated)

Originated loans include loans to subsidiaries, associated companies and other affiliates as well as long term loans given to employees for housing purposes.

### Recognition and measurement of current assets

#### *Inventories*

The cost of goods and raw materials are assigned by using the weighted average cost formula. Telephone cards are classified as goods available for sale and are valued using the FIFO method.

Inventories include assets whose future usage can not be determined at the time of purchase (i.e. whether they will be used for an investment project or maintenance). Inventories also include advance payments on inventories and assets held for sale reclassified from tangible fixed assets.

Tangible fixed assets reclassified to inventories are valued on an individual basis. Besides these assets Magyar Telekom Plc. considers its inventories as low per unit value. These inventories are impaired in proportion to a percentage of their book value with respect to their ageing as follows:

No movements in inventories from 181-360 days	40 per cent
No movements in inventories for more than 360 days	80 per cent

Impairment loss is charged based on the ageing of inventory and also on an individual basis to ensure that year-end values are in line with fair market values if they are lower than the book value.

#### *Trade receivables*

The balance of trade receivables reflects invoiced amounts accepted by the customers and does not include any irrecoverable and unaccepted receivables.

Rates of impairment for overdue receivables are the following:

Overdue for 91-180 days	30 per cent
Overdue for 181-360 days	70 per cent
Overdue for more than 360 days	100 per cent

Accounts receivable from companies under liquidation, bankruptcy and final settlement procedures are identified on an individual basis and fully impaired. Similarly, 100 per cent impairment loss is recorded for all trade receivables from customers (independently from the ageing) that have liabilities to Magyar Telekom Plc. that are overdue more than 360 days.

The Company records impairment for its receivables from countries participating in the international settlement on an individual basis. The Company does not impair receivables from related parties.

Accounts receivable and payable related to international telecommunications traffic are stated at gross value, even though the actual settlement of the balance is performed on a net basis.

## Magyar Telekom Plc.

Notes to the Financial Statements prepared  
in accordance with the Hungarian Act on Accounting  
As of December 31, 2005  
(All amounts in millions of HUF, unless otherwise indicated)

Magyar Telekom Plc. measures its foreign currency receivables at year-end at the official exchange rate of the Hungarian National Bank ("MNB") as of December 31.

### *Securities*

Securities among current assets include the original cost of short term investments in bonds, shares, other securities held for sale and the repurchase value of treasury stock.

## LIABILITIES AND SHAREHOLDER'S EQUITY

### *Valuation reserve*

Magyar Telekom Plc. does not apply the allowed alternative treatment for the recognition of a valuation reserve arising from market value and fair value measurement.

### *Restricted reserve*

Magyar Telekom Plc. records restricted amounts from capital reserves and retained earnings as restricted reserve. The book value of the repurchased treasury stock is recorded in restricted reserve.

### *Provisions*

Main items provided for:

- early retirement payments
- severance payments
- contingent liabilities and commitments
- environmental liabilities

### *Measurement of liabilities in foreign currencies*

Liabilities denominated in foreign currencies are measured at the official exchange rate of MNB at year-end.

### *Measurement principles applied in the preparation of the Income Statement*

Based on the Section 74. (2) of Act C/2000 on accounting the exports sales revenue includes the value of sales and services supplied to non-resident customer regardless of the location of the services provided, except the customer is non-residential in the territory of Hungarian Republic and has not declared it to Magyar Telekom Plc. (e.g. non-resident customer - whose registered office, place of abode or permanent residence is situated abroad – buys phone sets in T-Pont).

Revenues and expenses are recognized in line with the accrual concept of accounting. Non-realized exchange rate differences are recognized as follows:

- if the balance of non-realized foreign exchange gain and loss is a gain, it is recorded as other revenue from financial transactions,
- if the balance is a loss, it is recorded as other expenditure from financial transactions.

The Company recognizes dividends approved by the General Meeting of the subsidiaries and associates in the year following the one they relate to. Interim dividends paid by the subsidiaries and associates are recorded as liability until final approval.

## **Magyar Telekom Plc.**

Notes to the Financial Statements prepared  
in accordance with the Hungarian Act on Accounting  
As of December 31, 2005

(All amounts in millions of HUF, unless otherwise indicated)

Based on telecommunication regulations the Universal Electronic Telecommunication Cash Register (Egyetemes Elektronikus Hírközlési Kassza, "Kassza") – the former Universal Telecommunication Support Fund (Egyetemes Távközlési Támogatási Alap, "ETTA") - was established in 2004 to compensate universal service providers for their loss of revenue resulting from the low price of universal service packages. The rules of the operation, sources, supervision and usage of the Kassza are laid down by the Government of the Hungarian Republic. All the companies in the telecommunication market have a payment obligation to the Kassza. Donations are given from the Kassza to the fixed line service providers entitled to it. The Company records the fees paid to Kassza as other expenditure and the amounts received from the Kassza as other revenues.

The fees paid by Magyar Telekom Plc. to carrier, mobile and international service providers for call termination are invoiced to the customers by Magyar Telekom Plc. Therefore the payments for calls initiated in Magyar Telekom Plc.'s network and terminated by carrier, mobile and international service providers as well as payments for leased lines (both domestic and international) are recorded as mediated services disclosed as costs of services sold.

In compliance with the 30/2001. (XII. 23) MeHVM Regulation, the Company uses two methods for recording the fees due to the Internet service providers. In case an invoice is issued by the Internet service provider the Company records the amount as costs of other services, while in case the settlement is without invoice, the amount is recorded as other expenditure.

Extraordinary items are disclosed in the Notes.

Revenues and expenses not directly related to the ordinary operations are disclosed as extraordinary items.

### **OTHER**

Magyar Telekom Plc. pays special attention to meeting environmental protection regulations in its activities. The emergency power supply batteries used in switches and power generators are stored and neutralized in accordance with the applicable environmental protection laws.

The Company had no expense of penalty due to environmental liabilities.



**Magyar Telekom Plc.**  
Notes to the Financial Statements prepared  
in accordance with the Hungarian Act on Accounting  
As of December 31, 2005  
(All amounts in millions of HUF, unless otherwise indicated)

**3. Summary of the Company's financial position and liquidity**

The Company's financial position and liquidity as of December 31, 2004 and 2005 are represented by the following financial ratios:

	2004	2005
Liquidity ratio (= current assets / current liabilities)	0.30	0.32
Operating margin ((= operating profit / (sales revenues + other revenues))	-0.01	0.08
Operating return on assets (= operating profit / total assets)	-0.003	0.023
Leverage ratio ((= non current liabilities / (equity + non current liabilities))	0.38	0.34

The liquidity ratio increased from 0.30 in 2004 to 0.32, which is mainly due to the significant decrease in short term liabilities.

The favorable change in operating margin is mainly due to the significant increase in other revenues together with a significant decrease in other expenditures. This change is caused by the reversal of provision for severance payment and the reimbursement received for the introduction of the new brand names in other revenues.

The favorable change in operating return on assets is also caused by the significant increase in operating profit.

The decrease in leverage ratio is due to the increase of shareholder's equity because the current year's dividend payable has not been decided yet.

**Magyar Telekom Plc.**  
Notes to the Financial Statements prepared  
in accordance with the Hungarian Act on Accounting  
As of December 31, 2005  
(All amounts in millions of HUF, unless otherwise indicated)

The following is a summarized cashflow statement for the year ended on December 31, 2004 and 2005:

		2004	2005
<b>I. Cash flows from operating activities (lines 1-14)</b>		<b>1,121</b>	<b>12,330</b>
1. Profit before income tax (before dividend received)	(+/-)	-31,553	-334
2. Depreciation and amortization	(+)	66,810	64,110
3. Impairment losses charged and reversed	(+/-)	11,266	5,078
4. Change in provisions	(+/-)	10,594	-9,209
5. Profit or loss on the sale of non current assets	(+/-)	-2,041	-1,032
6. Change in accounts payable	(+/-)	-690	13
7. Change in other current liabilities	(+/-)	4,955	4,094
8. Change in accruals	(+/-)	-814	-1,877
9. Change in accounts receivable	(+/-)	-1,153	-5,934
10. Change in current assets (without accounts receivable and cash and cash equivalents)	(+/-)	1,935	32,319
11. Change in prepayments	(+/-)	8,881	843
12. Income tax paid	(-)	-117	0
13. Dividend paid	(-)	-72,637	-72,638
14. Other non cash items	(+/-)	5,685	-3,103
<b>II. Cash flows from investing activities (lines 15-17)</b>		<b>16,962</b>	<b>-23,769</b>
15. Acquisition of fixed assets and financial investments	(-)	-54,436	-80,594
16. Proceeds from sale of non current assets	(+)	2,967	2,436
17. Dividends received, interim dividend	(+)	68,431	54,389
<b>III. Cash flows from financial activities (lines 18-29)</b>		<b>-17,967</b>	<b>12,226</b>
18. Proceeds from issue of shares	(+)	0	0
19. Proceeds from the issuance of bonds	(+)	0	0
20. Loans received	(+)	367,646	283,575
21. Receipt from non current loans and bank deposits	(+)	40,238	43,032
22. Non-repayable liquid assets received	(+)	295	0
23. Share capital decrease	(-)	0	0
24. Treasury stock sales and purchases	(-)	0	0
25. Repayment of bonds	(-)	-5	-4
26. Repayment of loans	(-)	-359,748	-250,306
27. Non current loans granted and bank deposits	(-)	-66,387	-69,427
28. Non-repayable donations given	(-)	0	0
29. Change in liabilities to founders and other non current liabilities	(+/-)	-6	5,356
<b>IV. Change in liquid assets (lines I. + II. + III.)</b>	(+/-)	<b>116</b>	<b>787</b>
<b>Cash at the beginning of the year</b>		<b>770</b>	<b>886</b>
<b>Cash at year-end</b>		<b>886</b>	<b>1,673</b>

**Magyar Telekom Plc.**

Notes to the Financial Statements prepared  
in accordance with the Hungarian Act on Accounting

As of December 31, 2005

(All amounts in millions of HUF, unless otherwise indicated)

**4. Intangible fixed assets**

The following is a summary of intangible fixed asset movements between January 1, 2004 and December 31, 2005:

<b>GROSS BOOK VALUE</b>	<i>Capitalized costs of R&amp;D</i>	<i>Rights</i>	<i>Intellectual property</i>	<i>Goodwill</i>	<i>Total</i>
Opening balance as of January 1, 2004	<b>876</b>	<b>2,551</b>	<b>39,206</b>	<b>195,233</b>	<b>237,866</b>
Additions	0	0	5,909	5,165	11,074
Disposals	0	0	2,389	0	2,389
Reclassifications	0	0	664	0	664
<b>Balance as of December 31, 2004</b>	<b>876</b>	<b>2,551</b>	<b>43,390</b>	<b>200,398</b>	<b>247,215</b>
Additions	0	7,030	2,883	58	9,971
Disposals	0	140	1,156	0	1,296
Reclassifications	0	42,695	-42,679	0	16
<b>Balance as of December 31, 2005</b>	<b>876</b>	<b>52,136</b>	<b>2,438</b>	<b>200,456</b>	<b>255,906</b>
<b>AMORTIZATION</b>					
Opening balance as of January 1, 2004	<b>876</b>	<b>1,335</b>	<b>26,701</b>	<b>19,729</b>	<b>48,641</b>
Charge for the year	0	78	4,540	9,965	14,583
Impairment	0	0	0	0	0
Disposals	0	0	2,013	0	2,013
Reclassifications	0	0	325	0	325
<b>Balance as of December 31, 2004</b>	<b>876</b>	<b>1,413</b>	<b>29,553</b>	<b>29,694</b>	<b>61,536</b>
Charge for the year	0	4,570	494	10,147	15,211
Impairment	0	0	0	0	0
Disposals	0	127	1,134	0	1,261
Reclassifications	0	28,042	-28,033	0	9
<b>Balance as of December 31, 2005</b>	<b>876</b>	<b>33,898</b>	<b>880</b>	<b>39,841</b>	<b>75,495</b>
<b>NET BOOK VALUE</b> as of December 31, 2004	0	1,138	13,837	170,704	185,679
<b>NET BOOK VALUE</b> as of December 31, 2005	0	18,238	1,558	160,615	180,411

**Magyar Telekom Plc.**  
Notes to the Financial Statements prepared  
in accordance with the Hungarian Act on Accounting  
As of December 31, 2005  
(All amounts in millions of HUF, unless otherwise indicated)

Rights

The significant increase in Rights is caused by asset increase in the amount of HUF 7,030 and reclassification inside intangible fixed assets captions.

During the year assets in the amount of HUF 42,679 million were reclassified from intellectual properties to this caption. This reclassification is based on the change of accounting policy of Magyar Telekom Plc. in conformity with the change in Act C/2000 on accounting came into effect as of January 1, 2005. In pursuance of the act the assets those rights of use are submitted to the Company have to be recorded separately. Accordingly the rights of use were reclassified from intellectual properties to rights with preparing new classes of assets.

Intellectual properties

The increase in intellectual properties is mainly due to purchase of software (SDH) and additional capitalizations (OSS, BSS, CRM, NRPS-WFMS and ICBS).

The increase was offset by the reclassifications of software with rights of use to Rights, the amortization charge, scrapping and partial scrapping of OSS software, other own developed software and the software of Network Managing System.

Goodwill

In 2003, the SEEF Holdings Ltd. exercised its put option, resulting in an increase in the Company's share in Stonebridge Communication AD. Relating to this transaction HUF 2,591 million goodwill was recognized. The company defined a 20-year useful life and started the amortization.

In 2004, further goodwill has been recognized relating to the investment in Rába Szolgáltatóház Kft. The Company defined the length of the useful life (108 months) in line with the duration of the frame contract with Rába Automotive Group and started the amortization.

Also in 2004, the Company's investment in Stonebridge Communication AD increased due to the purchase of shares from CosmoTelco Added Value Services S.A. and SEEF Holdings Ltd. Relating to these transactions, HUF 2,150 million and HUF 2,706 million goodwill was recognized. The useful lives were defined in line with the remaining useful life of the previously recorded goodwill related to this investment.

In 2004, HUF 3 million goodwill has been recognized relating to the investment in Telemacedonia AD. Its useful life was defined in 60 months.

In 2005, HUF 10,147 million amortization has been charged on goodwill.

In 2005, the Company acquired an investment in X-Byte Számítástechnikai Kft. and relating to this transaction HUF 58 million goodwill was recognized. Amortization has not been charged on goodwill in accordance with the change of the Act C/2000 on accounting came into effect as of January 1, 2005.

**Magyar Telekom Plc.**

Notes to the Financial Statements prepared  
in accordance with the Hungarian Act on Accounting

As of December 31, 2005

(All amounts in millions of HUF, unless otherwise indicated)

The movements in gross value and amortization of goodwill in 2004 and 2005 are summarized as follows:

Description	Remaining useful life (month)	Gross book value as of December 31, 2004	Amort'n as of December 31, 2004	Net book value as of December 31, 2004	Goodwill recorded in 2005	Amort'n charge in 2005	Net book value as of December 31, 2005
T-Mobile Távközlési Magyarország Rt.	192	181,948	-27,300	154,648	0	-9,097	145,551
EMITEL Távközlési Zrt.	161	10,501	-2,012	8,489	0	-589	7,900
Stonebridge Communication AD	210	7,447	-274	7,173	0	-387	6,786
BCN Rendszerház Kft.	24	193	-77	116	0	-39	77
Integris-Rendszerház Kft. (Rába Szolgáltatónál Kft.)	85	306	-31	275	0	-34	241
Telemacedonia AD	46	3	0	3	0	-1	2
X-Byte Számítástechnikai Kft.	0	0	0	0	58	0	58
<b>Total</b>		<b>200,398</b>	<b>-29,694</b>	<b>170,704</b>	<b>58</b>	<b>-10,147</b>	<b>160,615</b>

**5. Tangible fixed assets**

The following is a summary of tangible fixed asset movements – without construction in progress and advance payments for construction in progress – between January 1, 2004 and December 31, 2005

GROSS BOOK VALUE	<i>Technical equipment, machinery and vehicles</i>			<i>Total</i>
	<i>Real estate and related rights</i>	<i>Real estate and related rights</i>	<i>Other equipment and vehicles</i>	
Opening balance as of January 1, 2004	<b>292,416</b>	<b>359,478</b>	<b>42,983</b>	<b>694,877</b>
Additions	8,824	17,103	2,724	28,651
Disposals	3,058	14,621	2,702	20,381
Reclassifications	-24	1,457	-2,097	-664
<b>Balance as of December 31, 2004</b>	<b>298,158</b>	<b>363,417</b>	<b>40,908</b>	<b>702,483</b>
Additions	10,377	19,592	1,834	31,803
Disposals	3,125	13,378	2,414	18,917
Reclassifications	8	770	-794	-16
<b>Balance as of December 31, 2005</b>	<b>305,418</b>	<b>370,401</b>	<b>39,534</b>	<b>715,353</b>

**Magyar Telekom Plc.**

Notes to the Financial Statements prepared  
in accordance with the Hungarian Act on Accounting

As of December 31, 2005

(All amounts in millions of HUF, unless otherwise indicated)

DEPRECIATION	<i>Technical equipment, machinery and vehicles</i>			<i>Total</i>
	<i>Real estate and related rights</i>	<i>Real estate and related rights</i>	<i>Other equipment and vehicles</i>	
Opening balance as of January 1, 2004	<b>81,978</b>	<b>198,480</b>	<b>32,488</b>	<b>312,946</b>
Charge for the year	10,684	36,659	4,603	51,946
Impairment	76	5,268	0	5,344
Disposals	1,653	12,563	2,378	16,594
Reclassifications	34	1,488	-1,847	-325
<b>Balance as of December 31, 2004</b>	<b>91,119</b>	<b>229,332</b>	<b>32,866</b>	<b>353,317</b>
Charge for the year	10,867	34,376	3,364	48,607
Impairment*	8	199	117	324
Disposals	1,300	12,021	2,301	15,622
Reclassifications	8	785	-802	-9
<b>Balance as of December 31, 2005</b>	<b>100,702</b>	<b>252,671</b>	<b>33,244</b>	<b>386,617</b>
<b>NET BOOK VALUE</b>				
as of December 31, 2004	207,039	134,085	8,042	349,166
<b>NET BOOK VALUE</b>				
as of December 31, 2005	204,716	117,730	6,290	328,736

*Real estate and related rights*

Decrease is mainly due to depreciation charge of telecommunications networks, which was partially offset by additions to metal conduit and optical fiber networks. In 2005, the increase connected with rebranding was HUF 310 million. Extraordinary depreciation arose due to investments relating to rented buildings in the amount of HUF 8 million.

Buildings of HUF 955 million net book value were sold. Rental rights of international connections were sold in the amount of HUF 222 million net book value. Scrapping and partial scrapping of telecommunication networks totaled HUF 225 million. In case of buildings the scrapping and partial scrapping was totaled HUF 162 million net book value.

*Technical equipment, machinery and vehicles*

Decrease in the current period is mainly due to depreciation charge of telecommunications equipment and machinery. Extraordinary depreciation arose due to the packet switched data transfer centers and equipment in the amount of HUF 199 million. The most significant additions relate to the following groups of assets: switching equipment (HUF 7,613 million), transmission technical equipment (HUF 7,860 million) and power supply equipment (HUF 983 million) in the total amount of HUF 16,456 million. Increase in connection with the rebranding was HUF 98 million in 2005. Scrapping of transmission technical equipment was HUF 835 million. The scrapping and partial scrapping of switching equipment was HUF 291 million.

**Magyar Telekom Plc.**

Notes to the Financial Statements prepared  
in accordance with the Hungarian Act on Accounting  
As of December 31, 2005  
(All amounts in millions of HUF, unless otherwise indicated)

Other equipment and vehicles

Decrease in the current period is mainly due to depreciation charge which was partly offset by the capitalization of servers, vehicles and Intranet local network equipment.

In 2005, increase connected to rebranding totaled HUF 416 million, of which office equipment totaled to HUF 336 million.

Extraordinary depreciation was recorded in the amount of HUF 117 million in case of servers.

Items were reclassified from other equipments to technical equipment, machinery and vehicles.

Construction in progress

Balance of construction in progress did not change significantly compared to year-end 2004.

Effect of change in useful life and residual value

During 2004 the useful life of tangible and intangible assets has been re-examined resulting modifications in useful life of several assets as of January 1, 2005. From the date the assets were put into operation to the end of the modified useful life the concerned assets (in books as of January 1, 2005) shall be written-off to zero (or to their residual value). In 2005 this change in useful life caused HUF 1,771 million increase in amortization not considering their movements (additions or disposals).

At the end of the year 2004, extraordinary depreciation arose due to the MLLN node equipment. In case of the concerned assets, in order to the write-off date shall be unaltered, the useful life had to be modified. In 2005, this modification resulted HUF 921 million decrease in amortization.

Residual value of personal cars for personal use has changed from 30 per cent to 40 per cent in accordance with the accounting policy. Since January 1, 2005 the useful life of these assets has decreased from 72 months to 36 months. In 2005 these changes resulted HUF 203 million increase in amortization not considering their movements.

Further details on tangible fixed assets are disclosed in Appendix 1.

**Magyar Telekom Plc.**  
Notes to the Financial Statements prepared  
in accordance with the Hungarian Act on Accounting  
As of December 31, 2005  
(All amounts in millions of HUF, unless otherwise indicated)

**6. Non current investments in affiliated companies**

As of December 31, 2004 and 2005, the Company's non current investments are summarized as follows (further details on investments are disclosed in Appendix 2):

	Ownership	Ownership	Net book value	
	direct (%)	indirect (%)	2004	2005
	2005			
Stonebridge Communication AD	100.00		87,896	90,725
T-Mobile Magyarország Rt.	100.00		59,675	59,675
Telekom Crne Gore	76.53		0	36,801
T-Online Magyarország Zrt.	100.00		12,750	12,750
InvesTel Rt.	62.28	37.72	7,162	7,162
BCN Rendszerház Kft.	100.00		5,042	5,042
EMITEL Zrt.	100.00		4,036	4,036
T-Systems Hungary Kft.	49.00		3,430	3,430
ViDaNet Zrt.	67.50	22.50	2,500	2,836
T-Kábel Magyarország Kft.	16.39	83.61	2,359	2,359
EGERTEL Zrt.	100.00		1,793	1,793
IKO-Telekom Zrt.	50.00		10	1,600
Integris-Rendszerház Kft.	100.00		594	594
EurAccount Kft.	99.00	1.00	0	446
EPT Nyrt.	97.20		615	304
ViaBridge Telecommunications H.L.	99.96	0.04	62	293
T-Systems Ric Kft.	20.00		74	74
Novatel Ukraine	99.94	0.06	0	70
HUNSAT Zrt.	50.00		50	50
CARDNET Zrt.	72.00		45	45
Telemacedonia AD	100.00		20	21
TELE-DATA Kft.	50.98		20	20
X-Byte Kft.	99.00	1.00	0	12
Gabriele 17 GmbH	100.00		7	7
Mindentudás Egyeteme Kht.	40.00	20.00	2	2
KIS-ASTRASAT Kft.	0.00		852	0
<b>Total</b>			<b>188,994</b>	<b>230,147</b>



**Magyar Telekom Plc.**  
Notes to the Financial Statements prepared  
in accordance with the Hungarian Act on Accounting  
As of December 31, 2005  
(All amounts in millions of HUF, unless otherwise indicated)

**Major investments:**

**T-Mobile Magyarország Távközlési Rt. (T-Mobile Magyarország Rt.)**

The company started its operations on March 31, 1994 under the name of Westel 900 GSM Mobil Távközlési Rt. with its headquarters in Budapest. T-Mobile provides GSM digital mobile telecommunications services.

On December 21, 2001 Magyar Telekom Plc. (Matáv Rt.) paid HUF 224.2 billion (EUR 909 million) for 49 per cent of the Westel shares and so brought its total ownership to 100 per cent. The purchase price was financed by a medium term loan provided by Deutsche Telekom Finance B.V. at an interest rate of EURIBOR plus 50 basis points. Repayment of this loan started in 2002. A further HUF 11,515 million was transferred to Deutsche Telekom as part of the purchase price, which is the 49 per cent of the dividend declared by the company in respect of its 2001 profits. The historical cost of the investment includes HUF 701 million consulting fee related to the acquisition. In relation to this acquisition HUF 181,949 million goodwill was recorded, which is amortized over a period of 20 years.

On the basis of an agreement between the Ministry of Informatics and Communications and Magyar Telekom Plc. (Matáv Rt.), the concession rights of Westel 0660 mobile phone-network were terminated and the company ceased its operations on June 30, 2003. The company merged into Westel Mobil Távközlési Rt. with HUF 1,637 million equity on November 30, 2003.

Westel Mobil Távközlési Rt. was rebranded between May 3 and June 5, 2004 as a result of which the company's name changed to T-Mobile Magyarország Távközlési Részvénytársaság as a member of T-Mobile Group.

The extraordinary general meeting of Magyar Telekom Plc. held on December 20, 2005 decided on the merger of Magyar Telekom Plc. and T-Mobile Magyarország Rt. In the course of this transaction T-Mobile Magyarország Rt. will merge into Magyar Telekom Plc. The transformation was registered at Court of Registry on February 28, 2006.

**Stonebridge Communications AD (Stonebridge AD)**

In December 2000, Magyar Telekom Plc. (Matáv Rt.), on behalf of a consortium, reached an agreement with the government of Macedonia to purchase 51 percent of MakTel on its privatization. The deal was concluded on January 15, 2001, whereby Matáv Rt. paid HUF 91 billion (EUR 343.3 million) on behalf of the consortium in accordance with the relevant agreement. The 51 percent ownership acquired by Magyar Telekom Plc. (Matáv Rt.) was contributed on January 16, 2001 to a newly established Macedonian holding company, Stonebridge, which carries out investment activities with a headquarter in Skopje.

In accordance with the deed of foundation and an agreement between Magyar Telekom Plc. (Matáv Rt.), SEEF Holdings Ltd. and CosmoTelco Added Value Services S.A., the latter two acquired 6.1 per cent and 7.4 per cent ownership in Stonebridge, respectively, reducing Matáv's investment in Stonebridge by HUF 11 billion. As a result, Matáv's share in Stonebridge decreased to 86.45 per cent.

The shareholders' agreement between Magyar Telekom Plc. (Matáv Rt.), SEEF and CosmoTelco signed on December 14, 2000 guarantees SEEF that it can enforce its put option related to 50 per cent of its shares in Stonebridge.

On June 25, 2003 SEEF exercised its put option, which had an exercise price of EUR 20.9 million (HUF 5,537 million) in exchange for a 3.05 per cent stake in Stonebridge. HUF 2,591 million goodwill was recognized on the acquisition.

In 2004, further 3.05 per cent stake has been purchased at a cost of USD 27.4 million (HUF 5,554 million). The goodwill arising on the purchase amounted to HUF 2,150 million.

**Magyar Telekom Plc.**  
Notes to the Financial Statements prepared  
in accordance with the Hungarian Act on Accounting  
As of December 31, 2005  
(All amounts in millions of HUF, unless otherwise indicated)

Also in 2004, CosmoTelco Added Value Services S.A and Magyar Telekom Plc. (Matáv Rt.) entered into a contract on the exchange of 7.4 per cent shares of CosmoTelco in Stonebridge. The purchase price was EUR 31.4 million (HUF 7,762 million) and the proportional part of the dividend to be paid for 2004 at MakTel, in the expected amount of EUR 4.7 million (HUF 1,161 million). As a result of this transaction, the Company owned 100 per cent of Stonebridge.

In connection with these acquisitions in 2004 HUF 13 million consulting fees have been recorded as part of the book value of the investments and HUF 4,856 million goodwill has been recognized.

**T-Online Magyarország Zártkörűen Működő Internet Szolgáltató Rt. ( T-Online Magyarország Internet Szolgáltató Rt.) /Axelero Rt.**

In the field of Internet servicing, this company was a very important investment of Magyar Telekom Plc. The company was established in 1999, with its headquarters in Budapest. The company has a strong position both in the residential and the business segments. To hold its market position and to enable further developments, in 2002 the Company decided to increase the share capital by HUF 237 million and the capital reserve by HUF 3,763 million.

In the first quarter of 2004, the founders decided to increase the common stock of the company through the issue of new shares. In the course of this transaction 2,060,000 pieces of dematerialized registered shares have been issued with a face value of HUF 100 per share and a total value HUF 206 million. As a consequence of this transaction the company's common stock increased to HUF 1,906 million. The issue price of the shares was HUF 2,206 million. Magyar Telekom Plc. (Matáv Rt.) has undertaken the takeover of the issued new shares and the payment of the issuing price into the company's account. The transaction occurred in the first half of 2004.

Axelero Rt. changed its name in 2005. The new name is T-Online Magyarország Internet Szolgáltató Részvénytársaság (T-Online Magyarország Rt.) and was registered at Court of Registry on May 6, 2005.

**BCN Rendszerház Informatikai és Kommunikációs Hálózatokat Szolgáltató Kft. (BCN Rendszerház Kft.)/ MatávCom Kft.**

MatávCom Kft. was established in 1997 with its headquarters in Budapest. MatávCom Kft. sells products and provides services for the integration of business communication networks and IT applications. The activities of the company were restructured during 2001, certain activities have been transferred to Magyar Telekom Plc. (Matáv Rt.). In 2002 this reorganization continued with a significant cost impact. HUF 1,731 million impairment loss was recorded for this investment in 2002.

In 2004, BCN Kft. has merged into MatávCom Kft and the book value of BCN Kft. in the amount of HUF 88 million was removed from the books. The transaction has increased the book value of the investment in MatávCom Kft. by HUF 120 million. Following this transaction MatávCom Kft. has changed its name to BCN Rendszerház Informatikai és Kommunikációs Hálózatokat Szolgáltató Kft. (BCN Rendszerház Kft.), which change was registered at Court of Registry on November 30, 2004.

**Investel Magyar Távközlési Befektetési Rt. (Investel Rt.)**

Investel Rt. was established on June 25, 1991 with majority ownership of Magyar Telekom Plc. (Matáv Rt.) for the purpose of ensuring financing for Magyar Telekom's investment programs. Investel obtained financing from domestic and international money markets. By the end of 1997, the original function of the company lost its importance. Currently it is the owner and trustee of cable TV companies. At present the Company's ownership in Investel Rt. is 62.28 per cent and the remaining 37.72 per cent is owned by EGERTEL Zrt.

**Magyar Telekom Plc.**  
Notes to the Financial Statements prepared  
in accordance with the Hungarian Act on Accounting  
As of December 31, 2005  
(All amounts in millions of HUF, unless otherwise indicated)

**EMITEL Távközlési Zártkörűen Működő Részvénytársaság (EMITEL Zrt.)**

Magyar Telekom Plc. (Matáv Rt.) had been a 50 per cent owner of EMITEL Zrt. since its establishment. The company's main profile is telecommunications activity, with its headquarters in Szeged. On December 31, 2000, Magyar Telekom Plc. (Matáv Rt.) agreed with Aphrodite BV, the owner of the other 50 per cent stake of EMITEL Zrt. that it would purchase its shares. The change of ownership was conditional upon the approval of the Minister responsible for telecommunications in Hungary as well as on the approval of the Hungarian Competition Office, which approval were received by the Company in June 2001. The purchase price of HUF 14 billion (USD 48 million) was determined at the finalization of the agreement on July 2, 2001, from which HUF 10,500 million goodwill was recorded and is being amortized over a period of 214 months.

**T-Kábel Magyarország Kábeltelevíziós Szolgáltató Kft. (T-Kábel Magyarország Kft.)/MatávkábelTV Kft.**

On July 1, 1998 Magyar Telekom Plc. (Matáv Rt.) established MatávkábelTV Kft. to provide cable television services. At the beginning of 2002, a remaining quota was purchased for HUF 641 million from Hungária Biztosító. In 2002, the share capital and capital reserve of MatávkábelTV Kft. was increased by HUF 1,718 million.

MatávkábelTV Kft. changed its name in 2005. The new name is T-Kábel Magyarország Kábeltelevíziós Szolgáltató Kft. (T-Kábel Magyarország Kft.) and was registered at Court of Registry on May 6, 2005.

**EGERTEL Távközlési Hálózat Létesítő Zrt. (EGERTEL Zrt.)**

The company was established on May 27, 1993 with the majority ownership of EMA (First Hungarian Fund) to build up telephone network in the area of Eger. Magyar Telekom Plc. (Matáv Rt.) has gradually bought out EMA by using its call option. At present Magyar Telekom Plc. owns 100 per cent of the company. EGERTEL Zrt. has 37.72 per cent ownership in Investel Rt.

**Első Pesti Telefonszolgáltató Nyrt. / Első Pesti Telefonszolgáltató Rt. (EPT Nyrt. / EPT Rt.)**

EPT Rt. was established in 1992 and with its headquarters in Budapest. At present EPT Rt. provides IP based international and domestic telecommunication and call center services. In 2003 additional shares were bought by the Company for HUF 65 million, increasing Magyar Telekom Plc.'s (Matáv Rt.) direct ownership in the company to 97.20 per cent.

In 2005 the company decreased its common stock together with a capital withdrawn which was registered at Court of Registry on March 1, 2005. At the registration Magyar Telekom Plc. (Matáv Rt.) decreased the book value of its investment with HUF 311 million.

**Integris-Rendszerház Informatikai Szolgáltató Kft. (Integris-Rendszerház Kft./ Rába Szolgáltatóház Kft.)**

The company provides telecommunications, IT, financial, accounting and human resources related services for Rába Automotive Group with its headquarters in Győr. The company started its operations on October 1, 2000.

On November 28, 2003, Magyar Telekom Plc. (Matáv Rt.) paid HUF 900 million to Rába Járműipari Holding Rt. for 100 per cent ownership of Rába-Szolgáltatóház Kft. The transaction was approved by the Competition Office on January 5, 2004. The acquisition provides the Company with the opportunity to take advantages of its economies of scale in new areas.

**Magyar Telekom Plc.**  
Notes to the Financial Statements prepared  
in accordance with the Hungarian Act on Accounting  
As of December 31, 2005  
(All amounts in millions of HUF, unless otherwise indicated)

The co-operation with the Rába Group is based on a frame-contract expiring in 2012 signed on November 14, 2003. The Rába Group is one of Hungary's largest automotive manufacturers, producing axles, automotive components and commercial vehicles.

In line with the ownership expectations and the new strategic aims the company changed its name to Integris-Rendszerház Kft. on September 14, 2004. The company continues its operations as an outsourcing firm of Magyar Telekom Plc. (Matáv Rt.) Group Business Services Line of Business.

Goodwill related to this transaction was recorded in the amount of HUF 306 million in 2004.

**KIS-ASTRASAT Telekommunikációs Kft. (KIS-ASTRASAT Kft.)**

After several transformations KIS-ASTRASAT Telekommunikációs Kft. has been registered in 2001, with headquarters in Budapest. The company's main activity is telecommunication, its share capital is HUF 300 million. In 2004 Matáv acquired a 65 per cent share in KIS-ASTRASAT Kft. for HUF 852 million.

In 2005 KIS-ASTRASAT Kft. merged into ViDaNet Zrt. Its book value was terminated reducing the investment of Magyar Telekom Plc. (Matáv Rt.) with HUF 852 million.

**ViDaNet Kábeltelevíziós Szolgáltató Zrt. (ViDaNet Zrt.)**

In 2003 the Győri KTV, Kaposkábel and Kábelholding merged into Németkábel Vagyonkezelő Rt. After the merger the company changed its name to ViDaNet Rt. and was registered on February 11, 2003 at the Court of Registry. The company's common stock is HUF 2,000 million which consists of 1000 pieces of shares (HUF 2 million per share at face value). In 2004, Deed of Foundation was changed by the shareholders, the common stock of the company remained HUF 2,000 million but the composition of shares was changed due to the stock conversion. The common stock consists of 20,000 nominal shares (HUF 100,000 per share at face value) with different ownership rights.

In 2004, Magyar Telekom Plc. (Matáv Rt.) has purchased prior to the stock conversion 249 shares with a face value of HUF 2 million per share and 9,017 shares with a face value of HUF 100,000 post stock conversion shares for HUF 2,595 million. In 2004, 498 shares (HUF 100,000 per share) have been sold, with a book value of HUF 95 million.

In 2005 KIS-ASTRASAT Kft. merged into ViDaNet Rt. and the book value of investment has increased by HUF 336 million. In 2005, the company's name was changed to ViDaNet Kábeltelevíziós Szolgáltató Zártkörűen Működő Részvénytársaság and was registered at Court of Registry.

**Mindentudás Egyeteme Tudományos Közhasznú Társaság (Mindentudás Egyeteme Kht.)**

The company was established in 2004 by Magyar Telekom Plc. (Matáv Rt.), the Hungarian Academy of Sciences and T-Online Magyarország Zrt. (Axelero Rt.). The company's share capital is HUF 5 million. Magyar Telekom Plc.'s (Matáv Rt.) quota in the company and its share in its capital is 40 per cent. The purpose of its activity is to organize public courses through media and other telecommunication equipment to help spreading knowledge of highly interesting scientific subjects by lecturers well-known both in Hungary and internationally. The company executes business activities only for accomplishing its main purposes and not endangering it. Its main activity is "Adult and other education not categorized elsewhere". The company's other activities are technological and human R&D, protecting the higher education, creative arts and cultural heritage. Its business activities include publishing books, publications, tape-records, copying tape and video-records, producing and presenting films.

The company was registered at Court of Registry on June 3, 2004.

## **Magyar Telekom Plc.**

Notes to the Financial Statements prepared  
in accordance with the Hungarian Act on Accounting  
As of December 31, 2005  
(All amounts in millions of HUF, unless otherwise indicated)

### **IKO-TELEKOM Média Holding Zártkörűen Működő Részvénytársaság (IKO-TELEKOM Zrt.)**

Magyar Telekom Plc. (Matáv Rt.) entered into an agreement with IKO Media Group for establishing a mutual holding with the aim of merging their interests in Magyar RTL Televízió Rt. and providing interactive and premium rate content services. As a result IKO-Matáv Média Holding Rt. was established with 50 per cent ownership of both owners. The company's share capital is HUF 20 million, fully paid in cash. It consists of 19,998 nominal shares ("A" type - HUF 1,000 per share at face value, ensuring equal and even membership rights) and 2 preference shares ("B" type - HUF 1,000 per share at face value). Magyar Telekom Plc. (Matáv Rt.) owns 9,999 "A" type and 1 "B" type shares. The company is headquartered in Budapest.

Through this business association Magyar Telekom Plc. increases its share in premium rate content services and strengthens its position in commercial broadcasting.

As stated in the decree of the General Meeting, the owners' M-RTL Rt. shares will be provided to the Holding as contribution-in-kind. In 2005 the contribution-in-kind by Magyar Telekom Plc. was registered at Court of Registry in the amount of HUF 1,590 million.

### **T-Systems Hungary Szolgáltató Kft. (T-Systems Hungary Kft.)**

In 2004 Magyar Telekom Plc. (Matáv Rt.) acquired a 49 per cent share in T-Systems Hungary Kft. based on an agreement between Magyar Telekom Plc. (Matáv Rt.) and T-Systems International. The acquisition included the purchase of the quota for HUF 1,430 million through a capital increase by HUF 82 million and of the transfer of HUF 1,918 million to capital reserves. As a result the company's share capital increase to HUF 281,690,000, Magyar Telekom Plc.'s share in it is HUF 138 million.

The company's main activity is software consultation and supply.

T-Systems Hungary Kft. and Magyar Telekom Plc. form a strategic alliance in providing integrated solutions to 200 of the most significant Hungarian companies. T-Systems Hungary Kft. acts as an outsourcing partner of Magyar Telekom Plc. for system integration services, while Magyar Telekom Plc. supports its partner in telecommunications and network services.

### **ViaBridge Telecommunications Holding Limited (ViaBridge Ltd.)**

ViaBridge Telecommunications Holding Ltd. was registered on July 6, 2004 in Malta. The company's share capital is EUR 251,000 (HUF 62 million) consisting of 2,510 shares (EUR 100 per share at face value). Magyar Telekom Plc. (Matáv Rt.) owns 2,509 shares and EGERTEL Zrt. owns 1 share.

In 2005, the company's share capital increased as a result of issuing 9,100 shares (EUR 100 per share at face value) and therefore Magyar Telekom Plc. (Matáv Rt.)'s investment increased by HUF 222 million.

### **Telekom Crne Gore AD (TCG)**

In 2004, the Montenegrin Privatization Agency issued a tender for the purchase of a 51.12 per cent stake in the Montenegrin Telecommunications Company (TCG). On January 14, 2005 the Magyar Telekom Plc. (Matáv Rt.) has been announced as the winner of the tender. TCG is the incumbent fixed line service provider of Montenegro with a 100 per cent owned mobile telecom service provider subsidiary, Monet. TCG is also the 100 per cent owner of Internet Crne Gore, the leading Montenegrin internet service provider company. The share purchase agreement has been signed on March 15, 2005 in the amount of EUR 114 million. Magyar Telekom Plc. (Matáv Rt.) acquired a further 25.41 per cent share in the amount of EUR 27 million based on an agreement with minority shareholders. Related to this investment consulting fees were capitalized in the amount of HUF 971 million and negative goodwill was recognized in the amount of HUF 239 million.

**Magyar Telekom Plc.**  
Notes to the Financial Statements prepared  
in accordance with the Hungarian Act on Accounting  
As of December 31, 2005  
(All amounts in millions of HUF, unless otherwise indicated)

**EurAccount Pénzügyi és Számviteli Szolgáltató Kft. (EurAccount Kft.)**

EurAccount Kft. was established on March 1, 2005 by Magyar Telekom Plc. and EGERTEL Zrt. to provide accounting services for Magyar Telekom Plc. The company was registered at Court of Registry on April 1, 2005.

The company's share capital is HUF 450 million, cash contribution in full, of which Magyar Telekom Plc.'s capital contribution is HUF 445.5 million.

**Other significant changes in non current investments:**

In 2005, Magyar Telekom Plc. established NOVATEL Ukraine Limited Liability Company with 99.9 per cent stake. The company's share capital is EUR 150,150, of which Magyar Telekom Plc. paid EUR 150,000 based on its ownership ratio. During the year the company's share capital increased by EUR 126,000.

In 2005, Magyar Telekom Plc. (Matáv Rt.) acquired a 100 per cent stake in X-Byte Pénzügyi és Számviteli Szolgáltató Kft. in the amount of HUF 70 million. Relating to this transaction HUF 58 million goodwill was recognized. During the year the goodwill was distributed and 1 per cent stake was sold. After these transactions, the Magyar Telekom Plc. (Matáv Rt.)'s investments increased by HUF 12 million.

HUF 3,477 million was recorded as foreign exchange difference on foreign exchange investments at the balance sheet date. This amount increased the book value of non current investments.

No impairment was recorded in 2005 in relation to financial investments.

**Magyar Telekom Plc.**  
Notes to the Financial Statements prepared  
in accordance with the Hungarian Act on Accounting  
As of December 31, 2005  
(All amounts in millions of HUF, unless otherwise indicated)

**7. Non current loans granted to affiliated companies**

As of December 31, 2004 and 2005 non current loans granted to affiliated companies are the following:

	2004	2005
T-Mobile Magyarország Rt.	75,300	77,900
T-Kábel Magyarország Kft.	1,152	5,325
EMITEL Zrt.	2,340	2,050
ViDaNet Zrt.	0	2,044
ViaBridge Ltd.	0	1,799
NOVATEL Ukraine	0	23
BCN Rendszerház Kft. (MatávCom Kft.)	208	0
<b>Total</b>	<b>79,000</b>	<b>89,141</b>

The amount of loans does not include the installments due within one year. These installments were reclassified to short term receivables from affiliated companies (see Note 12).

**8. Other non current investments**

**TELIT Szolgáltató Részvénytársaság (TELIT Rt.)**

The company was established by Magyar Telekom Plc. (Matáv Rt.) as a wholly owned private company limited by shares with headquarters in Budapest. Its main activity is renting and operating real estates. The company's shareholder's equity is HUF 20 million consisting of 200 shares with a face value of HUF 100,000 apiece. The shares are registered, ensuring even and equal membership rights. The Court of Registry has registered the company as of October 11, 2004.

In 2005 Magyar Telekom Plc. sold its shares in TELIT Rt. to DeTe Immobilien Deutsche Telekom Immobilien und Service GmbH and the book value of the investment in the amount of HUF 20 million has been removed from the books. Its purchase price was EUR 2,100,000 (HUF 515 million), from which EUR 1,100,000 was settled in 2005. The remaining EUR 1,000,000 will have to be settled until December 31, 2006.

**9. Other non current loans granted**

This caption contains long term loans granted to employees and deposits given.

**Magyar Telekom Plc.**  
Notes to the Financial Statements prepared  
in accordance with the Hungarian Act on Accounting  
As of December 31, 2005  
(All amounts in millions of HUF, unless otherwise indicated)

**10. Inventories**

Inventories include mainly network maintenance materials, cables and telecommunication assets stored. Goods include mainly telecommunication goods and abandoned fixed assets designated for sale.

The following is a movement table of inventories in 2004 and in 2005:

	<u>2004</u>	<u>2005</u>
Opening balance	2,783	2,235
Change in inventories	-607	726
Impairment loss	-189	-181
Impairment loss written back	<u>248</u>	<u>82</u>
<b>Closing balance</b>	<b><u>2,235</u></b>	<b><u>2,862</u></b>

Further details of inventory impairment are disclosed in Appendix 3.

**11. Accounts receivable**

As of December 31, 2004 and 2005 accounts receivable are the following:

	<u>2004</u>	<u>2005</u>
Domestic accounts receivable	19,202	22,591
Foreign accounts receivable	1,396	1,392
Impairment of receivables	<u>-1,927</u>	<u>-1,758</u>
<b>Total</b>	<b><u>18,671</u></b>	<b><u>22,225</u></b>

Further details on receivables impairment are disclosed in Appendix 3.



**Magyar Telekom Plc.**

Notes to the Financial Statements prepared  
in accordance with the Hungarian Act on Accounting

As of December 31, 2005

(All amounts in millions of HUF, unless otherwise indicated)

**12. Receivables from affiliated companies**

Receivables from affiliated companies as of December 31, 2004 and 2005 are summarized as follows:

	<u>2004</u>	<u>2005</u>
Loans to T-Mobile Magyarország Rt.	34,200	29,300
Receivables from T-Mobile Magyarország Rt. based on Decrees of NHH 999/2004. and NHH/DH-6584-12/2005 connected to settlement of connection fees	729	2,334
Receivables from T-Online Zrt.	1,094	1,347
Loans to EGERTEL Zrt.	670	554
Dividend receivable from M-RTL Zrt.	500	500
Loans to EPT Nyrt.	0	485
Loans to T-Kábel Kft.	6,104	300
T-Mobile Magyarország Rt. Interest-Pool	1,827	0
Loans to ViDaNet Zrt.	1,763	0
M-RTL Zrt. shares contributed in kind to IKO-TELEKOM Zrt.*	1,590	0
Loans to KIS-ASTRASAT Kft.	497	0
Other	<u>1,234</u>	<u>1,590</u>
<b>Total</b>	<b><u>50,208</u></b>	<b><u>36,410</u></b>

\* The contribution-in-kind has not been registered in the Court of Registry at the end of year 2004 therefore it was disclosed as Receivables from affiliated companies.

**13. Other receivables**

The Company's other receivables as of December 31, 2004 and 2005 are summarized as follows:

	<u>2004</u>	<u>2005</u>
Advance payments given	2,591	2,660
Receivables from employees	861	1,094
Reclaimable VAT	815	575
Receivables based on Decrees of NHH 999/2004. and NHH/DH-6584-12/2005 connected to settlement of connection fees (Vodafone Magyarország Zrt.)	0	473
Receivables from sale of TELIT Rt.	0	253
Tax receivables	388	220
Receivables from the government	104	94
Receivables from ETTA*	1,468	0
Other	<u>1,001</u>	<u>272</u>
<b>Total</b>	<b><u>7,228</u></b>	<b><u>5,641</u></b>

\* In 2005, HUF 619 million receivables were recovered related to ETTA. The Company recorded impairment on the remaining part (HUF 849 million).

**Magyar Telekom Plc.**  
Notes to the Financial Statements prepared  
in accordance with the Hungarian Act on Accounting  
As of December 31, 2005  
(All amounts in millions of HUF, unless otherwise indicated)

**14. Securities**

The amount of HUF 1,926 million, presented as securities, represents the value of repurchased treasury stock. On July 3, 2002 the Company issued new shares through CIB Bank Rt. to cover its management stock option plan. During the year HUF 1,916 million shares were sold on book value within the frame of the above mentioned plan. In connection with the sale, a part of the restricted reserve was released with the same amount in 2005 (see Note 16).

**15. Prepayments and accrued income**

	<u>2004</u>	<u>2005</u>
Accrued income related to telecommunication activities	8,348	6,452
Accrued income related to affiliated companies	2,240	2,735
Other	<u>166</u>	<u>773</u>
<b><i>Accrued income</i></b>	<b><i>10,754</i></b>	<b><i>9,960</i></b>
Rental fees	110	32
Insurance fees	56	13
Other	<u>243</u>	<u>315</u>
<b><i>Prepaid costs and expenses</i></b>	<b><i>409</i></b>	<b><i>360</i></b>
<b>Total</b>	<b><u>11,163</u></b>	<b><u>10,320</u></b>

Revenues related to the main activity are accrued depending on the billing-cycle. The revenues of actual, but not invoiced traffic are accrued.

In 2004, the donation system of ETTA has been replaced by Kassza and it is expected that there will not be any donations from or payment obligations to the Kassza so no accrual was recorded.

**Magyar Telekom Plc.**

Notes to the Financial Statements prepared  
in accordance with the Hungarian Act on Accounting

As of December 31, 2005

(All amounts in millions of HUF, unless otherwise indicated)

**16. Shareholder's Equity**

Shareholder	Number of shares	Nominal value (HUF per share)	Total value (HUF'000)	Ownership percentage (%)
MagyarCom Holding GmbH	617,452,081	100	61,745,208	59.21%
Free float	422,902,860	100	42,290,286	40.55%
Repurchased treasury stock	2,456,659	100	245,666	0.24%
State-owned	1	10,000	10	0.00%
<b>Total</b>	<b>1,042,811,601</b>		<b>104,281,170</b>	<b>100.00%</b>

Details of common stock by types of shares are the following:

Type of share	Series of shares	Number of shares	Common stock (HUF'000)
Nominal shares (HUF 100 per share)	A	1,042,811,600	104,281,160
Preference share (HUF 10,000 per share)	B	1	10
<b>Total</b>		<b>1,042,811,601</b>	<b>104,281,170</b>

Changes in the equity items during 2004 and 2005 are summarized as follows:

	<i>Common stock</i>	<i>Capital reserves</i>	<i>Retained earnings</i>	<i>Restricted reserves</i>	<i>Balance Sheet Net Profit</i>
<b>Opening balance as of January 1, 2004</b>	<b>104,281</b>	<b>52,837</b>	<b>241,630</b>	<b>3,842</b>	<b>2,520</b>
Increases	0	0	240	0	0
Decreases	0	0	33,626	0	0
Reclassifications	0	0	2,520	0	-2,520
<b>Balance as of December 31, 2004</b>	<b>104,281</b>	<b>52,837</b>	<b>210,764</b>	<b>3,842</b>	<b>0</b>
Increases	0	0	186	0	68,090
Decreases	0	0	0	0	0
Reclassifications	0	0	1,916	-1,916	0
<b>Balance as of December 31, 2005</b>	<b>104,281</b>	<b>52,837</b>	<b>212,866</b>	<b>1,926</b>	<b>68,090</b>

**Magyar Telekom Plc.**

Notes to the Financial Statements prepared  
in accordance with the Hungarian Act on Accounting  
As of December 31, 2005

(All amounts in millions of HUF, unless otherwise indicated)

**17. Provisions**

	<i>Early retirement and severance payments</i>	<i>Contingent liabilities</i>	<i>Other</i>	<i>Total</i>
<b>Opening Balance as of January 1, 2004</b>	<b>1,502</b>	<b>1,317</b>	<b>103</b>	<b>2,922</b>
Increase	12,228	418	132	12,778
Decrease	1,502	619	63	2,184
<b>Closing Balance as of December 31, 2004</b>	<b>12,228</b>	<b>1,116</b>	<b>172</b>	<b>13,516</b>
Increase	507	916	124	1,547
Decrease	9,928	656	172	10,756
<b>Closing Balance as of December 31, 2005</b>	<b>2,807</b>	<b>1,376</b>	<b>124</b>	<b>4,307</b>

In 2005, HUF 9,928 million provision was reversed in connection with headcount reduction.

At the end of 2005, the Company increased the provision for severance payments with HUF 507 million.

The main titles for reversals of provision for contingent liabilities during the year are as follows:

- transferred amount to Dimenzió Biztosító Egyesület (HUF 285 million)
- legal issues of the VPOP trial (HUF 220 million)
- forgiveness of employee loans (HUF 120 million)
- legal cases (HUF 17 million)
- other (HUF 14 million)

The main titles for increase of provision for contingent liabilities during the year are as follows:

- expected costs connected to severance payments of employees (HUF 410 million)
- cash and cash equivalent to be given to Dimenzió Biztosító Egyesület (HUF 193 million)
- employees' bonuses (HUF 102 million)
- PoP customer loyalty program (HUF 90 million)
- legal cases (HUF 82 million)
- other (HUF 39 million)

**Magyar Telekom Plc.**  
Notes to the Financial Statements prepared  
in accordance with the Hungarian Act on Accounting  
As of December 31, 2005  
(All amounts in millions of HUF, unless otherwise indicated)

**18. Construction loans**

The Company has long term loan liabilities in the amount of HUF 13,125 million as of December 31, 2005. During 2005 HUF 22,500 million was drawn down and HUF 27,641 million was reclassified to current loans. The Company repaid HUF 29,000 million during 2005.

The short term parts of construction loans are disclosed among current loans (see Note 20).  
The Company does not have any pledged liabilities on loans.

The maturities of non current loans are as follows (including owner's loan and debt from issuance of bonds):

Due dates	Amount
2007	77,125
2008	23,000
2009	81,000
2010	4,000
2011	40,000
Further installments in total	124
<b>Total</b>	<b>225,249</b>
of which:	
Construction loans	13,125
Non current liabilities to other related companies	212,000
Bonds	124

**19. Non current liabilities to other affiliated companies**

This caption contains the non current part of related party loans received from Deutsche Telekom Finance B.V. The closing balance of these loans as of December 31, 2005 is HUF 212,000 million.

HUF 28,000 million loan was drawn down in March 2005 repayable in 2009 (6 month BUBOR +0.3433 per cent).

In May 2005, further loans with fixed interest rates were drawn down. The two loans in the amount of HUF 20,000 million each have to be repaid in 2007, their interest rates are 7.55 per cent and 7.61 per cent.

In June 2005, further loans was drawn down in the amount of HUF 40,000 million in two parts, of which HUF 20,000 million has to be repaid in 2007 with interest rate of 7.45 per cent and the other HUF 20,000 million has to be repaid in 2009 with interest rate of 7.53 per cent.

The short term part of related party loans can be seen in Note 22.

**20. Current loans**

The Company has current loans received from banks in the amount of HUF 41,913 million as of December 31, 2005.

During 2005 HUF 113,858 million was drawn down and HUF 27,641 million was reclassified from long term loans. The Company repaid HUF 133,742 million during 2005.

The total amount of current loans (bank loans, related party loans and bonds) due in 2006 are HUF 116,632 million.

## Magyar Telekom Plc.

Notes to the Financial Statements prepared  
in accordance with the Hungarian Act on Accounting

As of December 31, 2005

(All amounts in millions of HUF, unless otherwise indicated)

### 21. Current liabilities to affiliated companies

This caption includes the interim dividends from T-Mobile Magyarország Távközlési Rt. (HUF 47,954 million) and HUNSAT Magyar Űrtávközlési Zrt. (HUF 104 million).

The balance of the loan payables to Stonebridge AD is HUF 12,550 million, to T-Online Magyarország Zrt. is HUF 2,500 million and to INVESTEL Magyar Távközlési Befektetési Rt. is HUF 830 million.

Interest-Pool liabilities to subsidiaries is amounted HUF 5,050 million. Other liabilities to affiliated companies are HUF 4,411 million.

### 22. Current liabilities to other affiliated companies

This caption contains the short term part of related party loans described in Note 19. Its balance as of December 31, 2005 is HUF 74,678 million. From this amount HUF 73,675 million has to be repaid on January 31, 2006 (fix interest rate of 9.36 per cent). The remaining HUF 973 million is due on February 28, 2006 (1 month BUBOR +0.164 per cent). Deutsche Telekom has pledged its support for Magyar Telekom Plc.'s financing needs through to June 30, 2007.

This caption contains a further HUF 30 million accounts payable liability to Deutsche Telekom AG.

### 23. Other current liabilities

Other current liabilities as of December 31, 2004 and 2005 are summarized as follows:

	<u>2004</u>	<u>2005</u>
VAT of continuous services	2,723	3,250
Liability relating to reversal of connection fee revenue based on Decrees of NHH 999/2004 and NHH/DH-6584-12/2005	1,522	2,870
Payables to employees, and its contributions	2,674	2,380
Value Added Tax	400	1,564
Personal income tax	1,599	1,319
Payment obligation connected to purchasing shares of Stonebridge AD	1,156	851
Liabilities to government	544	215
Withholding tax	0	224
Dividends payable *	72,654	0
Other	160	887
<b>Total</b>	<b><u>83,432</u></b>	<b><u>13,560</u></b>

\* The current year's dividend payable has not been decided yet.

The category "other" consists of HUF 61 million and HUF 77 million unpaid dividends approved for 2004 and 2005, respectively.

**Magyar Telekom Plc.**  
Notes to the Financial Statements prepared  
in accordance with the Hungarian Act on Accounting  
As of December 31, 2005  
(All amounts in millions of HUF, unless otherwise indicated)

**24. Accrued expenses and deferred income**

	2004	2005
Deferred subscription and traffic fees	1,217	1,233
Deferred income connected with rebranding *	0	773
Other **	855	496
<b><i>Deferred income</i></b>	<b><i>2,072</i></b>	<b><i>2,502</i></b>
Accounts payable accruals	8,530	8,160
Accrued interest on owners' loan	5,491	6,201
Accrued payroll related expenses	6,730	4,621
Accruals to affiliated companies	2,164	2,234
Accrued interest	895	393
Accrued taxes	311	0
Other	174	195
<b><i>Accrued expenses</i></b>	<b><i>24,295</i></b>	<b><i>21,804</i></b>
<b><i>Other deferred revenue **</i></b>	<b><i>287</i></b>	<b><i>522</i></b>
<b>Total</b>	<b><u>26,654</u></b>	<b><u>24,828</u></b>

\* The reimbursement received from the parent company in connection with capitalized expenditures is shown as deferred income, and recognized in other revenues in line with the depreciation of the related assets.

\*\* Based on Section 45 (1) c) of Act C/2000 on accounting the accrued amount of assets received without consideration (HUF 84 million in 2004 and HUF 80 million in 2005) and the accrued amount of surplus assets discovered (HUF 26 million in 2004 and HUF 26 million in 2005) have been reclassified from deferred income to other deferred revenue.

**25. Domestic sales**

Domestic sales in the years ending December 31, 2004 and 2005 are as follows:

	2004	2005
Subscriptions, connections and other charges	88,636	88,470
Outgoing domestic traffic revenues	93,121	68,921
Outgoing international traffic revenues	8,364	6,750
Total outgoing traffic revenues	101,485	75,671
Incoming domestic traffic revenues	8,937	9,970
Incoming international traffic revenues	18	12
Total incoming traffic revenues	8,955	9,982
Leased lines and data transmission	41,938	48,498
Equipment sales	2,050	3,061
Other revenues	10,814	11,397
<b>Total domestic sales</b>	<b><u>253,878</u></b>	<b><u>237,079</u></b>

**Magyar Telekom Plc.**  
Notes to the Financial Statements prepared  
in accordance with the Hungarian Act on Accounting  
As of December 31, 2005  
(All amounts in millions of HUF, unless otherwise indicated)

**26. Export sales by geographical areas**

Export sales by geographical areas in the years ending December 31, 2004 and 2005 are summarized as follows (sales are solely connected with services provided):

	2004	2004 %	2005	2005 %
	<u>          </u>	<u>          </u>	<u>          </u>	<u>          </u>
Europe (within the EU)	8,208	66.36%	6,898	57.19%
Europe (outside the EU)	2,333	18.86%	4,147	34.39%
America	716	5.79%	519	4.30%
Asia	1,025	8.29%	446	3.70%
Africa	22	0.18%	30	0.25%
Australia	<u>64</u>	<u>0.52%</u>	<u>20</u>	<u>0.17%</u>
<b>Total export sales</b>	<b><u><u>12,368</u></u></b>	<b><u><u>100.00%</u></u></b>	<b><u><u>12,060</u></u></b>	<b><u><u>100.00%</u></u></b>

**27. Other revenues**

Other revenues in the years ending December 31, 2004 and 2005 are as follows:

	2004	2005
	<u>          </u>	<u>          </u>
Reversal of provisions	2,184	10,756
Renaming and rebranding *	0	6,857
Revenue from sale of intangible and tangible fixed assets	2,966	2,436
Revenue from claims assigned **	84	1,195
Default interest, penalties, compensations	704	621
Reversal of impairment	573	388
Other	<u>687</u>	<u>931</u>
<b>Total</b>	<b><u><u>7,198</u></u></b>	<b><u><u>23,184</u></u></b>

\* Reimbursement received from Deutsche Telekom in connection with renaming and rebranding.

\*\* The increase in revenue from claims assigned is mainly due to the revenue from sale of receivables from governmental organizations.



**Magyar Telekom Plc.**

Notes to the Financial Statements prepared  
in accordance with the Hungarian Act on Accounting  
As of December 31, 2005  
(All amounts in millions of HUF, unless otherwise indicated)

**28. Import purchases**

Import purchases by geographical areas in the years ending December 31, 2004 and 2005 are summarized as follows:

	Services	Products	Total
	<u>                    </u>	<u>                    </u>	<u>                    </u>
Europe (within the EU)	6,592	4,880	11,472
Europe (outside the EU)	4,039	0	4,039
America	240	112	352
Asia	183	81	264
Australia	45	0	45
Africa	24	0	24
<b>Total import purchases</b>	<b><u>11,123</u></b>	<b><u>5,073</u></b>	<b><u>16,196</u></b>

**29. Cost of services**

Cost of services in the years ending December 31, 2004 and 2005 are as follows:

	2004	2005
	<u>                    </u>	<u>                    </u>
Repair and maintenance costs	18,164	19,474
Marketing expenses	7,204	9,853
Payments to international network operators	7,497	7,439
Fees paid to entrepreneurs	6,384	5,072
Consulting fees	4,121	3,931
Rental fees	3,278	3,296
Postage	3,233	3,180
Commissions paid	1,557	2,382
Property operating costs *	0	1,657
Bookkeeping services **	0	1,154
Payments to Internet service providers***	1,123	687
Travel and accommodation costs	431	410
Fleet management	0	79
Other	968	979
<b>Total</b>	<b><u>53,960</u></b>	<b><u>59,593</u></b>

\* Property operating activities have been outsourced to DeTe Immobilien-Hungary Szolgáltató Zrt. on February 1, 2005.

\*\* Magyar Telekom Plc. established EurAccount Kft. on March 1, 2005 which provides accounting services for the Company.

\*\*\* Payments to Internet service providers based on the decree of MeHVM 30/2001 (XII.23.).

**Magyar Telekom Plc.**

Notes to the Financial Statements prepared  
in accordance with the Hungarian Act on Accounting  
As of December 31, 2005  
(All amounts in millions of HUF, unless otherwise indicated)

**30. Costs of services sold (intermediated)**

Costs of intermediated services sold in the years ending December 31, 2004 and 2005 are as follows:

	<u>2004</u>	<u>2005</u>
Payment to mobile operators *	40,206	27,912
Payment to other LTO operators	3,378	3,696
Other	<u>9,345</u>	<u>10,205</u>
<b>Total</b>	<b><u>52,929</u></b>	<b><u>41,813</u></b>

\* Since May 25, 2005 settlements with mobile service providers have been recorded on the lower interconnection fees based on decrees of NHH.

**Magyar Telekom Plc.**

Notes to the Financial Statements prepared  
in accordance with the Hungarian Act on Accounting

As of December 31, 2005

(All amounts in millions of HUF, unless otherwise indicated)

**31. Employees**

The average number of employees in 2004 and 2005 are as follows:

		December 31, 2004		
		Average number of employees (person)	Salaries and Wages	Other payroll related expenses
Full-time employees				
	blue collar	1,815	4,108	2,377
	white collar	6,164	30,936	9,142
	total	7,979	35,044	11,519
Part-time employees				
	blue collar	2	2	1
	white collar	27	69	20
	total	29	71	21
Employees total				
	blue collar	1,817	4,110	2,378
	white collar	6,191	31,005	9,162
	total	8,008	35,115	11,540
Non-employee members*			607	128
<b>Total</b>		<b>8,008</b>	<b>35,722</b>	<b>11,668</b>
		December 31, 2005		
		Average number of employees (person)	Salaries and Wages	Other payroll related expenses
Full-time employees				
	Blue collar	1,498	3,556	1,414
	White collar	4,449	25,110	9,983
	total	5,947	28,666	11,397
Part-time employees				
	Blue collar	21	37	15
	White collar	410	827	328
	total	431	864	343
Employees total				
	Blue collar	1,519	3,593	1,429
	White collar	4,859	25,937	10,311
	total	6,378	29,530	11,740
Non-employee members*			3,022	1,202
<b>Total</b>		<b>6,378</b>	<b>32,552</b>	<b>12,942</b>

\* Includes employees doing their military services and employees on maternity leave, who are excluded from the average number of employees.

**Magyar Telekom Plc.**  
Notes to the Financial Statements prepared  
in accordance with the Hungarian Act on Accounting  
As of December 31, 2005  
(All amounts in millions of HUF, unless otherwise indicated)

**32. Remuneration of Board of Directors and Supervisory Board**

The remuneration of members of the Board of Directors and Supervisory Board of the Company in the years ending December 31, 2004 and 2005 is summarized below:

Year	Board of Directors	Supervisory Board	Total
2004	9	10	19
2005	10	14	24

The members of Board of Directors and Supervisory Board have not received any advance payments or loans from the Company.

**33. Other expenditures**

Other expenditures in the years ending December 31, 2004 and 2005 are as follows:

	2004	2005
Government taxes	4,592	4,445
Impairment of receivables and inventories	3,011	2,445
Write-off, extraordinary depreciation and scrapping of intangible and tangible fixed assets	8,521	2,313
Factored receivables *	184	1,773
Renaming and rebranding **	0	1,715
Net book value of fixed assets sold	2,079	1,705
Provisions	12,778	1,547
Other expenditures connected with Motorola - VPOP	0	220
Write-off of uncollectible receivables	127	120
Other	555	631
<b>Total</b>	<b>31,847</b>	<b>16,914</b>

\* The increase in factored receivables is mainly due to sale of receivables from governmental organizations.

\*\* Magyar Telekom Plc. reimburses to its affiliated companies for the operating costs incurred at affiliated companies in connection with renaming and rebranding.

The review of the value of assets and their revenue generating capacity resulted in the recognition of HUF 5,344 million extraordinary depreciation at the end of 2004.

At the end of 2004, HUF 12,228 million was provided for the headcount reduction in 2005-2006.

**Magyar Telekom Plc.**  
Notes to the Financial Statements prepared  
in accordance with the Hungarian Act on Accounting  
As of December 31, 2005  
(All amounts in millions of HUF, unless otherwise indicated)

**34. Results of financial activities**

*Revenues from financial transactions:*

The main driver in revenues from financial activities (HUF 83,624 million) is the dividend received related to 2004 (HUF 68,429 million). The most significant item is the dividend received from T-Mobile Magyarország Rt. (HUF 60,192 million). Further significant item is the interest on loans given to subsidiaries disclosed as interest income on financial investments (HUF 7,051 million) and as other interest income received (HUF 3,171 million). Major part of it is related to the loans given to T-Mobile Magyarország Rt. During the year a significant amount (HUF 3,477 million) was recorded as a foreign exchange gain on investments in foreign currency. HUF 804 million other foreign exchange gain and HUF 158 million gain on sale of treasury shares were recorded in 2005.

*Expenditures from financial transactions:*

The major portion of the HUF 32,278 million financial expenditures is the HUF 31,702 million interest payable in 2005. This includes the amount of the interest paid for owners' loans and for bank loans and foreign exchange losses on investments in foreign currency. Other foreign exchange losses totaled HUF 560 million which consists of a foreign exchange loss on sale of treasury shares in the amount of HUF 105 million.

In 2005, realized foreign exchange gain in the amount of HUF 41 million and foreign exchange loss in the amount of HUF 44 million were recorded in connection with closed forward transactions (over-the-counter hedging settlement transactions).

**35. Extraordinary revenues**

Extraordinary revenues in the years ending December 31, 2004 and 2005 are summarized as follows:

	<u>2004</u>	<u>2005</u>
Capital decrease in EPT Nyrt.	0	1,587
Assets received free of charge	<u>5</u>	<u>5</u>
<b><i>Extraordinary revenues adjusting tax base</i></b>	<b><u>5</u></b>	<b><u>1,592</u></b>
Merger of KIS-ASTRASAT Telekommunikációs Kft. into ViDaNet Zrt.	0	336
Development contributions	99	81
Assets surplus	4	3
Capital decrease in Hunsat Magyar Úrtávközlési Zrt.	1,650	0
Providing M-RTL Zrt. shares to IKO-TELEKOM Zrt. as contribution-in-kind	1,590	0
Merger of BCN Kft. into BCN Rendszerház Kft. (MatávCom Kft.)	120	0
Other extraordinary revenues	<u>8</u>	<u>1</u>
<b><i>Extraordinary revenues not adjusting tax base</i></b>	<b><u>3,471</u></b>	<b><u>421</u></b>
<b>Total</b>	<b><u><u>3,476</u></u></b>	<b><u><u>2,013</u></u></b>

**Magyar Telekom Plc.**  
Notes to the Financial Statements prepared  
in accordance with the Hungarian Act on Accounting  
As of December 31, 2005  
(All amounts in millions of HUF, unless otherwise indicated)

**36. Extraordinary expenditures**

The extraordinary expenditures of the Company in the years ending December 31, 2004 and 2005 are summarized as follows:

	2004	2005
Donation to foundations, charities and other organizations	3,491	4,030
Not reimbursable funds transferred to other organizations	0	1,120
Capital decrease in EPT Nyrt.	0	311
Repayment of state contribution	282	260
Net book value of receivables released	13	9
Net book value of assets contributed free of charge	6	1
Services provided free of charge	65	0
<b><i>Extraordinary losses adjusting tax base</i></b>	<b><i>3,857</i></b>	<b><i>5,731</i></b>
Merger of KIS-ASTRASAT Telekommunikációs Kft. into ViDaNet Zrt.	0	852
Capital decrease in Hunsat Magyar Úrtávközlési Zrt.	1,633	0
M-RTL Zrt. shares' removal from the accounts	1,052	0
Merger of BCN Kft. into BCN Rendszerház Kft. (MatávCom Kft.)	88	0
<b><i>Extraordinary losses not adjusting tax base</i></b>	<b><i>2,773</i></b>	<b><i>852</i></b>
<b>Total</b>	<b><u>6,630</u></b>	<b><u>6,583</u></b>

"Extraordinary Expenditures" include HUF 1,120 million paid under two consulting contracts entered into by the Company, where sufficient evidence could not be obtained that adequate value was received under these contracts. See Note 1 – Investigation into certain consultancy contracts.

**37. Transactions with affiliated companies**

Among affiliated companies the items connected to the members of Magyar Telekom Group are disclosed mainly in the relevant captions of the balance sheet and income statement. Only revenues are detailed in the follows.

Loans received from owners are disclosed as Non current liabilities to other affiliated companies or Current liabilities to other affiliated companies. Their interests are disclosed separately as expenditures from financial transactions in the income statement.

Revenues and expenditures related mainly to telecommunication services and to the subsidiaries of Deutsche Telekom Group were not disclosed separately as transactions with affiliated companies.

**Magyar Telekom Plc.**  
Notes to the Financial Statements prepared  
in accordance with the Hungarian Act on Accounting  
As of December 31, 2005  
(All amounts in millions of HUF, unless otherwise indicated)

Transactions with affiliated companies and subsidiaries of Deutsche Telekom in the years ending December 31, 2004 and 2005 are summarized as follows:

	2004	2005
<b><i>Net domestic sales</i></b>	<b><i>253,878</i></b>	<b><i>237,079</i></b>
- of which: affiliated companies	21,551	24,963
- of which: subsidiaries of Deutsche Telekom Group	52	609
<b><i>Net export sales</i></b>	<b><i>12,368</i></b>	<b><i>12,060</i></b>
- of which: affiliated companies	794	1,527
- of which: subsidiaries of Deutsche Telekom Group	3,303	3,060
<b><i>Other revenues</i></b>	<b><i>7,198</i></b>	<b><i>23,184</i></b>
- of which: affiliated companies	411	313
- of which: subsidiaries of Deutsche Telekom Group	0	6,739
<b><i>Accounts receivable</i></b>	<b><i>18,671</i></b>	<b><i>22,225</i></b>
- of which: subsidiaries of Deutsche Telekom Group	714	479
<b><i>Receivables from affiliated companies</i></b>	<b><i>50,208</i></b>	<b><i>36,410</i></b>
- of which: subsidiaries of Deutsche Telekom Group	30	36
<b><i>Other receivables</i></b>	<b><i>7,228</i></b>	<b><i>5,641</i></b>
- of which: subsidiaries of Deutsche Telekom Group	5	25
<b><i>Accrued income</i></b>	<b><i>10,754</i></b>	<b><i>9,960</i></b>
- of which: subsidiaries of Deutsche Telekom Group	213	542
<b><i>Accounts payable</i></b>	<b><i>20,372</i></b>	<b><i>19,499</i></b>
- of which: subsidiaries of Deutsche Telekom Group	645	771
<b><i>Current liabilities to other affiliated companies</i></b>	<b><i>60,000</i></b>	<b><i>74,678</i></b>
- of which: subsidiaries of Deutsche Telekom Group	0	30
<b><i>Accrued expenses</i></b>	<b><i>24,295</i></b>	<b><i>21,804</i></b>
- of which: subsidiaries of Deutsche Telekom Group	6,057	6,765

**Magyar Telekom Plc.**  
Notes to the Financial Statements prepared  
in accordance with the Hungarian Act on Accounting  
As of December 31, 2005  
(All amounts in millions of HUF, unless otherwise indicated)

**38. Corporate Income Tax**

The differences between profit before tax and the tax base for the years ending December 31, 2004 and 2005 are presented below:

	<u>2004</u>	<u>2005</u>
<b>Profit before tax</b>	<b>39,028</b>	<b>68,090</b>
Depreciation, amortization and write-off of assets	76,310	67,863
Non-repayable donations, assets and services given free of charge, assumed debt	3,903	6,984
Impairment of receivables	3,223	2,536
Provisions	12,778	1,547
Uncollectible and released receivables	127	79
Other increasing items	108	231
<b><i>Tax base increasing items</i></b>	<b><i>96,449</i></b>	<b><i>79,240</i></b>
Depreciation, amortization according to the Tax Law, tax book value of assets written-off	73,490	70,628
Dividend revenue	70,770	68,429
Reversal of provisions	2,183	10,756
Subsidies received	5	6,862
Donations	317	2,487
25 per cent (2004) and 50 per cent (2005) of local business tax	1,049	2,012
R&D costs	456	510
Bad debt write-off, reversal of impairment	534	482
Tax deductible portion of impairment of receivables	272	0
Other decreasing items	49	1,985
<b><i>Tax base decreasing items</i></b>	<b><i>149,125</i></b>	<b><i>164,151</i></b>
<b>Tax base</b>	<b><u>-13,648</u></b>	<b><u>-16,821</u></b>
<b><u>Calculated amount of tax</u></b>	<b><u>0</u></b>	<b><u>0</u></b>
Allowance	<u>0</u>	<u>0</u>
<b>Corporate Income Tax</b>	<b><u>0</u></b>	<b><u>0</u></b>

2180/2003 Government Resolution: The Company can reduce its corporate income tax liability by the present value of tax credit on broadband Internet investments. The tax credit is applicable from the year when the investment is completed up to four years and cannot exceed HUF 3,174 million.

552/2004 Ministry of Finance Resolution: Tax credit in connection with improvement program cannot exceed HUF 5,908 million at present value.

19/2005 Ministry of Finance Resolution: Tax credit in connection with improvement program cannot exceed HUF 2,614 million at present value.



**Magyar Telekom Plc.**  
Notes to the Financial Statements prepared  
in accordance with the Hungarian Act on Accounting  
As of December 31, 2005  
(All amounts in millions of HUF, unless otherwise indicated)

2001 is the last year closed by comprehensive audit by APEH at the Company. Tax authorities may inspect the books and records at any time within 5 years after the relevant tax year and can levy extra tax or penalty. Management of the Company is not aware of any circumstances which would cause significant liability in this respect.

**39. Dividend**

The current year's dividend payable has not been decided yet.

**40. Off-balance sheet items**

Off-balance sheet items are mainly rental commitments, repayable government grants and capital expenditure commitments.

For details see Appendix 4.

**41. Hazardous waste, Research & Development costs**

The following table shows the movement of hazardous waste at the Company in 2005 (data in kilograms):

Description	December 31, 2004	Increase	Decrease	December 31, 2005
Hazardous waste	59,892	503,339	512,138	51,093

Environmental expenses were HUF 67 million in 2004, and HUF 153 million in 2005.

Research and development costs amounted to HUF 530 million in 2005.

**42. Self-revisions**

At Magyar Telekom Plc., financial events that are related to prior years are recorded in the current year through self-revision.

According to the Hungarian Accounting Regulations, if the impact of the self-revision exceeds the 2 per cent of the total assets of the current year, or at least HUF 500 million, such items must be disclosed in a separate column in both the balance sheet and the income statement.

Errors related to prior years, that were discovered in 2005 exceeded the HUF 500 million limit (irrespective of their profit increasing or decreasing nature), therefore they are presented next to previous year's figures in the balance sheet and income statement.

**Magyar Telekom Plc.**  
Notes to the Financial Statements prepared  
in accordance with the Hungarian Act on Accounting  
As of December 31, 2005  
(All amounts in millions of HUF, unless otherwise indicated)

The total (profit increasing) impact of self-revisions is HUF 186 million and is broken down by corresponding years as follows:

<u>Year</u>		<u>Self-revision</u>
1999	HUF	11 million
2000	HUF	-20 million
2001	HUF	-23 million
2002	HUF	-15 million
2003	HUF	-105 million
2004	HUF	338 million

Self-revision is mainly due to over-accruals resulting from the early closing date of Magyar Telekom Plc. At that time, final information is not always available so the accruals are based on best estimates.

The major items based on the „A” type income statement lines are the following:

<b><i>I. Sales revenue</i></b>	<b><i>126</i></b>
Billing systems (OSS, BSS)	51
Revenues related to Magyar Telekom Group members	57
Other	18
<b><i>III. Other revenues</i></b>	<b><i>9</i></b>
Settlement of accruals	9
<b><i>IV. Material-type expenditures</i></b>	<b><i>-224</i></b>
Settlement of 2004 accruals	-224
<b><i>V. Payroll and related expenditures</i></b>	<b><i>16</i></b>
Other personal income tax paid by employer	24
Training contributions	-7
Other employee related expenses	-1
<b><i>VI. Depreciation</i></b>	<b><i>13</i></b>
Depreciation related to prior years	13
<b><i>VII. Other expenditures</i></b>	<b><i>140</i></b>
Land and building tax settled with municipality	116
Local tax settled with municipality	24
<b><i>D. NET INCOME ON EXTRAORDINARY ACTIVITIES</i></b>	<b><i>-4</i></b>
Contribution to foundations	-4
<b><i>Impact on the profit</i></b>	<b><i>186</i></b>

Budapest, December 5, 2006

Straub Elek  
Chairman and Chief Executive Officer

Thilo Kusch  
Chief Financial Officer

## Intangible Assets

(in HUF millions)

Description	Capitalized Value of Research and Development	Rights	Intellectual Property	Goodwill	Total
1. Gross value					
11. Opening gross value	876	2 551	43 390	200 398	247 215
12. Addition in gross value	0	7 030	2 883	58	9 971
13. Disposal in gross value	0	140	1 156	0	1 296
Reclassifications within Intangible Assets	0	42 679	-42 679	0	0
Reclassification between Intangible Assets and Tangible ,	0	16	0	0	16
14. Closing gross value	876	52 136	2 438	200 456	255 906
2. Accumulated amortization					
21. Opening amortization	876	1 413	29 553	29 694	61 536
22. Addition in amortization	0	4 570	494	10 147	15 211
23. Disposal in amortization	0	127	1 134	0	1 261
Reclassifications within Intangible Assets	0	28 033	-28 033	0	0
Reclassification between Intangible Assets and Tangible ,	0	9	0	0	9
24. Closing amortization	876	33 898	880	39 841	75 495
Net book value	0	18 238	1 558	160 615	180 411
4. Other data					
Annual amortization	0	4 570	494	10 147	15 211
Extraordinary amortization	0	0	0	0	0
Reversal of Extraordinary amortization	0	0	0	0	0

## Real estate and related rights representing value

(in HUF millions)

Description	Land	Building	Telecommunicatio n Network	Other Properties	Real Estate related Rights	Real Estate and related Rights Total
1. Gross value						
11. Opening gross value	2 404	51 546	225 374	14 069	4 765	298 158
12. Addition in gross value	31	833	9 192	240	81	10 377
13. Disposal in gross value	137	1 681	465	591	251	3 125
Reclassifications within Property,Plant and Equipmnet	0	-12	43	20	-43	8
Reclassification between Intangible Assets and Tangible Assets	0	0	0	0	0	0
14. Closing gross value	2 298	50 686	234 144	13 738	4 552	305 418
2. Accumulated depreciation						
21. Opening depreciation	0	10 578	71 545	5 684	3 312	91 119
22. Addition in depreciation	0	1 327	8 823	431	294	10 875
Correction of addition	0	0	0	0	0	0
23. Disposal in depreciation	0	553	225	493	29	1 300
Reclassifications within Property,Plant and Equipmnet	0	0	32	8	-32	8
Reclassification between Intangible Assets and Tangible Assets	0	0	0	0	0	0
24. Closing depreciation	0	11 352	80 175	5 630	3 545	100 702
Net book value	2 298	39 334	153 969	8 108	1 007	204 716
<i>- Of which residual value</i>	0	253	0	42	0	295
4. Other data						
Annual depreciation	0	1 319	8 823	431	294	10 867
Extraordinary depreciation *	0	8	0	0	0	8
Reversal of Extraordinary depreciation	0	0	0	0	0	0

\* Extraordinary depreciation of land is decreasing its gross value.

## Technical and Other Equipment, Machinery and Vehicles

(in HUF millions)

Description	Telecommunicatio n Equipment, Machinery	Other Technical Equipment, Machinery and vehicles	Technical Equipment, Machinery and Vehicles Total	Other Equipment Total	Technical and Other Equipment Total	Technical and Other Equipment used for environ- mental protection
1. Gross value						
11. Opening gross value	359 179	4 238	363 417	40 908	404 325	28
12. Addition in gross value	19 289	303	19 592	1 834	21 426	6
13. Disposal in gross value	12 830	548	13 378	2 414	15 792	1
Reclassifications within Property,Plant and Equipmnet	770	0	770	-778	-8	0
Reclassification between Intangible Assets and Tangible Assets	0	0	0	-16	-16	0
14. Closing gross value	366 408	3 993	370 401	39 534	409 935	33
2. Accumulated depreciation						
21. Opening depreciation	226 067	3 265	229 332	32 866	262 198	14
22. Addition in depreciation	34 321	254	34 575	3 481	38 056	4
Correction of addition	0	0	0	0	0	0
23. Disposal in depreciation	11 483	538	12 021	2 301	14 322	0
Reclassifications within Property,Plant and Equipmnet	785	0	785	-793	-8	0
Reclassification between Intangible Assets and Tangible Assets	0	0	0	-9	-9	0
24. Closing depreciation	249 690	2 981	252 671	33 244	285 915	18
3. Net book value	116 718	1 012	117 730	6 290	124 020	15
- Of which residual value	0	384	384	576	960	0
4. Other data						
Annual depreciation	34 122	254	34 376	3 364	37 740	4
Extraordinary depreciation	199	0	199	117	316	0
Reversal of Extraordinary depreciation	0	0	0	0	0	0

## Investments of Magyar Telekom Rt.

(in HUF millions)

Description	Headquarter	Ownership Direct (%)	Ownership Indirect (%)	Ownership (%)	Voting Rights	Common Stock	Capital Reserves	Net Income	Owner's Equity
<i>BCN Rendszerház Informatikai és Kommunikációs Hálózatokat Szolgáltató Kft.</i>	1107 Budapest, Bihari út 6.	100.00%		100.00%	100.00%	6 161	-207	264	6 218
<i>EGERTEL Távközlési Hálózat Létesítő Zrt.</i>	1013 Budapest, Krisztina krt. 55.	100.00%		100.00%	100.00%	1 425	237	74	1 736
<i>EMITEL Távközlési Zrt.</i>	6722 Szeged, Tisza Lajos krt. 41.	100.00%		100.00%	100.00%	3 110	402		3 512
<i>Gabriele 17 GmbH</i>	Németország, 60311 Frankfurt am Main, Bethmann str. 50-54.	100.00%		100.00%	100.00%	6	0	0	6
<i>Integris-Rendszerház Informatikai Szolgáltató Kft.</i>	9022 Győr, Bajcsy-Zsilinszky 46.	100.00%		100.00%	100.00%	615	15	113	743
<i>Stonebridge Communication AD Skopje</i>	1000 Skopje, Orce Nikolov bb.	100.00%		100.00%	100.00%	87 535	1 549	11 907	100 991
<i>Telemacedonia A.D.Skopje</i>	1000 Skopje, Orce Nikolov bb.	100.00%		100.00%	100.00%	4	165	-73	96
<i>T-Mobile Magyarország Távközlési Rt.</i>	1117 Budapest, Kaposvár u. 5-7.	100.00%		100.00%	100.00%	8 031	40 369	54 401	102 801
<i>T-Online Magyarország Zártkörűen Működő Internet Szolgáltató Rt.</i>	1117 Budapest, Neumann János út 1/B	100.00%		100.00%	100.00%	1 906	2 635	2 002	6 543
<i>Viabridge Telecommunications Holding Limited</i>	Level 2, Valletta Buildings, South Street, Valletta, Malta VLT 11	99.96%	0.04%	100.00%	100.00%	63	228	-10	281
<i>Novatel UKRAINE LLC.</i>	Pymonenska Str. 13, building 7, office 7B/36, - Kyiv, 04050 Ukraine	99.94%	0.06%	100.00%	100.00%	70	0	-39	31
<i>EurAccount Pénzügyi és Számviteli Szolgáltató Kft.*</i>	1077 Budapest, Kéthly Anna tér 1.	99.00%	1.00%	100.00%	100.00%	450	0	195	495
<i>X-BYTE Pénzügyi és Számviteli Szolgáltató Kft.</i>	1013 Budapest, Krisztina krt. 55.	99.00%	1.00%	100.00%	100.00%	20	54	-36	38
<i>Első Pesti Telefonszolgálat Nyr.</i>	1183 Budapest, Haladás út 5.	97.20%		97.20%	97.20%	777	118	10	905
<i>Telekom Cme Gore A.D. Podgorica</i>	2 Kralja Nikole Street, Podgorica, Serbia and Montenegro	76.53%		76.53%	76.53%	35 634	-517	529	35 646
<i>CARDNET Kartyarendszerek és -szolgáltatások Zrt.</i>	1032 Budapest, Kiscelli út 7-9.	72.00%		72.00%	72.00%	58	116	28	202
<i>ViDaNet Kábeltelevíziós Szolgáltató Zrt.</i>	1055 Budapest, Honvéd tér 10/a	67.50%	22.50%	90.00%	49.90%	2 000	604	719	3 323
<i>Investel Magyar Távközlési Befektetési Rt.</i>	1013 Budapest, Krisztina krt. 32.	62.28%	37.72%	100.00%	62.28%	4 862	722	179	5 763
<i>TELE-DATA Távközlési Adattfeldolgozó és Hirdetésszervező Kft.</i>	2040 Budaörs, Baross u. 89.	50.99%		50.99%	50.99%	39	8	79	126
<i>HUNSAT Magyar Úrtávközlés Zrt.</i>	1117 Budapest, Hauszmann Alajos u. 2.	50.00%		50.00%	50.00%	100	0	313	413
<i>IKO-Telekom Média Holding Zrt.</i>	1119 Budapest, Nagytétényi út 29.	50.00%		50.00%	50.00%	3 200	-11	672	3 861
<i>T-Systems Hungary Szolgáltató Kft.</i>	1117 Budapest, Infopark, Neumann János utca 1/C.	49.00%		49.00%	49.00%	282	2 895	129	3 306
<i>Mindentudás Egyeteme Tudományos Közhazsnú Társaság</i>	1105 Budapest, Zágrábi út 1-3.	40.00%	20.00%	60.00%	60.00%	5	1	1	7
<i>T-Systems RIC Kutatási Kft.</i>	1117 Budapest, Infopark, Neumann János utca 1/C.	20.00%		20.00%	20.00%	122	97	-116	103
<i>T-Kábel Magyarország Kábeltelevíziós Szolgáltató Kft.</i>	1089 Budapest, Baross u. 133.	16.39%	83.61%	100.00%	100.00%	920	4 661	1 362	6 943
<i>Axelero Kereskedelmi és Szolgáltató Kft.</i>	1013 Budapest, Krisztina krt. 55.	10.00%	90.00%	100.00%	100.00%	3	0	0	3
<i>Matáv Kereskedelmi és Szolgáltató Kft.</i>	1013 Budapest, Krisztina krt. 55.	10.00%	90.00%	100.00%	100.00%	3	0	0	3
<i>MatávKábelTV Kereskedelmi és Szolgáltató Kft.</i>	1013 Budapest, Krisztina krt. 55.	10.00%	90.00%	100.00%	100.00%	3	0	0	3
<i>ProMoKom Zártkörűen Működő Profeszionalis Mobil Kommunikációs Zrt.</i>	1033 Budapest, Huszti út 32.	0.47%	99.53%	100.00%	100.00%	21	-5	5	21
<i>Combridge S.R.L.</i>	Str. Viitorului, Nr. 24, Bloc 7, Scara C, Ap. 16. Sfantu Gheorghe, Romania		100.00%	100.00%	100.00%	226	22	-34	214
<i>Novatel EOOD</i>	37 Fridtjof Nances Street, Sofia 1142, Bulgaria		100.00%	100.00%	100.00%	39	-3	-34	2
<i>ÓBUDA TELEVÍZIÓ Kft.</i>	1032 Budapest, Gyenes u. 8/A.		100.00%	100.00%	100.00%	3	-2	0	1
<i>SafeCom Biztonságtechnikai Szolgáltató Zrt.</i>	1107 Budapest, Bihari út 6.		100.00%	100.00%	100.00%	20	15	8	43
<i>BALATEL Telekommunikációs Szolgáltató Rt.</i>	8600 Siófok, Somogyi Bacsó Béla u. 4.	96.63%		96.63%	96.63%	90	-84	0	6
<i>CompArgo Számítástechnikai, Távközlési és Szolgáltató Kft.</i>	1023 Bp., Zsigmond tér 13.		80.00%	80.00%	80.00%	3	51	20	74
<i>Internet Cme Gore DOO, Podgorica</i>	Vucedolska 13, 81000 Podgorica, Serbia and Montenegro		76.53%	76.53%	100.00%	249	216	220	685
<i>Monet DOO, Podgorica</i>	Bulevar Svetog Perta Cetinjskog 3, 81000 Podgorica, Serbia and Montenegro		76.53%	76.53%	100.00%	5 768	2 426	1 204	9 398
<i>Marketline Internet Szolgáltató Rt.</i>	1013 Budapest, Krisztina krt. 55.	65.30%		65.30%	65.30%	20	-4	-2	14
<i>Makedonski Telekomunikacii AD</i>	1000 Skopje, Orce Nikolov bb.	51.00%		51.00%	51.00%	39 582	39 643	21 778	101 003
<i>MOBIMAK A. D.</i>	1000 Skopje, Orce Nikolov bb.	51.00%		51.00%	100.00%	9 681	12 568	10 049	32 298
<i>Montenegrocard DOO, Podgorica</i>	Bulevar Lenjina 3, 81000 Podgorica, Serbia and Montenegro	39.03%		39.03%	51.00%	21	0	0	21
<i>Magyar RTL Televízió Zrt.</i>	1222 Budapest, Nagytétényi út 29.		25.00%	25.00%	25.00%	2 010	6 247	2 997	11 254
<i>Budakalász Kábel TV Szolgáltató Kft.</i>	2011 Budakalász, Szentendrei út 9.		25.00%	25.00%	25.00%	70	8	0	78

The indicated voting rights are define unambiguously the significant (more than 25%), the majority (more than 50%) and the direct control (more than 75%) according to the Companies Act.

\* HUF 150 million is unpaid share capital from HUF 450 million share capital of EurAccount Kft.

## Write down

(in HUF millions)

Description	For Financial Investments			For Current Assets		
	Investments	Loans granted	Securities	Inventories	Receivables*	Securities
Opening balance	2 424	0	0	138	3 849	0
Increase	0	0	0	181	2 264	0
Decrease	0	0	0	7	1 052	0
Released write down	0	0	0	82	306	0
Closing balance	2 424	0	0	230	4 755	0

\* The write down for receivables contains the other receivables write down, too.

## Off-balance Sheet Liabilities

(in HUF millions)

Description	Amount of liability	Amount due					
		2006	2007	2008	2009	2010	2011
<b>I. Contractual Liabilities</b>	<b>7 565</b>	<b>3 062</b>	<b>1 638</b>	<b>1 140</b>	<b>782</b>	<b>656</b>	<b>287</b>
1. Rental contracts	3 529	1 356	1 106	611	267	141	48
2. Rental contracts with affiliated companies	1 803	426	339	339	325	325	49
3. Repayable State loan	181	178	3	0	0	0	0
4. Capital Commitment	904	904	0	0	0	0	0
5. Environmental protection	1 148	198	190	190	190	190	190



**Magyar Telekom Telecommunications  
Public Limited Company**

**Consolidated Financial Statements**

**FOR THE YEAR ENDED DECEMBER 31, 2005**

Prepared in accordance with  
International Financial Reporting Standards  
(IFRS)

# MAGYAR TELEKOM

## INDEX TO THE CONSOLIDATED FINANCIAL STATEMENTS

	<u>Page</u>
<b>Consolidated Financial Statement:</b>	
Report of Independent Registered Public Accounting Firm .....	F-2
Consolidated Balance Sheets at December 31, 2004 and 2005 .....	F-3
Consolidated Income Statements for the years ended December 31, 2003, 2004 and 2005 .....	F-4
Consolidated Cashflow Statements for the years ended December 31, 2003, 2004 and 2005 .....	F-5
Consolidated Statements of Changes in Equity for the years ended December 31, 2003, 2004 and 2005 .....	F-6
Notes to the Consolidated Financial Statements .....	F-8

**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM  
TO THE BOARD OF DIRECTORS AND SHAREHOLDERS OF MAGYAR TELEKOM PLC.**

**NOT AVAILABLE**

**MAGYAR TELEKOM**  
**CONSOLIDATED BALANCE SHEETS**

	Notes	At December 31,		
		HUF		USD
		2004	2005	2005
		(in HUF millions)		(million USD) (unaudited) (note 2)
<b>ASSETS</b>				
<b>Current assets</b>				
Cash and cash equivalents .....	6	36,879	46,060	216
Other financial assets .....	7	576	1,817	9
Trade and other receivables .....	8	83,440	97,183	455
Current income tax receivable .....		3,549	452	2
Inventories .....	9	7,669	8,414	39
Assets held for disposal .....	10	3,063	2,302	11
<b>Total current assets</b> .....		<u>135,176</u>	<u>156,228</u>	<u>732</u>
<b>Non current assets</b>				
Property, plant and equipment – net .....	11	571,090	580,736	2,719
Intangible assets – net .....	12	298,351	319,797	1,497
Associates .....	14	5,750	5,020	23
Deferred taxes .....	26	12,527	14,966	70
Other non current assets .....	15	6,664	6,201	29
<b>Total non current assets</b> .....		<u>894,382</u>	<u>926,720</u>	<u>4,338</u>
<b>Total assets</b> .....		<u><u>1,029,558</u></u>	<u><u>1,082,948</u></u>	<u><u>5,070</u></u>
<b>LIABILITIES</b>				
<b>Current liabilities</b>				
Loans from related parties .....	17	60,000	74,648	350
Loans and other borrowings – third party .....	17	34,538	43,602	204
Trade and other payables .....	18	109,921	119,464	559
Current income tax payable .....		52	1,472	7
Deferred revenue .....	19	1,502	918	4
Provision for liabilities and charges .....	20	15,537	6,817	32
<b>Total current liabilities</b> .....		<u>221,550</u>	<u>246,921</u>	<u>1,156</u>
<b>Non current liabilities</b>				
Loans from related parties .....	17	177,675	212,000	993
Loans and other borrowings – third party .....	17	48,395	14,215	67
Deferred revenue .....	19	1,186	267	1
Deferred taxes .....	26	1,280	3,189	15
Provision for liabilities and charges .....	20	2,761	3,141	15
Other non current liabilities .....	18	47	5,521	26
<b>Total non current liabilities</b> .....		<u>231,344</u>	<u>238,333</u>	<u>1,117</u>
<b>Total liabilities</b> .....		<u>452,894</u>	<u>485,254</u>	<u>2,273</u>
<b>EQUITY</b>				
<b>Shareholders' equity</b>				
Common stock .....		104,281	104,281	488
Additional paid in capital .....		27,382	27,382	128
Treasury stock .....		(3,842)	(1,926)	(9)
Cumulative translation adjustment .....		(3,026)	(420)	(2)
Retained earnings .....		391,772	398,250	1,864
<b>Total shareholders' equity</b> .....		<u>516,567</u>	<u>527,567</u>	<u>2,469</u>
Minority interests .....		60,097	70,127	328
<b>Total equity</b> .....		<u>576,664</u>	<u>597,694</u>	<u>2,797</u>
<b>Total liabilities and equity</b> .....		<u><u>1,029,558</u></u>	<u><u>1,082,948</u></u>	<u><u>5,070</u></u>

These consolidated financial statements were authorized for issue by the Board of Directors on December 5, 2006 and signed on their behalf by:

Elek Straub  
Chairman and Chief Executive Officer

Thilo Kusch  
Chief Financial Officer

The accompanying notes form an integral part of these consolidated financial statements.

**MAGYAR TELEKOM**  
**CONSOLIDATED INCOME STATEMENTS**

	Notes	For the year ended December 31,			
		HUF			USD
		2003	2004	2005	2005
		(in HUF millions, except per share amounts)			(million USD) (unaudited) (note 2)
Fixed line services .....	21	358,655	334,174	331,062	1,550
Mobile services .....	22	248,597	267,264	289,635	1,356
<b>Total revenues</b> .....		<u>607,252</u>	<u>601,438</u>	<u>620,697</u>	<u>2,906</u>
Employee related expenses .....	23	(87,920)	(109,497)	(92,783)	(434)
Depreciation and amortization .....		(128,334)	(137,666)	(114,686)	(537)
Payments to other network operators .....		(84,449)	(87,580)	(89,097)	(417)
Cost of telecommunications equipment sales .....		(40,811)	(40,971)	(37,221)	(174)
Other operating expenses – net .....	24	(143,674)	(140,460)	(153,522)	(720)
<b>Total operating expenses</b> .....		<u>(485,188)</u>	<u>(516,174)</u>	<u>(487,309)</u>	<u>(2,282)</u>
<b>Operating profit</b> .....		122,064	85,264	133,388	624
Net financial expenses .....	25	(40,002)	(36,146)	(31,288)	(146)
Share of associates' profits/losses after tax .....	14	795	1,896	330	1
<b>Profit before income tax</b> .....		82,857	51,014	102,430	479
Income tax .....	26	(13,517)	(7,687)	(13,511)	(63)
<b>Profit for the year</b> .....		<u>69,340</u>	<u>43,327</u>	<u>88,919</u>	<u>416</u>
<b>Attributable to:</b>					
Equity holders of the Company (Net income) .....		57,475	34,641	78,564	368
Minority interests .....		11,865	8,686	10,355	48
		<u>69,340</u>	<u>43,327</u>	<u>88,919</u>	<u>416</u>
<b>Earnings per share (EPS) information:</b>					
Profit attributable to the equity holders of the Company		57,475	34,641	78,564	368
Weighted average number of common stock outstanding (thousands) used for basic EPS .....		1,037,912	1,037,912	1,038,803	
Average number of dilutive share options (thousands) .....		<u>122</u>	<u>318</u>	<u>417</u>	
Weighted average number of common stock outstanding (thousands) used for diluted EPS .....		1,038,034	1,038,230	1,039,220	
Basic earnings per share (HUF and USD) .....		55.38	33.38	75.63	0.35
Diluted earnings per share (HUF and USD) .....		55.37	33.37	75.60	0.35

The accompanying notes form an integral part of these consolidated financial statements.

**MAGYAR TELEKOM**  
**CONSOLIDATED CASHFLOW STATEMENTS**

		<b>For the year ended December 31,</b>			
		<b>HUF</b>			<b>USD</b>
Notes		<b>2003</b>	<b>2004</b>	<b>2005</b>	<b>2005</b>
		<b>(in HUF millions)</b>			<b>(million USD)</b>
		<b>(unaudited)</b>			
		<b>(note 2)</b>			
<b>Cashflows from operating activities</b>					
		240,497	234,681	236,937	1,110
	27	(30,063)	(34,030)	(31,078)	(146)
		(12,318)	(10,900)	(4,523)	(21)
		<b>198,116</b>	<b>189,751</b>	<b>201,336</b>	<b>943</b>
<b>Cashflows from investing activities</b>					
		(90,788)	(91,748)	(103,587)	(485)
	13	(7,992)	(17,273)	(35,927)	(168)
	5	61	16	1,866	9
	5	908	1,452	2,195	10
		575	2,633	1,729	8
		266	43	(371)	(2)
		2,269	4,090	2,529	12
		<b>(94,701)</b>	<b>(100,787)</b>	<b>(131,566)</b>	<b>(616)</b>
<b>Cashflows from financing activities</b>					
		(23,507)	(78,294)	(84,551)	(396)
		192,057	338,680	263,329	1,233
		(260,583)	(332,481)	(242,595)	(1,136)
		(3,842)	-	-	-
		3,842	-	1,969	9
		(2)	-	-	-
		<b>(92,035)</b>	<b>(72,095)</b>	<b>(61,848)</b>	<b>(290)</b>
		1,901	(2,122)	1,259	6
		<b>13,281</b>	<b>14,747</b>	<b>9,181</b>	<b>43</b>
		8,851	22,132	36,879	173
	6	22,132	36,879	46,060	216

The accompanying notes form an integral part of these consolidated financial statements.

**MAGYAR TELEKOM**

**CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY**

	Attributable to the equity holders of the Company					Minority interest	Total equity	
	Shares of common stock (a)	Common stock	Additional paid in capital	Treasury stock	Cumulative translation adjustment			Retained earnings (i)
<b>Balance at December 31, 2002</b> ....	1,042,811,600	104,281	27,382	(4,488)	(4,348)	393,317	59,436	575,580
Dividend (g) .....						(18,682)		(18,682)
Dividend declared to minority interest (h) .....							(4,796)	(4,796)
Business combinations (b) .....							(2,424)	(2,424)
Sale of treasury stock (c) .....				4,488		(646)		3,842
Purchase of treasury stock (c) ...				(3,842)				(3,842)
Cumulative Translation Adjustment					5,173		6,193	11,366
Profit for the year .....						57,475	11,865	69,340
<b>Balance at December 31, 2003</b> ....	1,042,811,600	104,281	27,382	(3,842)	825	431,464	70,274	630,384
Dividend (g) .....						(72,654)		(72,654)
Dividend declared to minority interest (h) .....							(5,651)	(5,651)
Business combinations (b) .....							(9,109)	(9,109)
Purchase of investment in T-Systems Hungary (d) .....						(1,679)		(1,679)
Cumulative Translation Adjustment					(3,851)		(4,103)	(7,954)
Profit for the year .....						34,641	8,686	43,327
<b>Balance at December 31, 2004 as reported</b> .....	1,042,811,600	104,281	27,382	(3,842)	(3,026)	391,772	60,097	576,664
Effect of adoption of changes in IAS 39 – net of tax (note 2(e)) .....						(733)		(733)
<b>Balance at December 31, 2004 as restated</b> .....	1,042,811,600	104,281	27,382	(3,842)	(3,026)	391,039	60,097	575,931
Dividend (g) .....						(72,654)		(72,654)
Dividend declared to minority interest (h) .....							(11,913)	(11,913)
Business combinations (b) .....							9,447	9,447
Sale of Telit to DeTe Immobilien (d) .....						495		495
TSI's capital injection in TSH (d)						669		669
Sale of treasury stock (e) .....				1,916		53		1,969
Effect of fair value of share based payments (f) .....						84		84
Cumulative Translation Adjustment					2,606		2,141	4,747
Profit for the year .....						78,564	10,355	88,919
<b>Balance at December 31, 2005</b> ....	1,042,811,600	104,281	27,382	(1,926)	(420)	398,250	70,127	597,694
Of which treasury stock .....	(2,456,659)							
<b>Shares of common stock outstanding at December 31, 2005</b> .....	1,040,354,941							

The accompanying notes form an integral part of these consolidated financial statements.

## MAGYAR TELEKOM

### CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY (notes)

- (a) In addition to the 1,042,811,600 issued shares of common stock (nominal value of HUF 100), total shareholders' equity includes one Series "B" preference share at the nominal value of HUF 10,000 at December 31, 2005. This Series "B" share is held by the Ministry of Informatics and Communications, and bestows certain rights on its owner, including access to information, and the appointment of a Director. This share may only be held by the Government or its nominee. The number of authorized shares on December 31, 2005 is 1,054,911,600.
- (b) Business combinations include the change in minority interests due to acquisitions. In case of new acquisitions where Magyar Telekom acquires a less than 100 percent stake, minority interests increase. Minority interests decrease where Magyar Telekom acquires further share of ownership in subsidiaries already consolidated.
- (c) Due to statutory requirements the Company sold and repurchased its 4,900,000 shares of common stock in 2003 for HUF 3,842 million, which resulted in a loss of HUF 646 million recognized in retained earnings.
- (d) Related party transactions

In 2004 Magyar Telekom acquired a 49% share of ownership in T-Systems Hungary (TSH), since which time TSH is an associate of Magyar Telekom Group. As both Magyar Telekom and TSH belong to the Deutsche Telekom group, the ultimate parent of Magyar Telekom, the transaction is considered as being between entities under common control. As a result, the difference between the carrying value of this investment in T-Systems International's books (HUF 1,751 million) and the purchase price (HUF 3,430 million) was accounted for directly against the retained earnings of the Group.

In 2005 Magyar Telekom sold its investment in Telit Rt., the real estate outsourcing company of Magyar Telekom to DeTe Immobilien, a Deutsche Telekom group member. As the transaction took place between entities under common control, the gain on the sale of the investment was recognized directly in retained earnings.

In 2005 T-Systems International (TSI) forgave a loan given to T-Systems Hungary (TSH) in an amount of HUF 1,366 million of which HUF 669 appears as an increase in Magyar Telekom's share of TSH's net assets on equity consolidation as TSH is an associated company of the Group. As all three parties are part of the Deutsche Telekom group and the transaction took place between entities under common control, the increase in Magyar Telekom's investment in TSH was recognized directly in retained earnings.

- (e) In 2005 Magyar Telekom's CEO and other managers exercised some of their share options, and the Company used its treasury shares reserved for the option programs. As a result of these transactions, the Company sold 2,443,341 of its treasury shares to the CEO and other managers at the fixed option prices. On the sale of the treasury shares the Company recognized a gain of HUF 53 million, which was recognized in retained earnings. For more details on the programs see note 28.
- (f) In 2005 Magyar Telekom adopted IFRS 2 – Share-based payment, which requires the Company to recognize the cost of the equity-settled share-based payments against retained earnings. In 2005 the Company accounted for HUF 84 million of such expenses. For more details see note 28.
- (g) In 2005 Magyar Telekom Plc. declared and paid HUF 70 dividend per share (HUF 70 in 2004, HUF 18 in 2003).
- (h) The dividend declared to minority interest almost entirely reflects the dividend declared by Maktel, Magyar Telekom's Macedonian subsidiary to its minority shareholders.
- (i) The distributable reserves of the Company under Hungarian law at December 31, 2005 amounted to approximately HUF 282,000 million (HUF 283,000 million at December 31, 2004).

The accompanying notes form an integral part of these consolidated financial statements.



**MAGYAR TELEKOM**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

**1 General Information**

Magyar Telekom Plc., (the "Company" or "Magyar Telekom Plc.") with its subsidiaries form Magyar Telekom Group ("Magyar Telekom" or "the Group"). Magyar Telekom is the principal supplier of telecommunications services in Hungary, Macedonia and Montenegro. Magyar Telekom is a full-service telecommunications provider.

The Company was incorporated in Hungary on December 31, 1991 and commenced business on January 1, 1992. The Company's registered address is Krisztina körút 55, 1013 Budapest, Hungary.

Magyar Telekom Plc. is listed on the Budapest and New York stock exchanges, its shares are traded on the Budapest Stock Exchange, while Magyar Telekom's American Depository Shares (ADSs) each representing five ordinary shares are traded on the New York Stock Exchange.

*Investigation into certain consultancy contracts*

On February 13, 2006, the Company announced that it was investigating certain contracts to determine whether they were entered into in violation of Company policy or applicable law or regulation. Concerns regarding two consultancy contracts entered into by one of the Company's subsidiaries were initially raised by the Company's auditors. As a result of the investigation, two additional consultancy contracts, which were entered into by the Company, have been called into question. The total amount of the four contracts under investigation is around HUF 2 billion. Concerns have also arisen regarding destruction by certain employees of electronic documents obstructing the investigation. As a consequence of the investigation, the Company had suspended a number of employees who have since resigned. The investigation, which is being conducted by an independent law firm and supervised by the Audit Committee, is still ongoing.

Although the investigation has not been finalized, based on the independent investigators' findings and conclusions to date, these contracts were entered into without full compliance with internal company procedures regarding the entry of such contracts. Moreover, sufficient evidence could not be obtained that adequate value was received under these contracts. In its 2005 preliminary results announcement the Company had capitalized the HUF 1.12 billion payment made related to two of these contracts. As a result of the findings of the investigation, the Company has expensed the total amount of the HUF 2 billion paid under these four contracts, and discloses these expenses under the caption "Other operating expenses – net." See Note 23. This has resulted in a commensurate effect on, among others, taxes, minority interest and net income when compared to what was reported in the Company's 2005 preliminary results announcement.

The Company has already implemented certain remedial measures designed to enhance its control procedures with respect to the entry into consultancy contracts, including the introduction of a new governance model and replacement of the Board of Directors at Crnogorski Telekom and termination of work contracts with employees initiating data deletions interfering with the investigation.

The Company's Board of Directors also approved on November 8, 2006 a more extensive program of remedial actions, which it expects to implement in the near future. These decisions include structural and procedural changes in relation to mergers and acquisitions and procurement as well as a new internal control regime. The Company's Board of Directors also decided on December 5, 2006 on certain additional enhancements of internal controls and the implementation thereof.

As a result of the delays in finalizing its 2005 financial statements as a result of the investigation, the Company and some of its subsidiaries have failed and may fail to meet certain deadlines prescribed by the Hungarian and other applicable laws and regulations for preparing and filing audited annual results and holding annual general meetings. The Company has already been fined HUF 12 million as a consequence of such delays. The Company has notified the Hungarian Financial Supervisory Authority, the U.S. Securities and Exchange Commission and the U.S. Department of Justice of the investigation and is in contact with these authorities

**MAGYAR TELEKOM**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS — (Continued)**

regarding the investigation and has responded to a number of inquiries these authorities have raised.

Magyar Telekom is Hungary's, Macedonia's and Montenegro's largest telecommunications service provider. In addition, Magyar Telekom provides leased lines, data transmission, corporate networks, cable television, internet services and sells and leases telecommunications equipment in Hungary, Macedonia and Montenegro.

On February 22, 2005, the General Meeting approved the renaming of Magyar Távközlési Rt. (Matáv) to Magyar Telekom Plc. and rebranding its products, which was completed by December 2005. As agreed, Deutsche Telekom, the controlling shareholder of the Group, supported the renaming and the product rebranding. The impact of renaming and product rebranding on the consolidated financial statements as of December 31, 2005 included HUF 7,281 million of expenditures accounted for in the operating expenses and a compensation by Deutsche Telekom of HUF 7,281 million disclosed separately in note 24.

On December 20, 2005 Magyar Telekom's Extraordinary General Meeting approved the merger of Magyar Telekom Rt. and T-Mobile Magyarország Rt. (T-Mobile Hungary), a 100% subsidiary of Magyar Telekom Rt. As the merger occur between the parent company and its 100% owned subsidiary, the transaction will not have any impact on the consolidated financial position of the Group or its operating segments. The merger was registered by the Hungarian Court of Registration on February 28, 2006, from which date the two companies continue as one legal entity, Magyar Telekom Plc.

The regulatory environment under which the Group operates is summarized as follows:

*Hungarian Fixed line*

Magyar Telekom Plc. is the market leading fixed line telecom service provider in Hungary. Act C of 2003 on Electronic Communications, the latest act on the telecommunications sector, came into effect on January 1, 2004. The National Communications Authority (NCA) is the supreme supervisory body. Magyar Telekom Plc. and its subsidiary, Emitel are designated as universal service providers in their former concession areas.

According to the Act on Electronic Communications, universal services are basic communications services that should be available to all customers at an affordable price. Universal service providers are entitled to compensation for their net avoidable costs, except for the costs incurred from discount pricing plans offered to residential subscribers.

The NCA assigned 18 relevant markets in the area of electronic communications in 2004. In 2004 and 2005 Magyar Telekom was designated as an SMP (an operator with significant market power) in 12 markets. These included all retail and wholesale voice markets, the market of wholesale leased line and termination, the market of minimum set of leased lines and the wholesale broadband market.

Currently in Hungary, beside the universal services, the retail voice tariff regulation is only concerned with the access market for both business and residential customers. This regulation is based on the price-cap method. There is a price-cap for universal service packages and the SMP designation on residential and business access markets has introduced a new price cap for all subscription fees.

Magyar Telekom Plc.'s regulated access prices currently include an access deficit, which should be eliminated according to the Pricing Act and the relating ministerial decrees.

According to the Act on Electronic Communications, designated SMP operators like Magyar Telekom are obliged to prepare reference offers for unbundled local loops (RUO) and bit-stream access and to provide these

**MAGYAR TELEKOM**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS — (Continued)**

services when there is a request for them by other telecommunications service providers. The reference offer of each SMP must be approved by the NCA. The price of these services has to be cost based and calculated using Fully Distributed Costs based on a 2003 Ministerial Decree.

The SMPs may refuse the offer for unbundling if there are technical barriers and providing access to the local loop or bit-stream access would endanger the unity of the SMPs' network. SMPs are also obliged to prepare reference offers for interconnection (RIO) and to provide these services in accordance with the reference offer when there is a request for them by other telecommunications service providers. The reference offers of the SMPs must be approved by the NCA, and prices have to be based on Long Run Incremental Costs (LRIC).

According to the Act on Electronic Communications, voice telephony customers have the right to select different service providers for each call directions including Internet calls by dialing a pre-selected number or by using a call-by-call pre-fixed number. The requirements for carrier selection are set out in the interconnection agreements between the affected service providers.

Fixed line telecommunications service providers are obliged under the law to provide number portability on their networks starting January 1, 2004. This means that service providers must enable subscribers to change service provider without changing their telephone numbers within the same numbering area.

*Macedonian Fixed line*

The Group is also present in the Macedonian fixed line telecommunications market through its subsidiary, MakTel. MakTel is the largest fixed line service provider in Macedonia. The Macedonian telecommunications sector is regulated by the newly implemented Electronic Communications Law (ECL) enacted in March 2005. MakTel has a concession contract (under the old Telecommunications Act) to provide services until December 31, 2018. Further, MakTel had been granted the exclusive rights in (a) fixed voice telephony services, leased line services and (b) to construct, lease, own, develop, maintain and operate fixed public telecommunications networks until December 31, 2004. These exclusive rights included local, national and international long distance public fixed voice services independently of the technology used, including voice over Internet Protocol services.

During the exclusivity period MakTel was obliged to provide universal services. It is expected that the Agency for Electronic Communications (Agency) will initiate a public tender proceeding for the purpose of electing one or more universal service providers (USP) in the first half of 2007, after enacting the relevant by-laws.

The regulatory framework for the tariff regulation for MakTel is provided in the currently valid Concession Contract. With the enactment of the ECL, the Agency may regulate retail prices of fixed telephony services. Regulated wholesale services are cost based using fully distributed costs (FDC). Long run incremental costs (LRIC) methodology is to be implemented from March 2007.

The concession contracts will be made compliant with the provisions of the ECL. Under the ECL, MakTel has been designated as an SMP in the market for fixed line voice telephone networks and services, including the market for access to the networks for data transmission and leased lines.

MakTel has neither the obligation nor the technical possibility to provide bit-stream unbundling. MakTel as an SMP operator has the obligation to enable its subscribers to access publicly available telephone services of any interconnected operator with officially signed interconnection contract. The number portability is scheduled to be fully implemented not later than two years after the enactment of the ECL, i.e. by March 5, 2007.

**MAGYAR TELEKOM**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS — (Continued)**

*Montenegrin Fixed line*

The Group's Montenegrin subsidiary, Crnogorski Telekom (CGT) is the holder of the only license issued for fixed line telecommunications services in Montenegro although the period of exclusivity provided by Telecommunications Law published in 2000 (the "2000 Law") expired at the end of 2003. The license allows CGT to provide domestic and international voice and data services as well as VOIP, leased line, public payphone, value added, etc. services.

The telecommunications sector in Montenegro is regulated by the 2000 Law. The 2000 Law established the Telecommunications Agency with broad authority and instituted a licensing regime whereby all telecommunications activity must be licensed by the Telecommunications Agency. Although a new Competition Law has come into force in 2006, a competition agency has not yet been instituted. To date, there is no consumer protection law or agency in Montenegro.

Prices of CGT must be approved by the Telecommunications Agency. CGT's tariff structure is currently highly unbalanced, monthly access fees and local calls are inexpensive, whereas long-distance and international calls are very expensive, and businesses are charged approximately twice as much as individuals. During the privatization process, a schedule for the cost-based re-alignment of prices for access lines and traffic, rebalancing tied to the timing of market liberalization was agreed with the Montenegrin government.

Although the 2000 Law defines universal service, no legislation covering universal service has been enacted to date.

CGT has an obligation to enter into interconnect agreements in a transparent and non-discriminatory way with operators requesting access to CGT's network. The 2000 Law requires CGT to publish a reference interconnection offer ("RIO") however CGT has the freedom to agree with operators on terms different from those set in the RIO.

There is no obligation for number portability, local loop unbundling, bit stream access or accounting separation in Montenegro.

The State Union of Serbia and Montenegro had been negotiating a Stabilization and Association Agreement with the EU. It was expected that the agreement would be very similar to the agreements signed with Croatia and Macedonia requiring the harmonization of the telecommunications regulations with the regulatory framework of the EU. In the case of Montenegro the expected amendment of the 2000 Law will achieve most of that goal. As Montenegro has become an independent state in 2006, the country will have to restart negotiations about a Stabilization and Association Agreement of its own, however, this will expectedly have no impact on the telecommunications section of the document.

**MAGYAR TELEKOM**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS — (Continued)**

*Hungarian Mobile*

The Group is the market leader in the Hungarian mobile market through its Mobile operations, T-Mobile Hungary. (T-Mobile H).

The initial duration of the concession regarding the GSM 900 public mobile radio telephone service is a period of 15 years calculated from the execution of the concession agreement (November 4, 1993 to November 4, 2008). On October 7, 1999 an amended concession contract was signed between the Ministry of Transport, Communications and Water Management and T-Mobile H extending T-Mobile H's rights and obligations to also provide service in the 1800 MHz band in Hungary. The DCS 1800 public mobile radio telephone service shall be 15 years from the execution of the new concession agreement (October 7, 1999 to October 7, 2014).

The Minister is entitled to extend the concession period for both the GSM 900 and the DCS 1800 public mobile radio telephone services upon their expiration, which with regard to the GSM 900 public mobile radio telephone service is on November 4, 2008, and with regard to the DCS 1800 public mobile radio telephone service is on October 7, 2014. The extension can be for another 7.5 years without the issuance of a tender invitation.

In November 2002, the NCA designated T-Mobile H as having significant market power in the interconnections market.

On December 7, 2004 the NCA awarded T-Mobile H the exclusive right of use of certain frequency blocks for the deployment and operation of an IMT2000/UMTS mobile telecommunications system (3G system). The duration of the frequency usage right is 15 years (until 2019) with an option to extend it for another 7.5 years.

T-Mobile H is obliged by the term of the license decree to start commercial 3G service within 12 months after the acquisition of the license within the inner city of Budapest. It is also obliged to reach a population-wide coverage of 30% within 36 months of license acquisition. As of August 26, 2005 T-Mobile H had started to provide 3G service in compliance with the license conditions.

T-Mobile Hungary is subject to number portability regulation since May 2004.

*Macedonian Mobile*

T-Mobile Macedonia (T-Mobile MK), Magyar Telekom's subsidiary, is the leading mobile service provider in Macedonia, which has a concession contract (under the old Telecommunications Act) to provide mobile telecommunications services until December 31, 2018, which can be renewed for an additional 20 years without a tender. According to the concession agreement, T-Mobile MK has the authorization to provide public cellular mobile telephony services and to construct, lease, own, develop, maintain and operate mobile public telecommunications networks throughout the entire territory of the Republic of Macedonia and between locations within Macedonia and places outside of Macedonia. T-Mobile MK is also registered to provide a public network for data transmission and radio transmission, with the corresponding data transmission and radio communications services, according to the ECL.

Prices of mobile services may be freely set by operators and providers. However, as a measure against a dominant position, the ECL provides the possibility to the Agency to impose regulated retail tariffs on the mobile market.

If the Agency determines that any of the existing mobile operators has significant market power, it will request the interconnection prices to be transparent and cost-oriented.

**MAGYAR TELEKOM**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS — (Continued)**

Carrier selection may be imposed on T-Mobile MK after the SMP announcement. Number portability is also applicable to the Mobile segment.

Under the Concession Agreement, T-Mobile MK has the exclusive license to use bandwidth 3 in the GSM 900 band and is entitled to operate all radio stations it reasonably requires to provide mobile public telephony services. T-Mobile MK's use of these frequencies is subject to terms and conditions set forth in the Concession Agreement.

*Montenegrin Mobile*

T-Mobile Crna Gora (T-Mobile CG), Magyar Telekom's subsidiary, is the holder of one of the two GSM licenses issued in Montenegro. T-Mobile CG was launched on July 1, 2000. It arrived as the second mobile telecommunications operator in Montenegro – four years after the first one.

The telecommunications sector in Montenegro is regulated by the Telecommunications Law, however, it has no specific prescriptions for mobile operators.

T-Mobile CG has to inform the Telecommunications Agency about planned changes in its tariffs, however, the Agency has no right to interfere with the pricing policy of the company.

No obligation for number portability is in force.

A tender for 3G mobile frequencies is currently being contemplated by the Montenegrin telecommunications regulator. The government plans to issue three 3G licenses, two to the incumbent mobile operators and one to a new entrant. In our view the size of the Montenegrin market would not justify the entry of a third operator to the already saturated mobile telecommunications market. We do not expect, however, that the tender would be issued before 2007.

**MAGYAR TELEKOM**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS — (Continued)**

**2 Accounting policies**

*(a) Basis of presentation*

The consolidated financial statements have been prepared under the historical cost convention, except as disclosed in the accounting policies below, and in accordance with International Financial Reporting Standards ("IFRS") as adopted by the European Union. In Magyar Telekom's case these are identical to the IFRS as issued by the IASB and effective for 2005.

According to Hungarian regulation, the Annual General Meeting has the power to approve the consolidated financial statements of the Group.

The consolidated financial statements are shown in millions of Hungarian Forints ("HUF"). For the convenience of the reader, the consolidated balance sheet, income statement and cashflow statement for the year 2005 are also presented in millions of U.S. dollars ("USD") translated at a rate of HUF 213.58 to USD 1 (the official rate of the National Bank of Hungary at December 31, 2005). These translations are supplementary information and are unaudited.

The preparation of financial statements in conformity with IFRS requires management to make estimates and assumptions that affect the amounts reported in the financial statements and notes thereto. Actual results could differ from those estimates.

In 2005, the Group adopted the IFRSs below, which are relevant to its operations.

- IAS 1 (revised 2003) Presentation of Financial Statements
- IAS 2 (revised 2003) Inventories
- IAS 8 (revised 2003) Accounting Policies, Changes in Accounting Estimates and Errors
- IAS 10 (revised 2003) Events after the Balance Sheet Date
- IAS 16 (revised 2003) Property, Plant and Equipment
- IAS 17 (revised 2003) Leases
- IAS 21 (revised 2003) The Effects of Changes in Foreign Exchange Rates
- IAS 24 (revised 2003) Related Party Disclosures
- IAS 27 (revised 2003) Consolidated and Separate Financial Statements
- IAS 28 (revised 2003) Investments in Associates
- IAS 32 (revised 2003) Financial Instruments: Disclosure and Presentation
- IAS 33 (revised 2003) Earnings per Share
- IAS 39 (revised 2003) Financial Instruments: Recognition and Measurement
- IFRS 2 (issued 2004) Share-based Payments
- IFRS 3 (issued 2004) Business Combinations
- IAS 36 (revised 2004) Impairment of Assets
- IAS 38 (revised 2004) Intangible Assets

The adoption of IAS 1, 2, 8, 10, 16, 17, 21, 24, 27, 28, 32 and 33 (all revised 2003) did not result in substantial changes to the Group's accounting policies. In summary:

- IAS 1 (revised 2003) has affected the presentation of minority interest and other disclosures.
- IAS 2, 8, 10, 16, 17, 27, 28, 32 and 33 had no material effect on the Group's policies.
- IAS 21 (revised 2003) had no material effect on the Group's policy. The functional currency of each of the consolidated entities has been re-evaluated based on the guidance of the revised standard. All the Group entities have the same functional currency as their measurement currency.
- IAS 24 (revised 2003) has affected the identification of related parties and some other related-party disclosures.

**MAGYAR TELEKOM**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS — (Continued)**

The adoption of IAS 39 (revised 2004) has resulted in a change in the accounting policy relating to the classification of financial assets at fair value through profit or loss. Further, the change in accounting policy resulted in the de-recognition of certain embedded derivatives (note 2(e)), which was implemented as required by IAS 8 – Accounting Policies.

The adoption of IFRS 2 has resulted in a change in the accounting policy for share-based payments. Until December 31, 2004, the provision of share options to employees did not result in a charge in the income statement. Subsequent to that date, the Group charges the cost of share options to the income statement (note 23).

The adoption of IFRS 3, IAS 36 (revised 2004) and IAS 38 (revised 2004) resulted in a change in the accounting policy for goodwill. Until December 31, 2004, goodwill was amortized on a straight line basis over a period ranging from 10 to 20 years, and assessed for an indication of impairment at each balance sheet date. In accordance with the provisions of IFRS 3:

- The Group ceased amortization of goodwill from January 1, 2005
- Accumulated amortization as at January 1, 2005 has been eliminated with a corresponding decrease in the cost of goodwill
- From the year ended December 31, 2004 onwards, goodwill is tested annually for impairment, as well as when there are indications of impairment.

The Group has reassessed the useful lives of its intangible assets in accordance with the provisions of IAS 38. No adjustment resulted from this reassessment.

All changes in the accounting policies have been made in accordance with the transitional provisions in the respective standards. All standards adopted by the Group require retrospective application other than:

- IAS 16 - the exchange of property, plant and equipment is accounted at fair value prospectively
- IAS 21 - prospective accounting for goodwill and fair value adjustments as part of foreign operations
- IAS 39 - does not require the classification of financial assets as at 'fair value through profit or loss' of previously recognized financial assets
- IFRS 2 - retrospective application for all equity instruments granted after November 7, 2002 and not vested at January 1, 2005
- IFRS 3 - prospectively after March 31, 2004
- IAS 39 requires simultaneous adoption with IAS 32
- IFRS 3 requires simultaneous adoption with IAS 36 and IAS 38

The adoption of IFRS 2 would have resulted in the following changes to the previously reported years and resulted in the following impact during 2005.

	<b>For the year ended December 31,</b>		
	<b>2003</b>	<b>2004</b>	<b>2005</b>
	<b>(in HUF millions)</b>		
Increase in Employee related expenses (share based payments) .....	30	82	84
Increase to Retained earnings .....	30	82	84



**MAGYAR TELEKOM**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS — (Continued)**

**(b) Consolidation**

(1) Subsidiaries

Subsidiaries (including Special Purpose Entities) in which the Group has an interest of more than one half of the voting rights or otherwise has power to govern the financial and operating policies, are consolidated.

The existence and effect of potential voting rights that are presently exercisable or presently convertible are also considered when assessing whether the Group controls another entity.

Subsidiaries are consolidated from the date on which control is transferred to the Group and are no longer consolidated from the date control ceases. The purchase method of accounting is used to account for the acquisition of subsidiaries. The cost of an acquisition is measured as the fair value of the assets given up, shares issued or liabilities undertaken at the date of acquisition plus costs directly attributable to the acquisition. The excess of the cost of acquisition over the fair value of the net assets and contingent liabilities of the subsidiary acquired is recorded as goodwill.

In case of business combinations where the transaction takes place between companies under common control, the transaction is recorded at cost and any gains or losses on the transaction are directly recognized in retained earnings.

Inter-company transactions, balances and unrealized gains on transactions between the Magyar Telekom group companies are eliminated. Where necessary, accounting policies of subsidiaries have been changed to ensure consistency with the policies adopted by the Group.

Business combinations before April 1, 2004 are accounted for according to the purchase method of accounting prescribed by IAS 22 – Business Combinations. For acquisitions after March 31, 2004, Magyar Telekom has been applying the provisions of IFRS 3 – Business Combinations. Although IFRS 3 continues to require purchase price allocation for new acquisitions, in case of additional shares acquired in subsidiaries already controlled (step acquisition), no purchase price allocation is made. Consequently, the difference between the consideration paid and the share of net assets acquired is accounted for as goodwill.

(2) Associates and joint ventures

Investments in associates and joint ventures are accounted for applying the equity method of accounting. Under this method the company's share of the post-acquisition profits or losses of associates and joint ventures is recognized in the income statement, under the caption "Share of associates' profits/losses after tax". The cumulative post-acquisition movements are adjusted against the cost of the investment.

Associates are entities in which the Group generally has between 20% and 50% of the voting rights, or over which the Group has significant influence, but which it does not control. Joint ventures are entities in which Magyar Telekom holds a 50% share of ownership with a third party owner of the other 50% with identical voting rights.

**MAGYAR TELEKOM**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS — (Continued)**

At December 31, 2005 and 2004 the principal operating subsidiaries and associates of the Group, which are incorporated in Hungary, Macedonia and Montenegro, were as follows:

Subsidiaries	Group interest in capital as at December 31,		Activity
	2004	2005	
<u>Incorporated in Hungary:</u>			
T-Mobile Hungary .....	100%	100%	Cellular telecom service provider
T-Online.....	100%	100%	Internet service and content provider
T-Kábel .....	100%	100%	Cable TV operator
BCN Rendszerház .....	100%	100%	Solutions for business customers
Emitel .....	100%	100%	Local telecom operator
InvesTel .....	100%	100%	Cable TV holding
<u>Incorporated in Macedonia:</u>			
Makedonski Telekomunikacii (MakTel) ...	51%	51%	Fixed line telecom service provider
T-Mobile Macedonia (T-Mobile MK) .....	51%	51%	Cellular telecom service provider
Telemacedonia .....	100%	100%	Management consulting
Stonebridge .....	100%	100%	Holding company
<u>Incorporated in Montenegro:</u>			
Crnogorski Telekom (CGT) .....	-	76.53%	Fixed line telecom service provider
T-Mobile Crna Gora (T-Mobile CG) .....	-	76.53%	Cellular telecom service provider
Internet Crna Gora (ICG) .....	-	76.53%	Internet service and content provider
Associates	Group interest in capital as at December 31,		Activity
	2004	2005	
<u>Incorporated in Hungary:</u>			
Hunsat .....	50%	50%	Satellite telecommunications
T-Systems Hungary (TSH) .....	49%	49%	Systems integration for business customers
Magyar RTL (M-RTL) .....	25%	25%	Television broadcast company

The Group's interest in the capital of the above subsidiaries and associates equals the voting rights therein.

**(c) Foreign currency translation**

Monetary assets and liabilities denominated in foreign currencies are translated into the functional currency of the reporting entities using the exchange rates at the balance sheet date, and any unrealized exchange gains and losses are recognized immediately. Gains and losses that arise on foreign currency transactions and financing activities are included under Net financial expenses.

For the initial consolidation of foreign subsidiaries acquired, their assets and liabilities at the acquisition date are incorporated into the consolidated financial statements after translating the balances into HUF using the exchange rate prevailing at that date. The fair value adjustments resulting from the purchase price allocation and goodwill are accounted for in HUF for acquisitions before March 31, 2004, after which date these adjustments arising on consolidation are accounted for in the functional currency of the subsidiary as required by IFRS 3 –

**MAGYAR TELEKOM**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS — (Continued)**

Business Combinations.

As the majority of the revenues and expenses of the Macedonian subsidiaries arise in MKD, the functional currency of these entities is MKD, while the majority of the revenues and expenses of the Montenegrin subsidiaries arise in EUR, the functional currency of these entities is EUR. At year-end the assets and liabilities of the foreign subsidiaries are translated into HUF using the exchange rates prevailing on the balance sheet date. The income statements of the foreign subsidiaries are translated into HUF using the average rate of exchange during the year. The translation difference arising on consolidation is accounted against the Cumulative translation adjustment in equity.

*(d) Cash and cash equivalents*

Cash and cash equivalents include cash on hand and in banks and all highly liquid deposits and securities with maturities of three months or less, and exclude all overdrafts.

*(e) Financial assets*

The Group classifies its financial assets into the following categories: at fair value through profit or loss, loans and receivables, and available for sale. The classification depends on the purpose for which the financial assets were acquired. Management determines the classification of its financial assets at initial recognition and re-evaluates this designation at every reporting date.

(1) Financial assets at fair value through profit or loss

This category has two sub-categories: financial assets held for trading, and those designated at fair value through profit or loss at inception. A financial asset is classified in this category if acquired principally for the purpose of selling in the short term or if so designated by management. Derivatives are also categorized as financial assets held for trading as Magyar Telekom does not apply hedge accounting. Assets in this category are classified as current assets if they are either held for trading or are expected to be realized within 12 months of the balance sheet date.

(2) Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. They are included in current assets, except for maturities greater than 12 months after the balance sheet date. These are classified as non current assets. Loans and receivables due within 12 months are classified as Trade and other receivables in the balance sheet, while those with a maturity over 12 months are included in Other non current assets.

(3) Available-for-sale financial assets

Available-for-sale financial assets are non-derivatives that are either designated in this category or not classified in any of the other categories. They are included in Other non current assets unless management intends to dispose of the investment within 12 months of the balance sheet date. Magyar Telekom has no financial assets that would be classified in this category.

## MAGYAR TELEKOM

### NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

Regular purchases and sales of investments are recognized on trade-date, the date on which the Group commits to purchase or sell the asset. Investments are initially recognized at fair value plus transaction costs for all financial assets not carried at fair value through profit or loss. Financial assets carried at fair value through profit or loss are initially recognized at fair value and transaction costs are expensed in the income statement. Investments are derecognized when the rights to receive cash flows from the investments have expired or have been transferred, and the Group has transferred substantially all risks and rewards of ownership. Available-for-sale financial assets and financial assets at fair value through profit or loss are subsequently carried at fair value.

Loans and receivables are carried at amortized cost using the effective interest method. Gains or losses arising from changes in the fair value of the financial assets at fair value through profit or loss category, including interest and dividend income, are presented in the income statement within Net financial expenses, in the period in which they arise.

The fair values of quoted investments are based on current bid prices. If the market for a financial asset is not active (and for unlisted securities), the Group establishes fair value by using valuation techniques. These include the use of recent arm's length transactions, reference to other instruments that are substantially the same, discounted cash flow analysis, and option pricing models, making maximum use of market inputs and relying as little as possible on entity-specific inputs.

The Group assesses at each balance sheet date whether there is objective evidence that a financial asset or a group of financial assets is impaired. If impairment is established, the loss on financial assets through profit or loss is recognized in Other financial expenses, while impairment loss of Trade and other receivables is charged in the Other operating expenses as Bad debt expense. Recoverable amounts of Trade and other receivables, used as a basis for determining whether impairment has become necessary, are estimated taking into account potential delays and defaults on payments.

Amounts due to, and receivable from, other network operators are shown net where a right of set-off exists and the amounts are settled on a net basis.

The revised interpretation of IAS 39 – Financial Instruments – Recognition and Measurement does not consider contracts denominated in a currency that is not the functional currency of either of the contracting parties as a separable host contract and an embedded derivative if the contract currency is widely used in that market. As a result of the change in the interpretation, Magyar Telekom has restated its opening retained earnings to eliminate the carrying amounts of these embedded derivatives previously recognized (HUF 873 million) and the related deferred tax liability (HUF 140 million) in the balance sheet as at December 31, 2004.

#### *(f) Inventories*

Inventories are stated at the lower of cost or net realizable value using the historical cost method of accounting, and are valued on a weighted average or individual basis.

Phone sets are often sold for less than cost in connection with promotions to obtain new subscribers with minimum commitment periods. Such loss on the sale of equipment is only recorded when the sale occurs as the normal resale value of the phone sets exceeds cost.

**MAGYAR TELEKOM**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS — (Continued)**

***(g) Assets held for disposal***

Assets held for disposal include real estate that is no longer needed for the future operations of the Group, and have been identified for sale, which is expected to take place within 12 months. These assets are accounted for at the lower of carrying value or fair value less cost to sell. These assets continued to be depreciated until the sale, in accordance with IAS 16 – Property, Plant and Equipment until December 31, 2004. From January 2005 Magyar Telekom applies the regulations of IFRS 5 – Non Current Assets held for Sale and Discontinued Operations, whereby the depreciation is discontinued from the date of designation to the held for sale status.

***(h) Property, plant and equipment***

Property, plant and equipment are stated at historical cost less accumulated depreciation and impairment losses.

The cost of an item of property, plant and equipment comprises its purchase price, including import duties and non-refundable purchase taxes, after deducting trade discounts and rebates, any costs directly attributable to bringing the asset to the location and condition necessary for it to be capable of operating in the manner intended by management. The initial estimate of the costs of dismantling and removing the item and restoring the site on which it is located is also included in the costs if the obligation incurred can be recognized as a provision according to IAS 37 – Provisions, Contingent Liabilities and Contingent Assets.

Government grants relating to the purchase of property, plant and equipment are deducted from the original cost of the items and are recognized in the income statement through the reduced amount of depreciation of the related assets over their useful lives. Investment tax credits relating to qualifying investment projects are also recognized in this manner (note 26).

Cost in the case of the outside plant comprises of all expenditures including the cabling within customers' premises and interest on related loans.

When assets are retired or disposed of, the cost and accumulated depreciation are removed from the accounts and any related gain or loss is recognized in the income statement in Other operating expenses.

Maintenance and repairs are charged to expense when incurred.

Depreciation is calculated on a straight-line basis from the time the assets are deployed and charged over their economic useful lives. Magyar Telekom regularly reviews the useful lives for consistency with current development plans and advances in technology.

The useful lives assigned are as follows:

	Years
Buildings .....	10 - 50
Duct, cable and other outside plant .....	25 - 38
Other telecommunications equipment .....	7 – 15
Other fixed assets .....	3 - 12

**MAGYAR TELEKOM**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS — (Continued)**

**(i) Intangible assets**

Intangible assets are stated at historical cost less accumulated amortization and impairment losses.

Acquired computer software licenses are capitalized on the basis of the costs incurred to acquire and bring to use the specific software. These costs are amortized over their estimated useful lives. Costs associated with developing or maintaining computer software programs are recognized as an expense as incurred. Costs that are directly associated with the production of identifiable and unique software products controlled by the Group, and that will probably generate economic benefits exceeding costs beyond one year, are recognized as intangible assets. Direct costs include the software development employee costs and an appropriate portion of relevant overheads. Computer software development costs recognized as assets are amortized over their estimated useful lives.

Costs associated with the acquisition of long term licenses are capitalized including any related borrowing costs. The useful lives of concessions and licenses are determined based on the underlying agreements and are amortized on a straight line basis over the period from the beginning of commercial use of the frequency until the end of the initial concession or license term. No renewal periods are considered in the determination of useful life.

Goodwill represents the excess of the cost of an acquisition over the fair value of the Group's share of the net assets and contingent liabilities of the acquired subsidiary at the date of acquisition. Goodwill on acquisitions completed before March 31, 2004 is reported in the balance sheet as an intangible asset and was amortized using the straight-line method over its estimated useful life. Goodwill arising on acquisitions after this date was not amortized in 2004. Following the change in the IFRS regulations, amortization of goodwill arising on acquisition before March 31, 2004 was discontinued from January 1, 2005, and impairment testing is now carried out on an annual basis for all goodwill recognized in the IFRS accounts.

Intangible assets other than goodwill are amortized over their respective economic useful lives.

	Years
Software .....	3 - 5
Concessions and licenses .....	8 - 25
Brand-name .....	5 - 10
Other intangible assets .....	3 - 10

Other than goodwill, the Group has no intangible assets with indefinite life.

**(j) Impairment of Property, plant and equipment and Intangible assets**

Assets that have an indefinite useful life are not subject to amortization and are tested for impairment annually or more frequently if circumstances indicate that impairment may have occurred. Assets that are subject to amortization are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. An impairment loss is recognized for the amount by which the asset's carrying amount exceeds its recoverable amount. The recoverable amount is the higher of an asset's fair value less costs to sell and value in use. For the purposes of assessing impairment, assets are grouped at the lowest levels for which there are separately identifiable cash flows (cash-generating units).

Goodwill impairment is tested at the cash generating unit level, which is defined one level below the primary reporting segments, i.e. the national activities of the Fixed line and the Mobile segments (see note 4). The corporate headquarters' assets are allocated to the Hungarian operations of the Fixed line segment.

**MAGYAR TELEKOM**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS — (Continued)**

***(k) Leases***

(1) Lessor

Assets leased to customers under operating leases are included in Property, plant and equipment in the balance sheet. They are depreciated over their expected useful lives on a basis consistent with similar fixed assets. Rental income is recognized on a straight-line basis over the lease term.

(2) Lessee

Leases of property, plant and equipment where Magyar Telekom assumes substantially all the benefits and risks of ownership are classified as finance leases. Finance leases are capitalized at the fair value of the asset or if lower, at the estimated present value of the future minimum lease payments. Each lease payment is allocated between the liability and finance charges so as to achieve a constant rate on the finance balance outstanding. The corresponding lease obligations, net of finance charges, are included in Loans and other borrowings. The interest element of the lease payments is charged to the Net financial expense line of the income statement over the lease period. Property, plant and equipment acquired under finance lease contracts are depreciated over the shorter of the lease term or the useful life of the asset.

Costs in respect of operating leases are charged to the income statement on a straight-line basis over the lease term, included in Other operating expenses.

(3) Sale and leaseback transactions

Sale and leaseback transactions involve the sale of an asset by Magyar Telekom and the leasing of the same asset or part of it back to Magyar Telekom. When sale and leaseback transactions qualify as finance leases any gain on the sale is deferred and recognized in the income statement over the lease term through lower depreciation expense.

***(l) Deferred taxes***

Deferred tax is recognized, using the liability method, for tax losses and tax credits and all temporary differences arising between the tax bases of assets and liabilities and their carrying values for financial reporting purposes. Currently enacted tax rates are used to determine deferred income tax.

***(m) Loans and other borrowings***

Borrowings are recognized initially at fair value less transaction costs. In subsequent periods, they are stated at amortized costs. The effective interest is recognized in the income statement over the period of the borrowings.

Borrowing costs are recognized as an expense as incurred, net of amounts capitalized. Interest on general borrowings was capitalized as part of the cost of the relevant fixed asset, up to the date of commissioning and is then amortized over the period the asset is depreciated. The rate used to determine the amount of borrowing costs eligible for capitalization was defined as the ratio of equity to debt financing, where debt excludes short term borrowings and loans related to the financing of acquisitions. As all loans taken for capital expenditure on tangible and intangible assets were repaid by the end of 2003, no interest was capitalized in 2004 and 2005.

**MAGYAR TELEKOM**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS — (Continued)**

Effective borrowing cost (note 17) is calculated using the average amount of loans and other borrowings during the year and the total interest and other financial charges. The weighted average interest rate on borrowings is calculated using the average amount of loans and other borrowings during the year and the interest expense charged.

Fair value information on loans and other borrowings is also presented in the financial statements (note 17). Fair value of loans and other borrowings is calculated using the discounted cashflow method.

***(n) Deferred revenue***

A portion of fees charged to customers in Hungary upon connection to the fixed line network prior to October 15, 1997 represented contributions to the cost of network construction. The capital contribution element of such fees was deferred and is amortized to revenue over the life of the related assets. Legislation was enacted effective October 15, 1997 eliminating refunds of such fees and signaling the removal of any capital contribution element of future customer fees. Since October 1997, these connection fees are recognized in the income statement upon connection, reflecting the change in related legislation and the advanced development of the network.

***(o) Employee benefits***

***(1) Short term employee benefits***

Short term employee benefits are recognized as a current expense in the period when employees render their services. These include wages, social security contributions, bonuses, paid holidays, discounted telephone bills, meal and holiday contributions and other fringe benefits and the tax charges thereon.

***(2) Pensions***

Payments to defined contribution pension and other welfare plans are recognized as an expense in the period in which they are earned by the employees.

Magyar Telekom does not have defined benefit pension schemes.

***(3) Share based compensation***

Magyar Telekom adopted IFRS 2 – Share-based Payment as of January 1, 2005. The standard requires the Group to reflect in its profit or loss and financial position the effects of share-based payment transactions, including expenses associated with transactions in which share options are granted to employees. Accordingly, Magyar Telekom recognizes the costs of services received from its employees in a share-based payment transaction when services are received. Magyar Telekom recognizes a corresponding increase in retained earnings if the services are received in an equity-settled share-based payment transaction, or a liability if the services are received in a cash-settled share-based payment transaction.

Fair values are determined using option pricing models (such as Black-Scholes) and other relevant techniques. As Magyar Telekom Plc. is listed and actively traded on the Budapest and New York Stock Exchanges, the share price and its history is readily available as a basis for fair value calculations.

Bonuses tied to the long term performance of the Magyar Telekom share are recognized in the income statement at their time-proportioned fair value (note 28) against an accumulating liability in Trade and other payables.



**MAGYAR TELEKOM**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS — (Continued)**

(4) Termination benefits

Termination benefits are payable whenever an employee's employment is terminated before the nominal retirement date or whenever an employee accepts voluntary redundancy in exchange for these benefits. The Group recognizes termination benefits when it is demonstrably committed to either terminate the employment of current employees according to a detailed formal plan without possibility of withdrawal or to provide termination benefits as a result of an offer made to encourage voluntary redundancy. Benefits falling due more than 12 months after balance sheet date are discounted to present value.

*(p) Provisions*

Provisions as required by IAS 37 are recognized when Magyar Telekom has a present legal or constructive obligation as a result of past events and it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation, and a reliable estimate of the amount of the obligation can be made.

*(q) Treasury stock*

When the Company or its subsidiaries purchase the Company's equity share capital, the consideration paid including any attributable incremental external costs are deducted from the Shareholders' equity as treasury stock until they are cancelled. Where such shares are subsequently sold or reissued, the treasury share balance decreases by the original cost of the particular shares, thereby increasing the equity, while any gains or losses are recognized in retained earnings.

*(r) Revenues*

Revenue is primarily derived from services provided to Magyar Telekom's customer subscribers and other third parties using Magyar Telekom's telecommunications network, and equipment sales. Revenues for all services and equipment sales (notes 21, 22) are shown net of VAT, discounts and after eliminating sales within the Group, and are recognized when there is persuasive evidence of an arrangement that services have been provided or equipment has been delivered, the price is fixed or determinable and collection is reasonably assured.

Customer subscriber arrangements typically include an activation fee, equipment sale, subscription fee and monthly charge for the actual airtime used. The Company considers the various elements of these arrangements to be separate earnings processes for IFRS purposes and classifies the revenue for each of the deliverables at their invoiced amounts into the categories as disclosed in notes 21 and 22.

Customers may also purchase public phone cards, prepaid mobile and internet cards which allow those customers to use Magyar Telekom's telecommunications network for a selected amount of time. Customers must pay for such services at the date when the card is purchased.

Third parties using Magyar Telekom's telecommunications network include roaming customers of other service providers and other telecommunications providers which terminate or transit calls on Magyar Telekom's network.

**MAGYAR TELEKOM**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS — (Continued)**

Magyar Telekom's IFRS revenue recognition policies for the different groups of services are as follows:

(1) Fixed line connection and mobile activation fees

Revenues earned from connecting subscribers to the fixed or the mobile network are recognized upon service activation. Fixed line connection fees received before October 1997 were deferred and are amortized to revenue over a period of 10 years. See also accounting policy note for deferred revenue.

(2) Subscription fees (fixed line and mobile access)

Monthly subscription fees represent a fixed monthly fee charged to customer subscribers for access to Magyar Telekom's network. Such fees are recognized in the month during which the customer is permitted access to the network. In case of subscriptions when certain amount of free airtime usage is included in the subscription, the total amount due for the month is recognized as subscription fee revenue.

(3) Outgoing traffic revenue (fixed line and mobile network usage)

Outgoing traffic represents customer use of Magyar Telekom's telecommunications network. Customers are charged for outgoing traffic based on their actual use of the network multiplied by a contractually agreed rate. The revenue from usage is recognized in the period in which service is provided to the customers or third parties. A proportion of the revenue received is often paid to other operators (including roaming and interconnect) for the use of their networks, where appropriate. The revenues and costs of these calls are stated gross in these consolidated financial statements.

Revenues from the sale of public phone cards, prepaid mobile cards and prepaid internet cards are recognized when used by the customers or when the cards expired with unused units.

(4) Incoming traffic revenue (fixed line and mobile network usage)

Incoming traffic revenue is recognized in the period of related usage. A proportion of the revenue received is often paid to other operators (interconnect) for the use of their networks, where appropriate. The revenues and costs of these transit calls are stated gross in these consolidated financial statements and recognized in the period of related usage.

(5) Leased lines and data transmission revenues

Leased line services are provided to customers on a monthly rental basis, while data transmission is charged on a unit basis. These revenues are recognized in the period of usage or availability of the service to the customer.

(6) Equipment sales

Revenues and costs from sale of telephone sets are recognized upon delivery.

(7) Value added services (other fixed line charges and enhanced mobile services)

Value added services mostly include SMS, MMS, WAP as well as directory assistance and similar services. To a lesser extent revenues from premium rate services are also included in this category, which are in most cases recognized on a gross basis, when the delivery of the service over Magyar Telekom's network is the responsibility of the Group and the Group also bears substantial risks of these services.

**MAGYAR TELEKOM**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS — (Continued)**

***(s) R&D and Marketing expenses***

Research and development costs that do not qualify for recognition as an intangible asset as well as marketing costs are expensed as incurred.

***(t) Earnings per share***

Basic earnings per share is calculated by dividing profit attributable to the equity holders of the company for the period by the weighted average number of common stocks outstanding, while diluted earnings per share is calculated considering the weighted average number of diluting share options in addition to the number of common stocks outstanding.

***(u) Dividends***

Dividends payable to the Company's shareholders and to minority shareholders of the subsidiaries are recorded as a liability and debited against equity in the Group's financial statements in the period in which they are approved by the shareholders.

***(v) Segment reporting***

Magyar Telekom determines segments primarily based on products and services that are subject to risks and returns that are different from those of other businesses. The primary segments are based on the business lines (Fixed line and Mobile operations), both of which include Hungarian, Macedonian and Montenegrin activities. Reported segments are consistent with information used by management for internal reporting and monitoring purposes. The Company's secondary format for reporting segment information is the geographical segments.

***(w) Comparative information***

In order to maintain consistency with the current year presentation, certain items have been reclassified for comparative purposes.

***(x) Critical accounting estimates and assumptions***

The Group makes estimates and assumptions concerning the future. Estimates and judgments are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances. The most critical estimates and assumptions are discussed below.

**(1) Useful lives of assets**

The determination of the useful lives of assets is based on historical experience with similar assets as well as any anticipated technological development and changes in broad economic or industry factors. The appropriateness of the estimated useful lives is reviewed annually, or whenever there is an indication of significant changes in the underlying assumptions. We believe that the accounting estimate related to the determination of the useful lives of assets is a critical accounting estimate since it involves assumptions about technological development in an innovative industry. Further, due to the significant weight of long-lived assets in our total assets, the impact of any changes in these assumptions could be material to our financial position,

**MAGYAR TELEKOM**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS — (Continued)**

and results of operations. As an example, if Magyar Telekom was to shorten the average useful life by 10%, this would result in additional annual depreciation and amortization expense of approximately HUF 11.5 billion.

(2) Impairment testing of goodwill

Under IFRS, goodwill is no longer amortized, but tested for impairment annually or more frequently. As all of our subsidiaries are either not listed on stock exchanges or there is no active market for their shares, the fair values of the business units and reportable segments are calculated based on the discounted projected cashflows of these units. This is highly judgmental, which carries the inherent risk of arriving at materially different fair values if estimates used in the calculations would prove to be inappropriate. If Magyar Telekom had used a WACC of 11.2% and a 0 percent perpetual growth rate after the ten year projected period, it would have resulted in an impairment charge. Any further increase in the WACC or a negative growth rate applied would have resulted in further amounts of impairment, initially related to goodwill allocated to the international operations of the Fixed line segment.

(3) Potential impairment of property, plant and equipment and intangibles

We assess the impairment of identifiable property, plant, equipment and intangibles whenever there is a reason to believe that the carrying value may materially exceed the recoverable amount and where impairment in value is anticipated. The recoverable amounts are determined by value in use calculations, which use a broad range of estimates and factors affecting those. Among others, we typically consider future revenues and expenses, technological obsolescence, discontinuance of services and other changes in circumstances that may indicate an impairment. As this exercise is highly judgmental, the amount of potential impairment may be significantly different from that of the result of these calculations.

(4) Impairment of trade and other receivables

We calculate impairment for doubtful accounts based on estimated losses resulting from the inability of our customers to make required payments. We base our estimate on the aging of our account receivables balance and our historical write-off experience, customer credit-worthiness and changes in our customer payment terms when evaluating the adequacy of the impairment loss for doubtful accounts. These involve assumptions about future customer behavior and the resulting future cash collections. If the financial condition of our customers were to deteriorate, actual write-offs of currently existing receivables may be higher than expected and may exceed the level of the impairment losses recognized so far.

(5) Provisions

Provisions in general are highly judgmental, especially in the cases of legal disputes. The Group assesses the probability of an adverse event as a result of a past event to happen and if the probability is evaluated to be more than fifty percent, the Group fully provides for the total amount of the liability. The Group is rather prudent in these assessments, but due to the high level of uncertainty, in some cases the evaluation may not prove to be in line with the eventual outcome of the case.

(6) Subscriber acquisition costs

Subscriber acquisition costs primarily include the loss on the equipment sales (revenues and costs disclosed separately) and fees paid to subcontractors that act as agents to acquire new customers. The up-front fees collected from customers for activation or connection are marginal compared to the costs. These revenues, costs and losses are recognized when the customer is connected to the Group's fixed or mobile networks. No such costs or revenues are deferred.

**MAGYAR TELEKOM**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS — (Continued)**

**3 Financial risk management**

*(a) Financial risk factors*

Magyar Telekom is exposed to interest and foreign exchange rate risk associated with its debt and anticipated transactions. As the vast majority of the revenues and expenses of the Hungarian entities arise in HUF, the functional currency of Magyar Telekom is HUF, and as a result, Magyar Telekom's objective is to minimize the level of its financial risk in HUF terms.

(1) Foreign exchange risk

The most significant foreign exchange exposure of the Group is related to its foreign direct investments in the Southern and Eastern European region. The Group through its subsidiaries is present in Macedonia, Montenegro, and to a lesser extent in Bulgaria, Romania and Ukraine. Most of these countries are candidates to accession to the European Union, which over time mitigates the currency risk of these countries. The high amount of foreign currency (EUR and USD) denominated cash portfolio of subsidiaries in these countries mitigates the currency risk on Group level.

The National Bank of Hungary lifted the devaluation of the Hungarian Forint against the Euro in October 2001 after widening the intervention band from +/-2.25% to +/-15% as of May 4, 2001. The introduction of this new foreign exchange regulation increased the foreign exchange risk of the Group significantly. In order to mitigate this increased risk, Magyar Telekom minimized its foreign currency borrowings in 2002 and 2003. In 2004 and 2005 Magyar Telekom had insignificant amount of foreign currency denominated debts.

A further foreign exchange exposure of Magyar Telekom is related to holding foreign currency cash balances, and operating activities through revenues from and payments to international telecommunications carriers as well as capital expenditure contracted with vendors in foreign currency. These revenues and payments, however, are almost in full balance, therefore Magyar Telekom very rarely has to buy or sell foreign currency on the market.

Magyar Telekom occasionally enters into derivative contracts for risk reduction purposes. These foreign currency forward contracts are taken to reduce the exchange rate risk related to the foreign exchange denominated payment obligations.

(2) Interest rate risk

Magyar Telekom is exposed to financial market risk primarily through interest rate fluctuations. This is due to the fact that changing HUF interest rates affect the fair value of fixed rate debts and also affect the cash outflow through the variable rate debts. To control interest rate risk, a combination of fixed and floating rate debt is used within the HUF portfolio. By the end of 2003 Magyar Telekom managed to convert almost all of its remaining foreign exchange debt portfolio to HUF, thereby limiting its exposure to interest rate fluctuations in the HUF environment.

(3) Credit risk

The Group has no significant concentrations of credit risk. Cash and cash equivalents held by the Hungarian members of the Group are primarily denominated in Hungarian Forint and concentrations of credit risk are limited as Magyar Telekom places its cash with substantial credit institutions. Cash and cash equivalents held by the Macedonian subsidiaries are denominated in Macedonian Denars, EUR and in U.S. dollars, while the Montenegrin subsidiaries possess cash and cash equivalents primarily denominated in EUR.

**MAGYAR TELEKOM**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS — (Continued)**

Concentrations of credit risk relating to trade receivables are limited due to the large number of customers comprising Magyar Telekom's customer base and their dispersion across many different industries and geographic areas.

(4) Liquidity risk

Prudent liquidity risk management implies maintaining sufficient cash and marketable securities as well as available funding through adequate amount of committed credit. The Group Treasury's management aims at maintaining flexibility in funding by keeping committed credit lines available.

*(b) Accounting for derivative financial instruments and hedging activities*

Magyar Telekom does not apply hedge accounting for its financial instruments, all gains and losses are recognized in the income statement. The fair value of derivative financial instruments is included in Other financial assets or Other non current assets or other current or non current liabilities depending on the maturity of the agreements.

*(c) Fair value estimation*

The fair value of publicly traded derivative financial instruments and other financial assets is based on quoted market prices at the balance sheet date. The fair value of forward foreign exchange contracts is determined based on forward exchange market rates at the balance sheet date.

In assessing the fair value of non-traded derivative financial and other instruments, the Group makes assumptions that are based on market conditions existing at each balance sheet date and estimated discounted future cashflows are used to determine fair value for the remaining financial instruments.

**MAGYAR TELEKOM**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS — (Continued)**

**4 Segment information**

Magyar Telekom has two primary segments, Fixed line and Mobile services, which include both Hungarian and international activities.

The Fixed line segment provides local telephony, domestic and international long distance telecommunications services in Hungary, Macedonia and Montenegro. The Hungarian operations include the activities of the points of presence extended to Romania, Bulgaria and Ukraine. Entities in the segment also provide services such as leased lines, data transmission, PBX, corporate network, internet and cable TV services.

The Mobile segment provides digital services in various frequency bandwidths in Hungary, Macedonia and Montenegro.

Inter-segment pricing is on an arms' length basis.

*(a) Primary reporting format*

The following tables present a summary of operating results of the Group by business segment for the years ended December 31, 2003, 2004 and 2005. The segments presented below are substantially consistent with the format used by the Company's Management Committee.

	<b>For the year ended December 31,</b>		
	<b>2003</b>	<b>2004</b>	<b>2005</b>
	<b>(in HUF millions)</b>		
<b>Revenues</b>			
Hungarian Fixed line .....	324,552	301,743	288,050
International Fixed line .....	49,690	45,184	55,850
Total .....	<u>374,242</u>	<u>346,927</u>	<u>343,900</u>
Less: intra-segment revenue .....	<u>(1,553)</u>	<u>(907)</u>	<u>(1,006)</u>
Total revenue of Fixed line segment .....	372,689	346,020	342,894
Less: inter-segment revenue .....	<u>(14,034)</u>	<u>(11,846)</u>	<u>(11,832)</u>
Fixed line revenue from external customers .....	358,655	334,174	331,062
Hungarian Mobile .....	254,141	263,023	270,362
International Mobile .....	31,575	33,734	42,693
Total .....	<u>285,716</u>	<u>296,757</u>	<u>313,055</u>
Intra-segment revenue .....	<u>(20)</u>	<u>(58)</u>	<u>(27)</u>
Total revenue of Mobile segment .....	285,696	296,699	313,028
Less: inter-segment revenue .....	<u>(37,099)</u>	<u>(29,435)</u>	<u>(23,393)</u>
Mobile revenue from external customers .....	248,597	267,264	289,635
Total revenue of the Group .....	<u><u>607,252</u></u>	<u><u>601,438</u></u>	<u><u>620,697</u></u>

**MAGYAR TELEKOM**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS — (Continued)**

	<b>For the year ended December 31,</b>		
	<b>2003</b>	<b>2004</b>	<b>2005</b>
	<b>(in HUF millions)</b>		
<b>Depreciation and amortization</b>			
Hungarian Fixed line – amortization of goodwill .....	1,599	1,601	-
Hungarian Fixed line – impairment of tangible and intangible assets ..	1,344	5,355	316
Hungarian Fixed line – other depreciation and amortization .....	68,918	65,610	61,074
Hungarian Fixed line .....	<u>71,861</u>	<u>72,566</u>	<u>61,390</u>
International Fixed line – amortization of goodwill .....	663	684	-
International Fixed line – other depreciation and amortization .....	9,081	8,411	10,505
International Fixed line .....	<u>9,744</u>	<u>9,095</u>	<u>10,505</u>
Fixed line segment .....	<u>81,605</u>	<u>81,661</u>	<u>71,895</u>
Hungarian Mobile – amortization of goodwill .....	9,540	9,540	-
Hungarian Mobile – impairment of tangible and intangible assets .....	-	4,426	-
Hungarian Mobile – other depreciation and amortization .....	30,355	33,605	33,897
Hungarian Mobile .....	<u>39,895</u>	<u>47,571</u>	<u>33,897</u>
International Mobile – amortization of goodwill .....	1,989	2,051	-
International Mobile – impairment of tangible and intangible assets .....	-	-	75
.....			
International Mobile – other depreciation and amortization .....	4,845	6,383	8,819
International Mobile .....	<u>6,834</u>	<u>8,434</u>	<u>8,894</u>
Mobile segment .....	<u>46,729</u>	<u>56,005</u>	<u>42,791</u>
Total depreciation and amortization of the Group .....	<u><u>128,334</u></u>	<u><u>137,666</u></u>	<u><u>114,686</u></u>
<b>Segment results (Operating profit)</b>			
Hungarian Fixed line .....	44,090	13,061	40,299
International Fixed line .....	11,765	7,028	9,067
Fixed line segment .....	<u>55,855</u>	<u>20,089</u>	<u>49,366</u>
Hungarian Mobile .....	55,030	56,128	71,717
International Mobile .....	11,179	9,047	12,305
Mobile segment .....	<u>66,209</u>	<u>65,175</u>	<u>84,022</u>
Total operating profit of the Group .....	<u><u>122,064</u></u>	<u><u>85,264</u></u>	<u><u>133,388</u></u>
<b>Share of associates' profits/losses after tax</b>			
Hungarian Fixed line .....	795	1,896	330



**MAGYAR TELEKOM**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS — (Continued)**

	<b>At December 31,</b>		
	<b>2003</b>	<b>2004</b>	<b>2005</b>
	<b>(in HUF millions)</b>		
<b>Assets</b>			
Assets of Hungarian Fixed line .....	503,091	454,564	444,328
Goodwill allocated to Hungarian Fixed line .....	14,194	13,655	13,655
Associates of Hungarian Fixed line .....	4,827	5,750	5,020
Hungarian Fixed line .....	<u>522,112</u>	<u>473,969</u>	<u>463,003</u>
Assets of International Fixed line .....	97,569	95,872	135,397
Goodwill allocated to International Fixed line .....	11,751	12,972	12,972
International Fixed line .....	<u>109,320</u>	<u>108,844</u>	<u>148,369</u>
Intra-segment elimination .....	<u>(879)</u>	<u>(369)</u>	<u>(761)</u>
Fixed line segment .....	630,553	582,444	610,611
Assets of Hungarian Mobile .....	186,720	201,032	206,996
Goodwill allocated to Hungarian Mobile .....	170,914	161,374	161,374
Hungarian Mobile .....	<u>357,634</u>	<u>362,406</u>	<u>368,370</u>
Assets of International Mobile .....	36,384	38,159	53,103
Goodwill allocated to International Mobile .....	35,253	38,918	44,156
International Mobile .....	<u>71,637</u>	<u>77,077</u>	<u>97,259</u>
Intra-segment elimination .....	<u>(1)</u>	<u>(41)</u>	<u>-</u>
Mobile segment .....	429,270	439,442	465,629
Inter-segment elimination .....	<u>(8,025)</u>	<u>(8,404)</u>	<u>(8,710)</u>
Total segment assets .....	1,051,798	1,013,482	1,067,530
Unallocated assets (a) .....	7,039	16,076	15,418
Total assets of the Group .....	<u><u>1,058,837</u></u>	<u><u>1,029,558</u></u>	<u><u>1,082,948</u></u>
<b>Liabilities</b>			
Hungarian Fixed line .....	69,138	84,801	80,988
International Fixed line .....	5,918	4,039	10,306
Intra-segment elimination .....	<u>(879)</u>	<u>(369)</u>	<u>(761)</u>
Fixed line segment .....	74,177	88,471	90,533
Hungarian Mobile .....	43,222	47,535	48,464
International Mobile .....	2,526	3,393	5,841
Intra-segment elimination .....	<u>(1)</u>	<u>(41)</u>	<u>-</u>
Mobile segment .....	45,747	50,887	54,305
Inter-segment elimination .....	<u>(8,025)</u>	<u>(8,404)</u>	<u>(8,710)</u>
Total segment liabilities .....	111,899	130,954	136,128
Unallocated liabilities (a) .....	316,554	321,940	349,126
Total liabilities of the Group .....	<u><u>428,453</u></u>	<u><u>452,894</u></u>	<u><u>485,254</u></u>

**MAGYAR TELEKOM**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS — (Continued)**

- (a) Unallocated assets include income tax assets (current and deferred), while unallocated liabilities include loans and other borrowings and income tax liabilities (current and deferred).

	<b>For the year ended December 31,</b>		
	<b>2003</b>	<b>2004</b>	<b>2005</b>
	<b>(in HUF millions)</b>		
<b>Purchase of tangible and intangible assets</b>			
Hungarian Fixed line .....	39,662	39,495	42,875
International Fixed line .....	8,227	5,270	5,997
Fixed line segment .....	47,889	44,765	48,872
Hungarian Mobile .....	37,131	41,440	47,401
International Mobile .....	5,768	5,543	7,314
Mobile segment .....	42,899	46,983	54,715
Total Group .....	90,788	91,748	103,587

**MAGYAR TELEKOM**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS — (Continued)**

*(b) Secondary reporting format*

Magyar Telekom's Fixed line and Mobile segments operate in Hungary, Macedonia and Montenegro. The Hungarian Fixed line segment also has points of presence in Romania, Bulgaria and Ukraine, which are shown in one amount in the table below. The geographical segment reporting information is included in the tables below.

	<b>For the year ended December 31,</b>		
	<b>2003</b>	<b>2004</b>	<b>2005</b>
	<b>(in HUF millions)</b>		
<b>Revenues</b>			
Revenue generated in Hungary .....	538,702	533,706	532,557
Less: inter-segment revenue .....	<u>(1,322)</u>	<u>(682)</u>	<u>(1,020)</u>
Revenue from external customers – Hungary .....	537,380	533,024	531,537
Revenue generated in Macedonia .....	70,014	68,352	67,549
Less: inter-segment revenue .....	<u>(250)</u>	<u>(283)</u>	<u>(311)</u>
Revenue from external customers – Macedonia .....	69,764	68,069	67,238
Revenue generated in Montenegro .....	-	-	20,522
Less: inter-segment revenue .....	<u>-</u>	<u>-</u>	<u>(62)</u>
Revenue from external customers – Montenegro .....	-	-	20,460
Revenue generated in other countries .....	128	509	2,133
Less: inter-segment revenues .....	<u>(20)</u>	<u>(164)</u>	<u>(671)</u>
Revenue from external customers – other countries .....	108	345	1,462
Total revenue of the Group .....	<u>607,252</u>	<u>601,438</u>	<u>620,697</u>
<b>Purchase of tangible and intangible assets</b>			
Hungary .....	76,793	80,390	88,996
Macedonia .....	13,995	10,813	9,623
.....			
Montenegro .....	-	-	3,688
Other countries .....	-	545	1,280
.....			
Total Group .....	<u>90,788</u>	<u>91,748</u>	<u>103,587</u>

**MAGYAR TELEKOM**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS — (Continued)**

	<b>At December 31,</b>		
	<b>2003</b>	<b>2004</b>	<b>2005</b>
	<b>(in HUF millions)</b>		
<b>Assets</b>			
Hungary .....	872,955	828,414	821,833
Macedonia .....	179,553	184,876	187,433
Montenegro .....	-	-	56,523
.....			
Other countries .....	201	1,187	3,265
Total .....	<u>1,052,709</u>	<u>1,014,477</u>	<u>1,069,054</u>
Inter-segment elimination .....	(911)	(995)	(1,524)
Total segment assets .....	<u>1,051,798</u>	<u>1,013,482</u>	<u>1,067,530</u>
Unallocated assets .....	7,039	16,076	15,418
Total assets of the Group .....	<u><u>1,058,837</u></u>	<u><u>1,029,558</u></u>	<u><u>1,082,948</u></u>

**MAGYAR TELEKOM**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS — (Continued)**

**5 Acquisitions**

*(a) Acquisition of a 76.53% share of ownership in Crnogorski Telekom (CGT) in 2005*

In 2005, the Company acquired a 76.53% stake in CGT in the course of the privatization tender. The purchase price of the stake was EUR 140.5 million. From this purchase price, Magyar Telekom paid EUR 114.0 million for a stake of 51.12% to the government of Montenegro and EUR 22.9 million for a stake of 21.92% to minority shareholders. For the remaining 3.49% Magyar Telekom paid EUR 3.6 million through a public offering. CGT owns 100% of the share capital of T-Mobile CG, the Montenegrin mobile company, 100% of the share capital of Internet Crna Gora, and 51% of the share capital of Montenegrocard. The total cost of the acquisition was HUF 35,927 million including directly related expenses.

CGT and its subsidiaries have been consolidated since March 31, 2005.

The fair value of the net assets acquired and the consideration paid for the acquisition is disclosed in the table below.

<b>In HUF millions</b>	<b>Total</b>	<b>Net assets included in the Fixed line segment on first consolidation</b>	<b>Net assets included in the Mobile segment on first consolidation</b>
Total cost of acquisition	35,927		
Less: Cash acquired	(1,866)	1,742	124
Consideration paid	34,061		
<u>Fair value of net assets acquired</u>	<u>28,939</u>		
Goodwill	5,122	-	5,122
<u>Fair value of net assets acquired:</u>			
Receivables	7,678	6,442	1,236
Income tax receivable	339	-	-
Inventory	609	426	183
Property, plant and equipment	28,687	22,495	6,192
Intangible assets	9,958	3,700	6,258
Other non current assets	1,080	1,080	-
Trade and other payables	(3,917)	(3,148)	(769)
Loans and other borrowings	(3,290)	-	-
Provisions	(1,951)	(1,914)	(37)
Net deferred tax liability	(807)	-	-
	<u>38,386</u>	<u>29,081</u>	<u>13,063</u>
Minority interest	(9,447)		
<u>Total</u>	<u>28,939</u>		

The Group's total revenue in 2005 amounted to HUF 620,697 million and profit for the year attributable to the equity holders of the Company amounted to HUF 78,564 million with CGT group consolidated from March 31, 2005. If the acquisition had taken place on January 1, 2005, the Group's total revenue would be HUF 626,019 million and profit for the year attributable to the equity holders of the Company would be HUF 78,198 million.

**MAGYAR TELEKOM**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS — (Continued)**

The acquisition of CGT group resulted in an additional profit for the year attributable to the equity holders of the Company of HUF 1,482 million for Magyar Telekom Group in 2005.

***(b) Acquisition of 49% share of ownership in T-Systems Hungary in 2004***

As of September 30, 2004, Magyar Telekom acquired a 49% share of ownership in T-Systems Hungary (TSH) from T-Systems International (TSI). The consideration paid amounted to HUF 3,430 million. As the transaction took place between companies of Deutsche Telekom Group, Magyar Telekom applied predecessor accounting. This means that Magyar Telekom took over the carrying value of the investment and the related goodwill from the accounts of TSI and the difference between the consideration paid and the carrying values was recorded in shareholders' equity (note d on F-7). The goodwill taken over from TSI's accounts (HUF 149 million) is included in the value of the associate.

***(c) Acquisition of additional shares in Stonebridge (holding company owning 51% of MakTel)***

The subscription and shareholders' deed (Deed) agreed between the original owners of Stonebridge provided for a put option which entitled SEEF Holdings, one of the co-owners, to sell its shares to Magyar Telekom at a price formula also set out in the Deed on May 15 of each of 2003, 2004 or 2005 or upon the occurrence of certain events. The formula took into account the purchase price paid by the consortium for the shares, the current earnings before interest, tax, depreciation and amortization (EBITDA) and the net debt of MakTel.

Pursuant to the terms of the Deed, SEEF exercised its put option (in relation to 3.05% holding in Stonebridge) in 2003 and Magyar Telekom paid EUR 21 million (HUF 5,545 million). In 2004, SEEF exercised its put option for the remaining 3.05% share of ownership in Stonebridge. Magyar Telekom paid USD 27.4 million (HUF 5,554 million) for these shares, thereby increasing its share of ownership to 92.6% in Stonebridge. The acquisition in 2003 was accounted for according to IAS 22 – Business combinations, while the 2004 acquisition was accounted for according to IFRS 3 – Business combinations.

CosmoTelco, the other co-owner in Stonebridge, and Magyar Telekom entered into a call option agreement whereby CosmoTelco had the right to acquire additional shares in Stonebridge from Magyar Telekom such that CosmoTelco's holding could have increased its original 7.44 percent stake in Stonebridge to 29 percent. The price was defined as Magyar Telekom's acquisition cost plus holding costs. Before the expiration of CosmoTelco's call option in 2002, Magyar Telekom and CosmoTelco amended the option agreement as a result of which CosmoTelco had until 2003 to exercise its option for a 10% share in Stonebridge. Magyar Telekom paid a fee of EUR 7 million (HUF 1,715 million) in return for CosmoTelco letting the option for the remaining 11.55% share expire unexercised in 2002. In 2003, the parties agreed that CosmoTelco allowed its option to lapse, and Magyar Telekom paid EUR 2.5 million (HUF 658 million) to CosmoTelco.

As of October 26, 2004 Magyar Telekom acquired CosmoTelco's 7.44% share of ownership in Stonebridge, whereby Magyar Telekom became the sole owner of Stonebridge. As a result of this acquisition, Magyar Telekom's effective ownership in MakTel increased to 51%. Total acquisition cost of the transaction amounted to HUF 9,003 million.

Since Magyar Telekom has a 100% ownership in Stonebridge, the holding company structure is no longer necessary. In November 2005 Magyar Telekom commenced the winding-up of Stonebridge in accordance with the relevant Macedonian laws. Once the process is complete, Magyar Telekom will directly own its shares in MakTel, thus simplifying the ownership structure.

**MAGYAR TELEKOM**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS — (Continued)**

*(d) Purchase of subsidiaries and business units in the cashflow statement*

	<b>For the year ended</b>		
	<b>December 31,</b>		
	<b>2003</b>	<b>2004</b>	<b>2005</b>
	<b>(in HUF millions)</b>		
CGT .....	-	-	35,927
T-Systems Hungary .....	-	3,430	-
Stonebridge .....	5,545	13,355	-
Amounts paid to CosmoTelco for unexercised call option .....	658	-	-
Other .....	1,789	488	-
<b>Total purchase of subsidiaries and business units .....</b>	<b>7,992</b>	<b>17,273</b>	<b>35,927</b>

Other items include the consideration paid for shares of non-principal subsidiaries and business units.

**6 Cash and cash equivalents**

	<b>At December 31,</b>		
	<b>2004</b>	<b>2005</b>	
	<b>(in HUF millions)</b>	<b>Average interest rate</b>	
HUF .....	1,552	1,794	3.22%
MKD .....	22,110	21,916	6.38%
EUR .....	7,815	13,527	2.12%
Other .....	5,402	8,823	3.44%
	<b>36,879</b>	<b>46,060</b>	<b>4.44%</b>

	<b>At December 31,</b>	
	<b>2004</b>	<b>2005</b>
	<b>(in HUF millions)</b>	
Cash on hand .....	93	166
Cash in banks and cash equivalents .....	36,786	45,894
	<b>36,879</b>	<b>46,060</b>

**7 Other financial assets**

Other financial assets include financial assets held for trading including financial instruments with maturities between three to twelve months and other instruments at fair value through profit or loss. The balance as at December 31, 2004 also included the fair value of certain embedded derivatives (HUF 438 million) that were derecognized against retained earnings as a result of the change in accounting policy for the recognition of embedded derivatives (note 2 (e)).

**MAGYAR TELEKOM**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS — (Continued)**

**8 Trade and other receivables**

	<b>At December 31,</b>	
	<b>2004</b>	<b>2005</b>
	<b>(in HUF millions)</b>	
Domestic trade receivables .....	87,290	100,206
Foreign trade receivables .....	4,624	7,080
Receivables from associates .....	555	1,008
Receivables from Deutsche Telekom Group companies .....	1,200	1,943
Advances paid for current assets .....	796	2,577
Other taxes receivable .....	4,259	2,742
Prepayments and accrued income .....	2,128	3,686
Other receivables .....	6,864	7,932
	<u>107,716</u>	<u>127,174</u>
Allowance for impairment loss .....	<u>(24,276)</u>	<u>(29,991)</u>
	<u>83,440</u>	<u>97,183</u>

The allowance for impairment loss and changes therein for 2004 and 2005 are as follows:

	<b>At December 31,</b>	
	<b>2004</b>	<b>2005</b>
	<b>(in HUF millions)</b>	
Impairment loss, beginning of period .....	(20,960)	(24,276)
Charged to expense (included in other operating expenses) .....	(6,082)	(6,266)
Impairment losses of acquired companies on acquisition .....	-	(3,674)
Utilized and translation differences .....	2,766	4,225
Impairment loss, end of period .....	<u>(24,276)</u>	<u>(29,991)</u>

**9 Inventories**

	<b>At December 31,</b>	
	<b>2004</b>	<b>2005</b>
	<b>(in HUF millions)</b>	
Cables, wires and other materials .....	3,933	3,493
Inventory for resale .....	4,724	6,215
Subtotal .....	<u>8,657</u>	<u>9,708</u>
Less allowances for obsolete inventory .....	<u>(988)</u>	<u>(1,294)</u>
	<u>7,669</u>	<u>8,414</u>

**10 Assets held for disposal**

Assets held for disposal include land and buildings identified for sale, which is expected within 12 months, as a result of the continuing improvement of utilization of properties and headcount reductions. All of these assets are included in the Fixed line segment.



**MAGYAR TELEKOM**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS — (Continued)**

**11 Property, plant and equipment - net**

	<u>Land and equivalent rights</u>	<u>Buildings</u>	<u>Telecom. equipment</u>	<u>Other equipment</u>	<u>Total</u>
	<b>in HUF millions</b>				
<b><u>At January 1, 2004</u></b>					
Cost .....	5,963	110,638	852,404	135,049	1,104,054
Accumulated depreciation .....	<u>(1,430)</u>	<u>(19,040)</u>	<u>(369,552)</u>	<u>(88,528)</u>	<u>(478,550)</u>
Carrying amount .....	4,533	91,598	482,852	46,521	625,504
.....					
Carrying amount - January 1, 2004 .....	4,533	91,598	482,852	46,521	625,504
Exchange differences .....	(2)	(779)	(3,914)	(384)	(5,079)
Reclassifications .....	-	-	(858)	-	(858)
Acquisitions .....	-	1	170	145	316
Additions .....	145	5,066	43,387	12,375	60,973
Disposals .....	(398)	(1,141)	(642)	(379)	(2,560)
Impairment charge .....	-	-	(5,355)	-	(5,355)
.....					
Depreciation charge .....	<u>(364)</u>	<u>(3,173)</u>	<u>(75,788)</u>	<u>(19,463)</u>	<u>(98,788)</u>
Carrying amount - December 31, 2004 .....	3,914	91,572	439,852	38,815	574,153
<b><u>At December 31, 2004</u></b>					
Cost .....	5,543	112,328	868,615	135,396	1,121,882
Accumulated depreciation .....	<u>(1,629)</u>	<u>(20,756)</u>	<u>(428,763)</u>	<u>(96,581)</u>	<u>(547,729)</u>
Carrying amount .....	3,914	91,572	439,852	38,815	574,153
.....					
Of which held for disposal .....					<u>(3,063)</u>
					<u>571,090</u>
.....					
Carrying amount - January 1, 2005 .....	3,914	91,572	439,852	38,815	574,153
Exchange differences .....	27	500	2,106	149	2,782
Acquisitions .....	1,226	6,502	19,116	1,843	28,687
Additions .....	185	6,625	54,194	14,701	75,705
Disposals .....	(203)	(818)	(201)	(313)	(1,535)
Impairment charge .....	-	(75)	(199)	(117)	(391)
.....					
Depreciation charge .....	<u>(214)</u>	<u>(3,137)</u>	<u>(76,916)</u>	<u>(16,096)</u>	<u>(96,363)</u>
Carrying amount - December 31, 2005 .....	4,935	101,169	437,952	38,982	583,038
<b><u>At December 31, 2005</u></b>					
Cost .....	6,743	124,636	931,111	143,832	1,206,322
Accumulated depreciation .....	<u>(1,808)</u>	<u>(23,467)</u>	<u>(493,159)</u>	<u>(104,850)</u>	<u>(623,284)</u>
Carrying amount .....	4,935	101,169	437,952	38,982	583,038
.....					
Of which held for disposal .....					<u>(2,302)</u>
					<u>580,736</u>

The closing balance of Property, plant and equipment includes assets in the course of construction in an amount of HUF 28,069 million as at December 31, 2005 (2004: HUF 16,283 million). This was reported as a separate category until 2004, while in the table above the assets in course of construction are shown in the categories where the capitalization is expected. We have also changed the categorization of the property plant

**MAGYAR TELEKOM**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS — (Continued)**

and equipment, and prior year balances and movements are now shown in line with the new disclosure.

**MAGYAR TELEKOM**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS — (Continued)**

Acquisitions include the fair value of the assets of the companies that were acquired by Magyar Telekom in the reported years.

Additions to property, plant and equipment are shown net of the investment tax credit related to broadband investments of HUF 5,373 million in 2005 (HUF 6,849 million in 2004). For more details, see note 26.

Impairment losses charged in 2005 relate to various assets, the recoverable amounts of which were defined based on the respective assets' fair value less cost to sell as these were found higher than their value in use.

Impairment losses charged in 2004 mainly related to MLLN node equipment and operational system, DTU, FMUX, High Speed Subscriber's Facilities. The recoverable amount for the above mentioned equipment was defined based on the value in use, determined using discounted cashflow analysis. The discount rate used in the discounted cashflow calculations was 9.74% in 2004. All impairment losses charged are included in the Fixed line segment.

Included in buildings are assets sold and leased back under finance lease conditions. At December 31, 2005 the gross book value of the leased back assets is HUF 752 million and the net book value is HUF 645 million.

Included in telecommunications equipment at December 31, 2005 are assets leased under operating lease contracts to customers with a gross book value of HUF 5,657 million (2004: HUF 5,436 million) and net book value of HUF 2,217 million (2004: HUF 2,730 million). Depreciation for the year of these assets amounted to HUF 934 million (2004: HUF 463 million).

As a result of the continuous revision of the useful life of the Group's assets, the lives of certain assets were changed as of January 1, 2005. These assets mainly included ISDN and ADSL equipment, other equipment and vehicles and the change in life resulted in HUF 1,771 million higher depreciation expense in 2005.

**MAGYAR TELEKOM**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS — (Continued)**

**12 Intangible assets - net**

	Goodwill	Software	Concessions and licenses	Brand name	Other	Total
<b>in HUF millions</b>						
<b>At January 1, 2004</b>						
Cost	289,183	75,747	19,770	7,706	6,769	399,175
Accumulated amortization	(57,062)	(40,401)	(6,251)	(2,839)	(4,290)	(110,843)
Carrying amount	232,121	35,346	13,519	4,867	2,479	288,332
Carrying amount - January 1, 2004	232,121	35,346	13,519	4,867	2,479	288,332
Exchange differences	-	(227)	(2)	-	(433)	(662)
Reclassifications	-	858	-	-	-	858
Acquisitions	8,675	-	-	365	151	9,191
Additions	-	16,898	17,073	-	206	34,177
Disposals	-	(2)	-	-	(20)	(22)
Impairment	-	-	-	(4,426)	-	(4,426)
Amortization charge	(13,876)	(12,791)	(1,638)	(346)	(446)	(29,097)
Carrying amount - December 31, 2004	226,920	40,082	28,952	460	1,937	298,351
<b>At December 31, 2004</b>						
Cost	297,858	90,101	36,829	525	5,661	430,974
Accumulated amortization	(70,938)	(50,019)	(7,877)	(65)	(3,724)	(132,623)
Carrying amount	226,920	40,082	28,952	460	1,937	298,351
Carrying amount - January 1, 2005	226,920	40,082	28,952	460	1,937	298,351
Exchange differences	115	336	61	35	81	628
Acquisitions	5,122	1,698	2,820	1,740	3,700	15,080
Additions	-	16,705	-	-	6,964	23,669
Amortization charge	-	(14,676)	(2,055)	(319)	(881)	(17,931)
Carrying amount - December 31, 2005	232,157	44,145	29,778	1,916	11,801	319,797
<b>At December 31, 2005</b>						
Cost	232,157	110,038	40,139	2,305	16,197	400,836
Accumulated amortization	-	(65,893)	(10,361)	(389)	(4,396)	(81,039)
Carrying amount	232,157	44,145	29,778	1,916	11,801	319,797

We have changed the categorization of intangible assets, prior year balances and movements are now shown in line with the new disclosure.

Acquisitions include the assets of the companies that were acquired by Magyar Telekom in the reported years and the goodwill arising on acquisitions.

The amortization expense as well as the impairment losses of intangible assets including goodwill is accounted for in the depreciation and amortization line of the income statement.

The Group carried out an impairment test on goodwill in the last quarter of 2004 and 2005 and established that the carrying amount goodwill allocated to the cash generating units did not suffer impairment as the recoverable amounts of the segments based on value in use determined using discounted projected cashflows proved to be higher than the carrying values. Consequently, no goodwill impairment was charged in any of the reported years. The cashflows attributable to the national operations of the segments were projected for the coming ten years with terminal values determined.

**MAGYAR TELEKOM**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS — (Continued)**

The most significant amounts of goodwill are allocated to the Hungarian and the International operations of the Mobile segment. Beyond the 10 year planning period, the perpetual growth rates of these Mobile operations were determined at 2.5%. The weighted average cost of capital was determined at 7.43% for the Hungarian Mobile operations, and 9.34% for the International Mobile operations.

In 2004, the Hungarian mobile subsidiary, Westel, was renamed to T-Mobile Hungary. As a result of the change of the brand name, the carrying value of the capitalized Westel brand name was impaired and then derecognized after the completion of the rebranding.

The most significant individual intangible assets as of December 31, 2005 are listed in the table below.

Description	Carrying amount in HUF millions	Remaining useful life (years)
Goodwill allocated to Hungarian Mobile .....	161,374	-
Goodwill allocated to International Mobile .....	44,156	-
Goodwill allocated to Hungarian Fixed line .....	13,655	-
Goodwill allocated to International Fixed line .....	12,972	-
T-Mobile H UMTS licence .....	16,654	14
T-Mobile H DCS 1,800 licence .....	8,368	9
Other intangible assets .....	62,618	3-10
	<u>319,797</u>	

**13 Purchase of tangible and intangible assets**

	<b>For the year ended December 31,</b>		
	<b>2003</b>	<b>2004</b>	<b>2005</b>
	<b>(in HUF millions)</b>		
Additions to property, plant and equipment .....	70,767	60,973	75,705
Additions to intangible assets .....	<u>17,506</u>	<u>34,177</u>	<u>23,669</u>
Total additions to tangible and intangible assets .....	88,273	95,150	99,374
Recognition of investment tax credit (note 26) .....	-	6,849	5,373
Change in payables relating to capital expenditures .....	<u>2,515</u>	<u>(10,251)</u>	<u>(1,160)</u>
	<u>90,788</u>	<u>91,748</u>	<u>103,587</u>

**MAGYAR TELEKOM**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS — (Continued)**

**14 Associates**

	<b>For the year ended December 31,</b>	
	<b>2004</b>	<b>2005</b>
	<b>(in HUF millions)</b>	
Opening balance of associates .....	4,827	5,750
Acquisition of TSH .....	1,602	-
Goodwill arising on TSH's acquisition .....	149	-
TSI's capital injection to TSH .....	-	669
Other additions .....	10	-
Share of associates' profits/losses after tax .....	1,896	330
Disposal of associates .....	(101)	-
Dividends .....	(2,633)	(1,729)
Closing balance of associates .....	<u>5,750</u>	<u>5,020</u>

The following table shows the total assets and liabilities as at December 31, 2005, and revenues and profit for the year ended December 31, 2005 of the major associates of the Group.

	<b>Hunsat</b>	<b>T-Systems Hungary</b>	<b>Magyar RTL</b>
	<b>(in HUF millions)</b>		
Total assets .....	1,327	9,420	30,486
Total liabilities .....	911	6,264	19,537
Revenues .....	3,324	9,323	30,797
Profit for the year .....	316	315	2,988

The profit of T-Systems Hungary includes the income from the loan forgiven by its majority owner, T-Systems International in an amount of HUF 1,366 million. See more details in note d on page F-7.

**15 Other non current assets**

	<b>At December 31,</b>	
	<b>2004 as reported</b>	<b>2005</b>
	<b>(in HUF millions)</b>	
Employee loans .....	3,515	4,089
Other loans receivable .....	326	98
Derivative instruments .....	435	-
Other .....	2,388	2,014
	<u>6,664</u>	<u>6,201</u>

Derivative instruments as at December 31, 2004 included the fair value of certain embedded derivatives that were derecognized against retained earning as a result of the change in accounting policy for the recognition of

**MAGYAR TELEKOM**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS — (Continued)**

embedded derivatives (note 2 (e)).

**MAGYAR TELEKOM**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS — (Continued)**

**16 Financial Instruments**

Financial instruments carried on the balance sheet include cash and bank balances, financial investments, trade and other receivables, trade and other payables, loans and other borrowings. Magyar Telekom is occasionally also a party to derivative financial instruments that reduce exposure to fluctuations in foreign currency exchange.

For the acquisition of the remaining 49% of T-Mobile Hungary and 44% of MakTel Group in 2001, Magyar Telekom received loans from Deutsche Telekom International Finance B.V. (DTIF), the treasury vehicle of Deutsche Telekom. In 2002, Magyar Telekom entered into several swap agreements with Deutsche Telekom AG in order to exchange the cashflows of the EUR loans payable to HUF cashflows. These loans were accounted for in the originally denominated currency (EUR), while the related swap agreements were accounted for as derivative financial instruments. All swap agreements were terminated in 2003 parallel with the refinancing of the underlying loans.

Derivative contracts entered into in 2003, 2004 and 2005 were limited to foreign currency forward contracts.

The net carrying amounts of current financial assets reflect reasonable estimates of their fair values due to the short period to maturity of the instruments.

Non current loans receivable are accounted for at amortized cost.

The fair value of short term liabilities other than loans and other borrowings approximates their carrying values due to their relatively short maturities. For the fair value of loans and other borrowing see note 17. The fair values of other non current liabilities are reflected in their carrying amount as they are discounted to fair value.

**17 Loans and other borrowings**

	Notes	<b>At December 31,</b>	
		<b>2004</b>	<b>2005</b>
<b>(in HUF millions)</b>			
Current loans from related parties .....		60,000	74,648
Non current loans from related parties .....		<u>177,675</u>	<u>212,000</u>
Total loans from related parties .....	(a)	237,675	286,648
Current bank loans .....		34,161	43,196
Non current bank loans .....		<u>47,266</u>	<u>13,278</u>
Total bank loans .....	(b)	81,427	56,474
Current other borrowings .....		377	406
Non current other borrowings .....		<u>1,129</u>	<u>937</u>
Total other borrowings .....		1,506	1,343
Total third party loans and other borrowings .....		<u>82,933</u>	<u>57,817</u>
Total loans and other borrowings .....		<u><u>320,608</u></u>	<u><u>344,465</u></u>



**MAGYAR TELEKOM**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS — (Continued)**

At December 31, 2005, principal repayments fall due in:

Year	<b>Maturity</b>	
	<b>At December 31,</b>	
	<b>2004</b>	<b>2005</b>
	<b>(in HUF millions)</b>	
2005 .....	94,538	-
2006 .....	103,538	118,250
2007 .....	25,673	77,342
2008 .....	23,053	23,075
2009 .....	33,063	81,090
2010 .....	-	4,110
Thereafter .....	40,743	40,598
Total loans and other borrowings .....	<u>320,608</u>	<u>344,465</u>

The effective borrowing cost (total interest payable and other charges) for Magyar Telekom's loans and borrowings was 10.1% in 2005 (11.9% in both in 2004 and 2003). The weighted average interest rate on borrowings was 9.4% in 2005 (10.9% in 2004, 7.5% in 2003).

**(a) Loans from related parties**

Primarily all the related party loans are taken from Deutsche Telekom International Finance (DTIF), the treasury vehicle of Deutsche Telekom Group, and are denominated in HUF. One loan as at December 31, 2005, however, was taken from Deutsche Telekom AG (DTAG). DTAG provided this loan to Magyar Telekom for the financing of the rebranding, the final settlement of which was due in February 2006.

The table below shows the details of the loans outstanding as at December 31, 2005.

<b>Lender</b>	<b>Amount</b> <b>(HUF millions)</b>	<b>Interest rate</b> <b>(%)</b>	<b>Fixed /</b> <b>variable</b>	<b>Repayable</b>
DTIF	73,675	9.36	fixed	Jan 2006
DTAG	973	6.19	variable	Feb 2006
Total current	<u>74,648</u>			
DTIF	20,000	7.55	fixed	Jan 2007
DTIF	20,000	7.61	fixed	May 2007
DTIF	14,000	10.20	fixed	May 2007
DTIF	20,000	7.45	fixed	Dec 2007
DTIF	20,000	8.21	fixed	May 2008
DTIF	5,000	9.68	fixed	Sep 2009
DTIF	20,000	7.53	fixed	Oct 2009
DTIF	25,000	9.61	fixed	Oct 2009
DTIF	28,000	6.40	variable	Oct 2009
DTIF	40,000	8.73	fixed	May 2012
Total non current	<u>212,000</u>			
	<u><u>286,648</u></u>			

**MAGYAR TELEKOM**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS — (Continued)**

**(b) Bank loans**

Bank loans are denominated in HUF and EUR at December 31, 2005, while in 2004 all bank loans were denominated in HUF.

Loans totaling HUF 3,825 million at December 31, 2005 are revolving loans (HUF 25,581 million in 2004) which can be prepaid at any time and may be drawn down in one to six month rolling periods.

Certain loan agreements contain covenant restrictions that require the maintenance of pre-defined financial ratios. Breach of those covenants would result in HUF 2,000 million (HUF 15,500 million in 2004) being due and payable in 30 days if not remedied. At December 31, 2005 the Company was in compliance with these covenants. One of the covenants allows a debt to EBITDA (earnings before interest, tax, depreciation and amortization) ratio of maximum 3.0. The other covenant requires the maintenance of an EBITDA to interest expense ratio of minimum 2.0.

The following table shows the weighted average interest rates of bank loans as at December 31, 2005.

	<b>Maturities</b>					<b>There- after</b>	<b>Total</b>
	<b>2006</b>	<b>2007</b>	<b>2008</b>	<b>2009</b>	<b>2010</b>		
	(in HUF millions, except percentages)						
<b>Bank loans (HUF Denominated)</b>							
Variable rate .....	41,917	3,125	3,000	3,000	4,000	-	55,042
Average interest rate .....	6.43%	6.64%	6.43%	6.67%	6.62%	-	6.47%
<b>Bank loans (EUR Denominated)</b>							
Variable rate .....	458	126	-	-	-	-	584
Average interest rate .....	6.31%	5.29%	-	-	-	-	6.09%
Fixed rate .....	821	27	-	-	-	-	848
Average interest rate .....	6.05%	5.90%	-	-	-	-	6.05%
Total.....	1,279	153	-	-	-	-	1,432
<b>Total bank loans.....</b>	<b>43,196</b>	<b>3,278</b>	<b>3,000</b>	<b>3,000</b>	<b>4,000</b>	<b>-</b>	<b>56,474</b>

**MAGYAR TELEKOM**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS — (Continued)**

*(c) Fair values*

The following table is a summary of Magyar Telekom's market sensitive debt instruments, including fair value calculated using the discounted cashflow method.

	<b>At December 31,</b>			
	<b>2004</b>		<b>2005</b>	
	<b>(in HUF millions)</b>			
	<b>Book value</b>	<b>Fair value</b>	<b>Book value</b>	<b>Fair value</b>
<b>Bank loans</b>				
Fixed rate .....	-	-	848	848
Variable rate .....	81,427	81,427	55,626	55,626
Total bank loans .....	<u>81,427</u>	<u>81,427</u>	<u>56,474</u>	<u>56,474</u>
<b>Related party loans</b>				
Fixed rate .....	177,675	178,997	257,675	268,599
Variable rate .....	60,000	60,000	28,973	28,973
Total related party loans .....	<u>237,675</u>	<u>238,997</u>	<u>286,648</u>	<u>297,572</u>

Variable interest rate loans are subject to interests calculated based on mostly BUBOR (Budapest Inter-Bank Offered Rate) plus a margin interest formula.

The majority of the Group's loans and borrowings are subject to fixed interest rates that are exposed to fair value risk as it is stated in the table above. Any decrease of market interest rates will result in an increase of the fair value of the liabilities. The rest of the Group's loans and borrowings are subject to variable interests, which are exposed to cashflow risks if interest rates are rising, resulting in higher cash outflows through interest payments.

*(d) Credit facilities and pledges*

At December 31, 2005, Magyar Telekom had un-drawn committed credit facilities of HUF 71,374 million. These credit facilities, should they be drawn down, are subject to an interest rate of LIBOR, BUBOR and commercial floating bank prime rates plus a margin depending on the currency and institution providing the facilities. There are pledges on receivables for loans totaling HUF 181 million.

**MAGYAR TELEKOM**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS — (Continued)**

**18 Trade and other payables**

	<b>At December 31,</b>	
	<b>2004</b>	<b>2005</b>
	<b>(in HUF millions)</b>	
Domestic trade payables .....	47,529	58,292
Foreign trade payables .....	3,885	7,658
UMTS license fee payable .....	11,500	-
Salaries and wages .....	10,175	8,794
Other taxes and social security .....	8,305	12,191
Amounts received in advance .....	6,380	6,861
Accrued expenses and prepayments .....	5,457	6,587
Accrued interest to DTIF .....	5,491	6,198
Accrued interest to third parties .....	906	461
Amounts owed to DT Group companies .....	2,321	1,828
Payable to associates .....	1,621	694
Dividends payable .....	61	77
Other payables .....	6,290	9,823
	<u>109,921</u>	<u>119,464</u>

Included in other payables as at December 31, 2005 is an amount of HUF 2,950 million (HUF 1,544 million as at December 31, 2004) potentially repayable to universal customers related to the reduced fixed to mobile termination charges (note 30), which was accounted for as a reduction of revenues.

Included in other payables is also HUF 739 million that relates to the acquisition of a service contract in 2005 for the operation of a governmental backbone network. This represents the short term portion of a total amount of HUF 6,095 million payable, while the rest is included in Other non current liabilities, which caused the increase of that line of the balance sheet as at December 31, 2005.

**19 Deferred revenue**

	<b>At December 31,</b>	
	<b>2004</b>	<b>2005</b>
	<b>(in HUF millions)</b>	
Beginning of period .....	4,446	2,688
Amortization .....	<u>(1,758)</u>	<u>(1,503)</u>
End of period .....	<u>2,688</u>	<u>1,185</u>
Amount to be recognized within one year .....	1,502	918

**MAGYAR TELEKOM**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS — (Continued)**

**20 Provision for liabilities and charges**

	Severance	Customer loyalty programs	Legal cases	Other	Total
	(in HUF millions)				
January 1, 2004 .....	1,570	1,453	3,061	415	6,499
Amounts utilized / retired .....	(1,570)	(1,453)	(1,369)	(330)	(4,722)
Additions.....	13,022	1,785	1,468	246	16,521
December 31, 2004	<u>13,022</u>	<u>1,785</u>	<u>3,160</u>	<u>331</u>	<u>18,298</u>
January 1, 2005 .....	13,022	1,785	3,160	331	18,298
Acquired through business combinations .....	-	-	173	1,778	1,951
Amounts utilized / retired .....	(10,721)	(1,701)	(2,945)	(509)	(15,876)
Additions .....	1,328	1,823	2,257	177	5,585
December 31, 2005 .....	<u>3,629</u>	<u>1,907</u>	<u>2,645</u>	<u>1,777</u>	<u>9,958</u>
Less: non current portion .....	(1,074)	(1,307)	(103)	(657)	(3,141)
Current provision .....	<u>2,555</u>	<u>600</u>	<u>2,542</u>	<u>1,120</u>	<u>6,817</u>

The provision for severance as at December 31, 2005 mostly relates to the employee termination in 2006 and in later years in accordance with the agreement made with employee representatives of Magyar Telekom Plc. in 2004. The number of employees impacted by the headcount reduction covered in the agreement is approximately 1,900 and includes mostly network and back office personnel. Of this number, approximately 1,600 lay-offs were completed in 2005, while the remaining 300 are expected in the coming years. In 2005 an additional headcount of 300 was identified for redundancy in 2006 in various entities of the Group, for which an additional provision was recognized.

The total payments made in relation to employee termination in 2005 amounted to HUF 14,535 million (HUF 7,549 million in 2004), of which HUF 10,721 million (HUF 1,570 million in 2004) was charged against the provision for liabilities and charges as at December 31, 2004, while the rest was recognized as employee related expense in 2005.

Provision for customer loyalty programs includes the fair value of discount credits earned by customers that have not been utilized.

Provisions for legal cases mainly include amounts expectedly payable to tax and regulatory authorities and amounts expected to be paid as compensation for loss of value of real estates of inhabitants allegedly caused by cellular base stations installed on neighboring sites.

**MAGYAR TELEKOM**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS — (Continued)**

**21 Revenues – Fixed line services**

	<b>For the year ended December 31,</b>		
	<b>2003</b>	<b>2004</b>	<b>2005</b>
	<b>(in HUF millions)</b>		
Subscriptions, connections and other charges .....	109,063	106,224	105,665
Outgoing domestic traffic revenues .....	131,659	112,381	90,933
Outgoing international traffic revenues .....	13,096	12,255	11,141
Total outgoing traffic revenues .....	<u>144,755</u>	<u>124,636</u>	<u>102,074</u>
Incoming domestic traffic revenues .....	10,797	5,883	9,618
Incoming international traffic revenues .....	20,024	15,781	16,007
Total incoming traffic revenues .....	<u>30,821</u>	<u>21,664</u>	<u>25,625</u>
Leased lines and data transmission .....	41,502	50,976	63,743
Equipment sales .....	3,249	3,678	4,046
Other revenues .....	29,265	26,996	29,909
Total Fixed line revenues .....	<u>358,655</u>	<u>334,174</u>	<u>331,062</u>

Included in other revenues in 2003 is HUF 6,032 million of subsidies from the Universal Telecommunications Support Fund to compensate for the maintenance of low usage discount packages provided by the Hungarian fixed line telecommunications service providers of the Group. No such compensation was recognized in 2004 or 2005.

**22 Revenues – Mobile services**

	<b>For the year ended December 31,</b>		
	<b>2003</b>	<b>2004</b>	<b>2005</b>
	<b>(in HUF millions)</b>		
Network usage and access .....	193,322	208,193	226,176
Enhanced services .....	28,037	31,945	38,421
Equipment sales .....	23,109	24,549	22,653
Activation fees .....	1,534	820	819
Other revenues .....	2,595	1,757	1,566
Total Mobile revenues .....	<u>248,597</u>	<u>267,264</u>	<u>289,635</u>

Enhanced services include mainly non-voice value added services like SMS, MMS, WAP, GPRS, etc.

**MAGYAR TELEKOM**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS — (Continued)**

**23 Employee related expenses**

	<b>For the year ended December 31,</b>		
	<b>2003</b>	<b>2004</b>	<b>2005</b>
	<b>(in HUF millions)</b>		
Short term benefits .....	91,056	92,733	90,605
Share based payments .....	-	70	270
Termination benefits .....	1,101	20,180	5,142
Total before capitalization .....	<u>92,157</u>	<u>112,983</u>	<u>96,017</u>
Expenses capitalized .....	(4,237)	(3,486)	(3,234)
.....	<u>87,920</u>	<u>109,497</u>	<u>92,783</u>
 Total amount paid to defined contribution plans (including social security) .....	 21,546	 25,876	 21,797

**24 Other operating expenses - net**

	<b>For the year ended December 31,</b>		
	<b>2003</b>	<b>2004</b>	<b>2005</b>
	<b>(in HUF millions)</b>		
Materials, maintenance and service fees .....	57,992	58,104	60,696
Subcontractors and agent commissions .....	21,792	22,491	25,994
Marketing .....	16,902	22,189	24,888
Fees and levies .....	23,833	20,268	21,821
Consulting .....	6,102	7,082	7,571
Rental and operating lease .....	6,338	6,716	7,246
Bad debt expense .....	4,450	6,082	6,266
Other expenses .....	6,265	3,448	6,321
Total other operating expenses .....	<u>143,674</u>	<u>146,380</u>	<u>160,803</u>
 Other income .....	 -	 (5,920)	 (7,281)
	<u>143,674</u>	<u>140,460</u>	<u>153,522</u>

Other expenses include HUF 2,059 million paid under four consulting contracts entered into by the Group, as to which the Company has not been able to obtain sufficient evidence that it or its subsidiaries received adequate value. This amount also includes the operating tax implications of the payments as well. See Note 1 – Investigation into certain consultancy contracts.

Other income includes compensation received from Deutsche Telekom AG related to the renaming and rebranding of the Group (note 31).

Contributions payable to the Universal Telecommunications Support Fund were accrued as part of Fees and levies in 2003 (HUF 5,098 million). According to the decision of the National Regulatory Authority on the actual amounts payable, HUF 1,353 million of the accruals was reversed in 2004 on the same line where the expenses were originally accrued. As the Fund did not accept the claims of the fixed line telecom operators with respect to 2004 and the same is expected for 2005, no additional amounts payable were accrued in 2004 or 2005.

**MAGYAR TELEKOM**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS — (Continued)**

**25 Net financial expenses**

	<b>For the year ended December 31,</b>		
	<b>2003</b>	<b>2004</b>	<b>2005</b>
	<b>(in HUF millions)</b>		
Interest expense:			
HUF .....	21,315	34,611	31,218
Foreign currency .....	4,469	120	122
(Gains) / losses on the valuation of derivative financial instruments .....	972	(647)	-
Net foreign exchange losses / (gains) .....	8,799	523	(1,014)
Other financial expenses .....	5,364	3,183	3,157
Total financial expenses .....	<u>40,919</u>	<u>37,790</u>	<u>33,483</u>
Interest capitalized .....	(41)	-	-
Interest and other financial income .....	(876)	(1,644)	(2,195)
	<u>40,002</u>	<u>36,146</u>	<u>31,288</u>

**26 Income tax**

	<b>For the year ended December 31,</b>		
	<b>2003</b>	<b>2004</b>	<b>2005</b>
	<b>(in HUF millions)</b>		
Corporate income tax .....	12,259	9,352	11,686
Deferred income taxes .....	1,258	(1,665)	1,825
	<u>13,517</u>	<u>7,687</u>	<u>13,511</u>

The Company qualified for a reduction in corporate income tax payable for ten years on meeting certain conditions. The last year of tax reduction was in 2003, when the Company's corporate tax payable could be reduced by 60% to 7.2%.

In December 2003 the Hungarian Parliament passed the new tax law in which the corporate tax rate was reduced from 18% to 16% from January 2004. Deferred tax balances of the Hungarian members of the Group were amended accordingly at the end of 2003.

Deferred taxes have been recognized for temporary differences arising on the valuation of investments (mainly currency differences) in subsidiaries and associates in the parent companies' books as required by IAS 12.

Deferred tax assets are recognized for tax loss carry forwards only to the extent that realization of the related tax benefit is probable. Recognized tax losses of HUF 2,718 million will expire in 2006, HUF 2,435 million in 2007 and HUF 1,517 million in 2008. The remaining balance of the recognized tax losses of HUF 31,755 million is not subject to statutory limitations.

In order to increase broadband internet penetration in Hungary, the Hungarian Government decided that companies investing over HUF 100 million in broadband assets (e.g. DSL lines) from 2003 can apply for a corporate tax reduction. The potential reduction of the corporate tax charge is defined as a percentage of the companies' capital investment in broadband assets.

As the recoverability of these investment tax credits was uncertain in 2003, no deferred tax asset was recognized in 2003. Due to the change of the assessment of the recoverability, Magyar Telekom recognized a deferred tax asset of HUF 6,849 million in 2004 (HUF 3,879 million related to 2004 and HUF 2,970 million



**MAGYAR TELEKOM**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS — (Continued)**

related to 2003). As these investment tax credits are of a governmental grant nature, Magyar Telekom recognized the deferred tax asset against the cost of the related investment (see also notes 11, 13). If the tax credits are not utilized in the year when earned, the amount of tax credits carried forward can be utilized at a higher amount as the Government allows the outstanding amounts to be accreted. This accretion is recognized as an increase in the deferred tax asset against a reduction in the income tax expense.

The following table shows the details of the tax credits in HUF millions:

Earned in year	Amount of broadband investment	Amount of tax credit earned	Tax credit utilized	Accretion recognized in tax expense to date	Tax credit carried forward at December 31, 2005
2003 .....	6,638	2,872	(146)	464	3,190
2004 .....	7,230	3,214	-	277	3,491
2005 .....	15,285	6,136	(2,161)	-	3,975
Total .....	<u>29,153</u>	<u>12,222</u>	<u>(2,307)</u>	<u>741</u>	<u>10,656</u>
			Expires in		
				2007	3,190
				2014	7,145
				2015	187
				2016	134
					<u>10,656</u>

Magyar Telekom's deferred tax balances are as follows:

	Balance at Dec. 31, 2003	Income statement effect	Other movements	Balance at Dec. 31, 2004	Income statement effect	Other movements	Balance at Dec. 31, 2005
<u>Deferred tax assets and (liabilities)</u>							
Investment tax credits .....	-	-	6,849	6,849	741	3,066	10,656
Net operating loss carry-forward .....	2,377	1,344	-	3,721	2,354	1	6,076
Investments in subsidiaries .....	(500)	(832)	(2)	(1,334)	434	-	(900)
Other financial assets .....	(36)	(104)	-	(140)	24	140	24
Impairment of receivables, inventory and financial investments .....	3,142	381	(59)	3,464	264	-	3,728
Property, plant and equipment and intangible assets .....	(3,725)	(1,050)	(20)	(4,795)	(1,918)	(852)	(7,565)
Goodwill .....	-	-	-	-	(1,864)	-	(1,864)
Trade and other payables .....	(61)	144	(2)	81	23	-	104
Loans and other borrowings .....	221	(16)	-	205	(49)	-	156
Deferred revenue .....	616	(236)	-	380	(223)	-	157
Provisions for liabilities and charges ..	782	2,034	-	2,816	(1,611)	-	1,205
Total net deferred tax assets .....	<u>2,816</u>	<u>1,665</u>	<u>6,766</u>	<u>11,247</u>	<u>(1,825)</u>	<u>2,355</u>	<u>11,777</u>
Add back: deferred tax liability .....	<u>1,768</u>			<u>1,280</u>			<u>3,189</u>

**MAGYAR TELEKOM**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS — (Continued)**

Deferred tax assets .....	<u>4,584</u>	<u>12,527</u>	<u>14,966</u>
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**MAGYAR TELEKOM**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS — (Continued)**

Deferred tax assets and liabilities are determined by the legal entities of the Group and disclosed as assets or liabilities accordingly in the balance sheet.

The amounts of other movements in tax credits were booked against the cost of the related investment.

The amount of other movement in deferred taxes on other financial assets represent the deferred tax on embedded derivatives derecognized against the opening retained earnings as a result of the change in accounting policy for the measurement of certain embedded derivatives (note 2 (e)).

Included in other movements are HUF -44 million (2004: HUF -24 million) of currency translation adjustments and HUF -807 million (2004: HUF -59 million) deferred tax arising on business combinations.

The reconciliation between the reported income tax expense and the theoretical amount arising by applying the statutory income tax rates is as follows:

	<b>For the year ended December 31,</b>		
	<b>2003</b>	<b>2004</b>	<b>2005</b>
	<b>(in HUF millions)</b>		
IFRS profit before income tax .....	82,857	51,014	102,430
Tax at 18% .....	(14,914)	-	-
Tax at 16% .....	-	(8,162)	(16,389)
Effect of reduced tax rates in foreign countries .....	567	191	451
Impact of tax rate change from 18% to 16% enacted for 2004 .....	(296)	-	-
Impact of tax incentives .....	901	584	897
Tax on items not subject to tax .....	1,714	1,889	2,623
Tax on non deductible expenses .....	(2,586)	(2,189)	(1,093)
Temporary differences reversing at different rates .....	1,097	-	-
Income tax expense .....	<u>(13,517)</u>	<u>(7,687)</u>	<u>(13,511)</u>

Items not subject to income tax consist primarily of the other income from DTAG (note 31), which is not taxable, as well as the share of associates' profit after income tax as it is included net of tax in the IFRS profit before income tax.

The tax authorities may at any time inspect the books and records within five years from the end of the year when tax declarations were submitted and may impose additional tax assessments with penalties and penalty interest. Management is not aware of any circumstances which may give rise to a potential material liability in this respect.

**MAGYAR TELEKOM**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS — (Continued)**

**27 Cash generated from operations**

	<b>For the year ended December 31,</b>		
	<b>2003</b>	<b>2004</b>	<b>2005</b>
	<b>(in HUF millions)</b>		
Profit for the year .....	69,340	43,327	88,919
Income tax expense .....	13,517	7,687	13,511
Share of associates' profits/losses after tax .....	(795)	(1,896)	(330)
Net financial expenses .....	40,002	36,146	31,288
Depreciation and amortization .....	128,334	137,666	114,686
Change in payables .....	2,885	(3,474)	9,662
Change in inventory .....	4,117	2,825	(303)
Change in receivables .....	(2,168)	4,500	(8,034)
Amortization of deferred revenue .....	(2,732)	(1,758)	(1,503)
Other financial expenses paid .....	(5,364)	(3,183)	(3,157)
Other cashflows from operations .....	(6,639)	12,841	(7,802)
Cash generated from operations .....	<u>240,497</u>	<u>234,681</u>	<u>236,937</u>

**28 Share-based compensation**

**(a) Management share option plan**

On April 26, 2002, the annual Shareholders' Meeting approved the introduction of a new management share option plan and authorized the Company's Board of Directors to purchase 17 million "A" series registered ordinary shares, each having a nominal value of HUF 100 as treasury shares. Consequently, the Company issued 4,900,000 shares on July 1, 2002, which were repurchased immediately as treasury shares.

On July 1, 2002, the Company granted 3,964,600 options to participants of the stock option plan at an exercise price of HUF 933 for the first tranche (exercisable in 2003) and HUF 950 for the second and third tranches (exercisable in 2004 and 2005). As the Company's share price as quoted on the BÉT (Budapest Stock Exchange) on the grant date was HUF 833 per share, there was no intrinsic value to the options. The options have a life of five years from the grant date, meaning that the options are forfeited without replacement or compensation on June 30, 2007.

The option with respect to a maximum of one-third of the shares that can be purchased under the first tranche may be exercised from July 1, 2003 until the end of the term. The option with respect to a maximum of a further one-third of the shares that can be purchased under the second tranche may be exercised from July 1, 2004 until the end of the term. The option with respect to the rest of the shares that can be purchased under the third tranche may be exercised from July 1, 2005 until the end of the term.

As the management share option plan does not fall into the scope of IFRS 2 – Share based Payments, the Group did not recognize compensation expense in any of the periods.

**MAGYAR TELEKOM**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS — (Continued)**

The table below shows the movements in the number of management stock options in thousands.

	<u>2003</u>	<u>2004</u>	<u>2005</u>	<u>Average exercise price (HUF)</u>
Opening number of share options .....	3,964	3,655	3,207	944
Number of share options exercised .....	-	-	(991)	944
Forfeited share options .....	(309)	(448)	(287)	944
Closing number of share options.....	<u>3,655</u>	<u>3,207</u>	<u>1,929</u>	<u>944</u>
Number of exercisable options at end of year....	1,218	2,138	1,929	944

**(b) The CEO's share option plan**

The CEO of Magyar Telekom was granted share options in 2000, 2001, 2002, 2003 and 2004. The exercise price of the options is determined in US dollars and the options had no intrinsic values on the grant dates in 2000, 2001, 2002 and 2003, while those granted in 2004 had an intrinsic value of HUF 63 million. One third of the options granted vests after one year, another one third vests two years after the grant date, while the last third vests after three years. The options are exercisable for ten years after the grant date. In 2005 the Group recognized compensation expense in an amount of HUF 84 million among employee related expenses against retained earnings.

The table below shows the details of the CEO's share options.

	<u>Options granted in year</u>					
	<u>2000</u>	<u>2001</u>	<u>2002</u>	<u>2003</u>	<u>2004</u>	<u>Total</u>
Number of options granted (thousand) ...	103	250	303	619	1,462	2,737
Exercised (thousand) – all in 2005 .....	-	(250)	(303)	(413)	(487)	(1,453)
Outstanding (thousand) at December 31, 2005 .....	103	-	-	206	975	1,284
Exercisable (thousand) at December 31, 2005 .....	103	-	-	-	-	103
Exercise price in USD .....	7.36	2.93	3.48	3.62	3.87	
Remaining contractual life at December 31, 2005 (years) .....	4.5	-	-	7.5	8.5	

**MAGYAR TELEKOM**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS — (Continued)**

*(c) Mid-term incentive plan (MTIP)*

In 2004 Magyar Telekom launched a Mid Term Incentive Plan (MTIP) for its top management, whereby the targets to be achieved are based on the performance of the Magyar Telekom share. The MTIP is a cash settled long term incentive instrument which is planned to cover five years, with a new package being launched in each year, and with each tranche lasting for three years.

The first tranche of the program spans the period between January 1, 2004 and December 31, 2006. The second tranche of the program spans the period between January 1, 2005 and December 31, 2007. Participants are employees of Magyar Telekom who are incumbents of certain top and senior managerial positions.

At the beginning of the plan each participant has an offered bonus. This value will be paid out at the end of the plan, depending on the achievement of the two fixed targets, an absolute Magyar Telekom share specific and a relative Index target.

The absolute performance target is achieved when the Magyar Telekom share price, adjusted for dividends paid during the tenure, is more than 35 percent higher at the end of the lock-up period than at the beginning of the plan. The basis of the calculation is the unweighted average closing price of the Magyar Telekom share at the Budapest Stock Exchange during the last 20 trading days before the beginning and the end of the plan. The share price calculated according to the above was HUF 755 at the grant date of the first tranche, and HUF 843 at the grant date of the second tranche.

The relative performance target is linked to the Total Return of the Magyar Telekom share compared to the performance of the Dow Jones Euro STOXX Total Return Index during the vesting period, each at the last 20 trading days. Measurement is the unweighted average Magyar Telekom share price plus dividend payments.

Total compensation expense accrued for the first two tranches of the program as at December 31, 2005 is HUF 256 million (HUF 186 million expensed in 2005 and HUF 70 million in 2004). The expenses are included in employee related expenses recognized against payables to employees.

**MAGYAR TELEKOM**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS — (Continued)**

**29 Commitments**

*(a) Lease commitments*

Finance leases in 2005 relate to the sale and lease back of spaces in buildings accommodating telephone exchanges. Operating lease commitments are mainly in respect of the rental of cell sites, with other leases related to buildings, network and other telecommunications facilities.

Future minimum lease payments under finance and operating leases at December 31, 2004 and 2005 are as follows:

Year	<b>Finance Leases</b>	
	<b>At December 31,</b>	
	<b>2004</b>	<b>2005</b>
	<b>(in HUF millions)</b>	
2005 .....	150	-
2006 .....	137	211
2007 .....	137	213
2008 .....	137	214
2009 .....	137	213
2010.....	137	215
Thereafter .....	417	739
Total minimum lease payments .....	1,252	1,805
Less: amounts representing interest .....	(604)	(944)
Present value of net minimum lease payments .....	648	861
Less: finance lease obligations included in current other borrowings	(45)	(51)
Long-term finance lease obligations included in non current other borrowings .....	603	810
Year	<b>Operating Leases</b>	
	<b>At December 31,</b>	
	<b>2004</b>	<b>2005</b>
	<b>(in HUF millions)</b>	
2005 .....	5,283	-
2006 .....	4,932	5,410
2007 .....	4,583	4,548
2008 .....	4,157	3,736
2009 .....	3,241	3,031
2010 .....	2,984	2,588
Thereafter .....	2,984	10,494
Total minimum lease payments .....	25,180	29,807

The lease commitments represent a high amount of smaller lease agreements, the terms of which vary on a wide range. These lease agreements range from 3 to 20 years with renewal options in most cases.

**MAGYAR TELEKOM**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS — (Continued)**

**(b) Purchase commitments for tangible assets**

As of December 31, 2004, Magyar Telekom had contractual commitments for capital expenditures of HUF 3.2 billion (HUF 6.1 billion in 2004, HUF 3.4 billion in 2003) falling due within 1 year.

In addition to the above, in October 2005 Magyar Telekom won the government tender and signed a contract with the Prime Minister's Office to build and operate the nationwide Unified Digital Radio Network (EDR) system in Hungary. EDR is a 380-400MHz band nation-wide Professional Mobile Radio (PMR) network used by public safety and security services in Hungary. The main users of EDR will be the Police, Fire Departments and Ambulance Services. The rollout of EDR is planned for 2006 and the contract lasts until end of 2015. Magyar Telekom expects to invest HUF 20-22 billion in 2006 in the assets required to build out the EDR service. In line with its contractual obligations Magyar Telekom Group established a fully owned subsidiary, Pro-M to deliver the EDR services. The company is included in the Hungarian operations of the Group's Mobile segment.

**(c) Future lease revenues**

The following table sets forth the future minimum lease payments receivable by the Group for the operating leases of PBX equipment where Magyar Telekom is the lessor.

Year	<u>Lease revenues</u> <u>(in HUF millions)</u>
2006 .....	2,426
2007 – 2009 .....	2,438
2010 and thereafter .....	164
Total minimum lease payments receivable .....	<u>5,028</u>

**30 Contingencies**

Magyar Telekom's most significant contingency is related to the fixed to mobile termination charges in Hungary.

The Hungarian National Communications Authority (NHH) published several decisions in 2004 and 2005 as to how the termination charges of the fixed to mobile calls should be reduced in the interconnect contracts of the fixed line and mobile telecom operators. All mobile telecom operators appealed against the decisions at court and in most cases did not change their contracts with the fixed line telecom operators.

As the interconnect contracts were not amended to reflect the appealed decisions of the NHH, the fixed line operators did not change their charges to their customers for the fixed to mobile calls. There is a high level of uncertainty as to whether any of these NHH decisions will be found properly established by the Hungarian Court. If so, it is also uncertain as of when these new interconnect rates should be applied and whether retrospectively or prospectively and whether the fixed line telecom operators can be forced to repay the difference to their customers for these calls.

These consolidated financial statements reflect the Group's estimate of the most probable outcome. Thereby the fixed line operators can be forced to repay the difference only to their customers with universal packages, while the interconnect charges between the fixed line and mobile companies are accrued based on the fees required by the NHH decisions, regardless of the actual amounts invoiced, the difference being treated as



**MAGYAR TELEKOM**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS — (Continued)**

payables or receivables.

**31 Related party transactions**

All transactions with related parties are on an arm's length basis.

*(a) Deutsche Telekom Group*

Deutsche Telekom AG is the ultimate majority owner of Magyar Telekom Plc. holding 59.21% of the issued shares. Deutsche Telekom (DT) Group has a number of fixed line and mobile telecom service provider subsidiaries worldwide, with whom Magyar Telekom Group has regular transactions.

The Company is directly owned by MagyarCom GmbH, which is a holding company of DTAG. Magyar Telekom pays dividends annually to its owners including MagyarCom GmbH. These payments are made during the year resulting in no outstanding payable at the end of the years.

MagyarCom Services Kft., a Hungarian company owned by Deutsche Telekom, provides Magyar Telekom with management and consulting services.

Deutsche Telekom International Finance (DTIF) is the treasury vehicle of DT Group, which provides loan financing across the DT Group including Magyar Telekom.

DTAG entered into cross-currency swap agreements with Magyar Telekom in 2002, which were closed in 2003. The related derivative interest expenses incurred in 2003 were included in the 2003 income statement.

The Company's Mobile subsidiary, Westel was renamed as T-Mobile Hungary during 2004, while other companies were renamed in 2005. The expenditure incurred in connection with the launch and promotion of the new brands and the loss of value caused by discontinuing the old brands were compensated in value by Deutsche Telekom AG. The compensation received was recognized as other operating income in the "Other operating expenses – net" line of the income statement (note 24).

The table below summarizes the above related party transactions with DT group.

	<u>2003</u>	<u>2004</u>	<u>2005</u>
	(in HUF millions)		
Revenues from telecom services provided to DT Group .....	8,682	6,921	5,155
Costs of telecommunications services provided by DT Group .....	(4,955)	(6,289)	(6,158)
Consulting expenses to MagyarCom Services Kft. ....	(1,287)	(1,488)	(1,140)
Other income from DTAG .....	-	5,920	7,281
Interest expense to DTIF .....	(15,009)	(23,271)	(24,518)
Derivative interest paid to DTAG .....	(3,219)	-	-
Dividends paid to MagyarCom GmbH .....	(11,114)	(43,222)	(43,222)
Accounts receivable from DT Group .....	2,692	1,200	1,943
Accounts payable to MagyarCom Services Kft .....	(456)	(410)	(313)
Accounts payable to other DT Group companies .....	(1,105)	(1,911)	(1,515)
Accrued interests payable to DTIF .....	(4,674)	(5,491)	(6,198)

**MAGYAR TELEKOM**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS — (Continued)**

Loans payable to DTIF and DTAG .....	(200,319)	(237,675)	(286,648)
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Deutsche Telekom has pledged its support for Magyar Telekom's financing needs through to June 30, 2007.

***(b) Governments***

Magyar Telekom provides services to Government departments and businesses in Hungary, Macedonia and Montenegro, but individually none of these customers represent a significant source of revenue.

***(c) Associates***

Hunsat is an enterprise founded by the Company (50%) and Antenna Hungária Rt. (50%). The revenues of Hunsat include commissions received from Hungarian telecommunications companies for the use of services of international satellite agencies. The operational transactions and balances with Hunsat are insignificant. Dividends received from Hunsat amounted to HUF 1,376 million in 2005 (HUF 2,133 million in 2004 and HUF 75 million in 2003).

M-RTL is a Hungarian television broadcast company, in which Magyar Telekom has a 25% effective share of ownership through a holding company, IKO-Telekom Média Holding Rt. M-RTL sells airtime through media agencies to Magyar Telekom, and Magyar Telekom provides telecom services to M-RTL mainly through an interactive service provider. Consequently, the direct operating transactions between M-RTL and the Group are insignificant. M-RTL declared dividends to Magyar Telekom directly and indirectly in an amount of HUF 550 million in 2005 (HUF 500 million in 2004 and HUF 500 million in 2003).

T-Systems Hungary (TSH) is an associated company of Magyar Telekom, in which the Company acquired a 49% share of ownership in September 2004. The acquisition took place through share purchase from T-Systems International, a Deutsche Telekom Group company, and a capital increase in TSH. The inter-company transactions and balances with TSH are not significant. All inter-company transactions and balances with TSH are included in the amounts shown in the table earlier in this note for the Deutsche Telekom Group relations.

***(d) Board and supervisory board members***

The remuneration of the members of the Company's Board of Directors amounted to HUF 10 million in 2005 (HUF 9 million in 2004 and in 2003). The remuneration of the members of the Company's Supervisory Board amounted to HUF 14 million in 2005 (HUF 10 million in 2004, HUF 9 million in 2003).

***(e) Key management***

Key management has been identified as the members of the Group's Management Committee, which is the main operational decision making body of Magyar Telekom.

**MAGYAR TELEKOM**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS — (Continued)**

The table below shows in total the compensation expenses incurred (including social security and payroll related taxes as well) by the Group in relation to the key management.

	<b>At December 31,</b>		
	<b>2003</b>	<b>2004</b>	<b>2005</b>
	<b>(in HUF millions)</b>		
Salaries and other short-term employee benefits .....	801	800	670
Contractual termination expense .....	-	-	350
Share based compensation (note 28) .....	30	101	130
	831	901	1,150

The Group does not provide loans to its key management.

**32 Subsequent events**

On January 12, 2006 Magyar Telekom signed a project financing loan agreement in an amount of HUF 47.4 billion. The loan was granted by the European Investment Bank through Deutsche Telekom International Finance BV to finance the broadband investments of Magyar Telekom. The loan matures in January 2013, and will be repaid in five equal installments with two years grace period. The loan bears a variable interest rate based on the 3-month BUBOR.

In June, 2006 MakTel acquired 10% of its own shares at a public auction held by the Macedonian Government, the minority owner for EUR 60.9 million. Following the share purchase transaction, Magyar Telekom's voting rights in MakTel increased from 51% to 56.7%, while the Macedonian Government's share of ownership fell to 36.81%, with the rest of the shares owned by smaller minority shareholders.

In June 2006 Magyar Telekom and Deutsche Telekom decided to change the Group's Macedonian mobile operator, MobiMak's name to T-Mobile Macedonia (T-Mobile MK), and to introduce the "T" brands in Montenegro as well for both the Fixed line and the Mobile operations.

At the end of 2004, the Group had receivables amounting to HUF 1,468 million and liabilities in the amount of HUF 1,131 million related to the Universal Telecommunication Support Fund. During 2005, HUF 619 million of the receivables was recovered. Due to a Court decision as of September 15, 2005, which annulled the Group's liability toward the above Fund, the remaining receivable and the outstanding liability were written off. With its review decision of April 25, 2006 the Supreme Court upheld the resolution that the Group was still liable with the previously recognized amount of HUF 1,131 million, which indicated that the Group would be able to partly recover the previously written-off receivable. This event has been identified as an adjusting post-balance sheet event and accounted for as such, consequently both a receivable and a liability in relation to the above Fund have been reinstated in the financial statements of 2005.

***Purchase of subsidiaries and business units after the balance sheet date***

On November 29, 2005 Magyar Telekom concluded an agreement to acquire a 100% stake in Orbitel for EUR 8 million. Orbitel is an alternative Bulgarian telecommunications and internet service provider offering countrywide voice and data services to the business community utilizing IP technology. In 2005, the company generated revenues of EUR 11.5 million. The financial closing of the deal took place on February 3, 2006.

**MAGYAR TELEKOM**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS — (Continued)**

On December 12, 2005 Magyar Telekom agreed to acquire a 100% stake in Dataplex Kft. for HUF 5.1 billion, based on the net debt position of the company at the time of the agreement. Dataplex is an operator in the Hungarian IT outsourcing market with revenues of around HUF 1.3 billion in 2005 (unaudited). The financial closing of the transaction took place following the approval by the Hungarian Competition Authority, on April 5, 2006.

In April 2006 Magyar Telekom acquired the 100% ownership of iWiW Kft., the leading Hungarian online social network, for a purchase price of HUF 1.1 billion. iWiW ('who is who') operates the so far only online social network for existing friendships and relationships with more than half a million registered members, making it the fourth most visited web page in Hungary. In 2005 iWiW generated revenues of HUF 5 million.

In May 2006 Magyar Telekom acquired the 100% ownership of Adnetwork Kft, the leading Hungarian online advertisement network for a purchase price of HUF 0.2 billion. Adnetwork was established in 2005 and generated revenues of HUF 28 million in 2005.

In June 2006 Magyar Telekom signed a share purchase agreement to acquire the 100% ownership of KFKI-LNX, one of the leading Hungarian IT companies for a purchase price HUF 8.2 billion plus an optional earn-out payment of HUF 1.5 billion dependent on the 2006 financial performance. The acquisition was closed on September 15, 2006, from which date KFKI Group will become consolidated in the Group. In 2005, KFKI Group's revenues amounted to approximately HUF 17 billion. KFKI-LNX has two 100% owned subsidiaries, ICON and IQSYS.

All of the above business combinations effected in 2006 will be included in the Fixed line segment of the Group.

By the time of the approval of the financial statements the Company has only finalized the purchase price allocation for the Orbitel acquisition. The result of the remaining purchase price allocations will be available by the closing of 2006 and therefore will be included in 2006 financial statements of the Group.

**MAGYAR TELEKOM**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS — (Continued)**

The carrying values and the fair values of Orbitel's net assets at acquisition as well as the consideration paid are disclosed in the table below.

<b>In HUF millions</b>	<b>Fair values</b>	<b>Carrying values</b>
Purchase price of ownership acquired	2,014	
Additional costs directly attributable to the business combination	38	
Consideration paid	2,052	
<b>Net assets acquired</b>	<b>1,015</b>	
Goodwill	1,037	
<b>Net assets acquired:</b>		
Cash	22	22
Other financial assets	6	6
Receivables	378	378
Income tax receivable	8	8
Inventory	12	12
Property, plant and equipment	512	370
Intangible assets	802	211
Other non current assets	4	4
Trade and other payables	(396)	(396)
Loans and other borrowings	(199)	(199)
Net deferred tax liability	(134)	(24)
<b>Total</b>	<b>1,015</b>	<b>392</b>

**MAGYAR TELEKOM**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS — (Continued)**

The carrying values of the net assets of the companies (KFKI group, iWiW and Adnetwork) acquired in individually immaterial business combinations are disclosed in their aggregate amounts in the table below.

<b>In HUF millions</b>	<b>Carrying values</b>
Purchase price of ownership acquired	10,968
Additional costs directly attributable to the business combination	161
Consideration paid	11,129
<b>Net assets acquired</b>	<b>1,339</b>
Goodwill	9,790
<b>Net assets acquired:</b>	
Cash	350
Receivables	2,886
Income tax receivable	32
Inventory	656
Property, plant and equipment	633
Intangible assets	238
Net deferred tax asset	23
Trade and other payables	(2,737)
Loans and other borrowings	(588)
Provisions	(154)
<b>Total</b>	<b>1,339</b>

Dataplex did not have IFRS accounts at the date of the acquisition, which makes the book value disclosure on Dataplex's balance sheet as at the acquisition date impracticable.

**MAGYAR TELEKOM**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS — (Continued)**

**33 Recent Accounting Pronouncements**

The Group has reviewed the new standards, amendments and interpretations to existing standards that have been published that are mandatory for the Group's accounting periods after January 1, 2006 and found the following changes relevant.

IFRIC 4 - Determining whether an Arrangement contains a Lease requires the determination of whether an arrangement is or contains a lease to be based on the substance of the arrangement. It requires an assessment of whether: (a) fulfillment of the arrangement is dependent on the use of a specific asset or assets (the asset); and (b) the arrangement conveys a right to use the asset. As Magyar Telekom often provides complex services to its business clients that require the deployment of certain technological assets as well, revenues that have so far been reported as service revenues may have to be split and some reported as lease revenues. In case lease components are identified and the lease qualifies as a finance lease according to IAS 17, the applicable part of the service revenues that would have been recognized evenly over the service period will be recognized upfront as revenue from sale of assets. Consequently, the depreciation that would have arisen over the useful life of the applicable assets will be recognized as cost of equipment sold at the deployment of the asset. In the relevant cases, finance income will also accrue on the finance lease receivables. This will result in changes in the relevant income statement and balance sheet lines, but the expected change to the net income or the equity of the Group is not expected to be significant. One of the examples that is impacted by the adoption of this interpretation is the Tetra services commenced in 2006. See more details on the Tetra services in note 29 (b).

IAS 39 (Amendment), The Fair Value Option (effective from January 1, 2006). This amendment changes the definition of financial instruments classified at fair value through profit or loss and restricts the ability to designate financial instruments as part of this category. The Group believes that this amendment should not have a significant impact on the classification of financial instruments, as the Group should be able to comply with the amended criteria for the designation of financial instruments at fair value through profit and loss. The Group will apply this amendment from annual periods beginning January 1, 2006.

IFRS 7 - Financial Instruments: Disclosures, and a complementary amendment to IAS 1, Presentation of Financial Statements – Capital Disclosures (effective from January 1, 2007). IFRS 7 introduces new disclosures to improve the information about financial instruments. It requires the disclosure of qualitative and quantitative information about exposure to risks arising from financial instruments, including specified minimum disclosures about credit risk, liquidity risk and market risk, including sensitivity analysis to market risk. The Group will apply IFRS 7 and the amendment to IAS 1 from annual periods beginning January 1, 2007.

**MAGYAR TELEKOM**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS — (Continued)**

**Reconciliation to U.S. GAAP (unaudited)**

Magyar Telekom's consolidated financial statements are prepared in accordance with International Financial Reporting Standards, which in certain respects differ from U.S. GAAP, the generally accepted accounting principles in the USA. The principal differences between IFRS and U.S. GAAP are presented below, together with explanations of the adjustments that affect consolidated profit for each of the three years in the period ended December 31, 2005 and total shareholders' equity as of December 31, 2004 and 2005.

	Notes	For the year ended December 31,		
		2003	2004	2005
(in HUF millions)				
Profit attributable to the equity holders of the Company (Net income) under IFRS .....		57,475	34,641	78,564
Profit attributable to minority interests under IFRS .....		11,865	8,686	10,355
Profit for the year under IFRS .....		<u>69,340</u>	<u>43,327</u>	<u>88,919</u>
Adjustments for U.S. GAAP:				
Revenue recognition .....	(a)	3,712	4,749	4,237
Asset retirement obligation .....	(b)	(136)	(871)	(402)
Employee expenses.....	(c)	-	950	(1,110)
Interest capitalized.....	(d)	359	420	472
Derivatives .....	(e)	-	-	(227)
Other income (rebranding) .....	(f)	-	(5,920)	(7,281)
Purchase price allocation (business combinations) .....	(g)	(6,720)	(6,977)	(4,775)
Goodwill.....	(h)	13,795	13,876	-
Profit before tax .....		<u>11,010</u>	<u>6,227</u>	<u>(9,086)</u>
Tax.....	(i)	(711)	(1,503)	610
Profit after tax .....		<u>10,299</u>	<u>4,724</u>	<u>(8,476)</u>
.....				
Minority interest .....	(j)	<u>(1,370)</u>	<u>319</u>	<u>(828)</u>
Total U.S. GAAP adjustments on Net income .....		<u>8,929</u>	<u>5,043</u>	<u>(9,304)</u>
Profit attributable to the equity holders of the Company (Net income) under U.S. GAAP .....		66,404	39,684	69,260
Profit attributable to minority interests under U.S. GAAP .....		13,235	8,367	11,183
		<u>79,639</u>	<u>48,051</u>	<u>80,443</u>

The amounts in the table above show by topic how much more or less income or expense was recognized in the U.S. GAAP accounts in comparison to the IFRS accounts.



**MAGYAR TELEKOM**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS — (Continued)**

	<u>Notes</u>	<u>At December 31,</u>	
		<u>2004</u>	<u>2005</u>
		(in HUF millions)	
Total Shareholders' equity under IFRS – as reported .....		516,567	527,567
Restatement for IAS 39 .....		(733)	-
Total Shareholders' equity under IFRS – as restated .....		<u>515,834</u>	<u>527,567</u>
Minority interests under IFRS .....		60,097	70,127
Total equity under IFRS - as restated .....		<u>575,931</u>	<u>597,694</u>
<u>Adjustments for U.S. GAAP:</u>			
Revenue recognition .....	(a)	(13,705)	(9,468)
Asset retirement obligation .....	(b)	(1,007)	(1,409)
Employee expenses .....	(c)	960	(213)
Interest capitalized .....	(d)	4,993	5,465
Derivatives .....	(e)	873	646
Purchase price allocation (business combinations) .....	(g)	13,881	8,132
Goodwill .....	(h)	16,693	14,237
Tax .....	(i)	(5,747)	(5,049)
Minority interest .....	(j)	2,132	2,190
Total U.S. GAAP adjustments on Shareholders' equity .....		<u>19,073</u>	<u>14,531</u>
U.S. GAAP adjustment on Minority interest .....	(j)	(2,132)	(2,190)
Total U.S. GAAP adjustments on Equity .....		<u>16,941</u>	<u>12,341</u>
Total Shareholders' equity under U.S. GAAP .....		534,907	542,098
Minority interests under U.S. GAAP .....		57,965	67,937
		<u>592,872</u>	<u>610,035</u>

In previous years the Group's equity reconciliation was presented on the basis of the cumulative income statement impact of the reconciling adjustments between U.S. GAAP and IFRS. The amounts included in the table above show the cumulative adjustments on the net assets by reconciling item. The format of the disclosure has been changed on the basis that the revised format is more informative.

**MAGYAR TELEKOM**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS — (Continued)**

***(a) Revenue recognition***

In Magyar Telekom's IFRS accounts fixed line connection fees collected after October 1997 are recognized immediately together with the directly related expenses. Mobile activation fees are also recognized when customers' subscriptions are activated. In the U.S. GAAP accounts, however, fixed line connection fees and mobile activation fees until December 31, 2003 were deferred and recognized as revenue over the expected customer relationship period as regulated by SAB 101. Directly related expenses of the connections and activations were also deferred up to the amount of the revenues.

As of January 1, 2004 Magyar Telekom adopted EITF 00-21 and SAB 104 in its U.S. GAAP accounts, according to which bundled customer packages are analyzed by the elements of the bundle. Revenues from the individual elements of multiple deliverable packages are recognized in proportion of the relative fair values of the elements. Connections in all cases are bundled with other deliverables such as equipment and/or prepaid usage. As connections and activations are no longer considered separate earnings events, the fair value of this element is considered zero. Accordingly, amounts collected for connections and activations are allocated to the other elements of the packages and recognized according to revenue recognition policies applied to those services (such as equipment sales, prepaid airtime, etc.).

In the U.S. GAAP accounts there is a higher amount of deferred revenues and there are deferred expenses as well related to the direct costs of the activations and connections due to the amounts deferred until 2003, not yet fully amortized to revenue and expense respectively.

***(b) Asset retirement obligation***

On January 1, 2003 Magyar Telekom adopted SFAS 143, "Accounting for Asset Retirement Obligations". SFAS 143 requires that the fair value of a liability for an asset retirement obligation be recognized in the period in which it is incurred if a reasonable estimate of the fair value can be made. The associated asset retirement costs are capitalized as part of the carrying amount of the long-lived asset. As opposed to the U.S. GAAP accounts, Magyar Telekom does not recognize a provision for asset retirement obligations in its IFRS accounts when the criteria to recognize a provision according to IAS 37 are not met.

In the U.S. GAAP accounts these assets have a higher gross book value which implies higher amount of depreciation, and there is a higher amount of provisions, which are accreted until utilized.

***(c) Employee expenses***

Certain severance related expenses recognized as a provision in 2004 in the IFRS accounts related to redundancies in 2005 did not meet the criteria to be recognized as a liability in U.S. GAAP. These expenses were recognized in the U.S. GAAP accounts in 2005.

In addition, different amount of expense was recognized in the IFRS accounts for share based payments according to IFRS 2 than in the U.S. GAAP accounts according to APB 25.

**MAGYAR TELEKOM**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS — (Continued)**

***(d) Interest capitalized***

In the IFRS accounts Magyar Telekom capitalized a gradually decreasing amount of interest in prior years, and did not capitalize any interest in 2004 and 2005. This was the case as all loans taken for capital investment projects in prior years had been gradually repaid by the end of 2003.

In accordance with U.S. GAAP, Magyar Telekom does not differentiate the loans based on the purpose for which they were taken, all are considered for interest capitalization. As a result, a higher amount of interest is capitalized in the U.S. GAAP accounts, which results in a higher balance of property, plant and equipment and consequently a higher amount of depreciation.

***(e) Derivatives***

The revised interpretation of IAS 39 – Financial Instruments – Recognition and Measurement does not consider contracts denominated in a currency that is not the functional currency of either of the contracting parties as a separable host contract and an embedded derivative if the contract currency is widely used in that market. As a result of the change in the interpretation, Magyar Telekom has restated its opening IFRS retained earnings to eliminate the carrying amounts of these embedded derivatives (HUF 873 million) and the related deferred tax liability (HUF 140 million) as at December 31, 2004.

The change in the IFRS interpretation does not have an impact on the U.S. GAAP accounts, in which these embedded derivatives remain to be recognized and re-measured to fair value.

***(f) Other income (rebranding)***

The Company's Mobile subsidiary, Westel was renamed as T-Mobile Hungary during 2004, while other companies of the Group were renamed in 2005 (note 31). The compensation received from DTAG is shown as other income in the IFRS income statement.

Under U.S. GAAP, Magyar Telekom recognizes the compensation received as a contribution of capital by the majority shareholder. This results in a lower net income in the U.S. GAAP accounts, but the Shareholders' equity is no different in this respect.

***(g) Purchase price allocation (business combinations)***

Due to the different intangible asset recognition rules of IFRS and U.S. GAAP in earlier years, the fair value of the net assets of T-Mobile H, MakTel and Emitel on the 2001 acquisition was different. In the U.S. GAAP accounts, in general, a higher amount of intangible assets was recognized in those years. Consequently, the amortization expense of these intangibles is higher than in the IFRS accounts.

In addition, from March 31, 2004 in the IFRS accounts the total amount of fair value adjustments on the net assets of the acquired companies are recognized on consolidation, while in the U.S. GAAP accounts the fair value adjustments are only recognized in proportion to the share of ownership acquired, as was the policy in the IFRS accounts before the above mentioned date. This results in a lower amount of depreciation and amortization expense in the U.S. GAAP accounts for intangible and tangible asset adjustments arising on business combinations since March 31, 2004.

**MAGYAR TELEKOM**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS — (Continued)**

***(h) Goodwill***

Due to the different asset and liability recognition rules of IFRS and U.S. GAAP in earlier years, the fair value of the net assets of T-Mobile H, MakTel and Emitel on the 2001 acquisition was different. In the U.S. GAAP accounts, in general, a higher amount of intangible assets was recognized in those years on business combinations. Consequently, the goodwill recognized in the U.S. GAAP accounts was lower than in the IFRS accounts.

Further, according to SFAS 141 and 142, goodwill is not amortized under U.S. GAAP in the 3-year period presented, which resulted in significant differences between the IFRS and U.S. GAAP accounts in 2003 and 2004. From January 1, 2005 goodwill is also not amortized in IFRS, consequently no additional differences arise in this respect.

Goodwill is recorded in the currency of the acquired company under U.S. GAAP, while in earlier years goodwill was recognized in HUF under IFRS. This results in currency translation adjustments in the Shareholders' equity when compared to IFRS, the impact of which is included in the Goodwill line of the reconciliation.

***(i) Tax***

Most of the above described U.S. GAAP adjustments result in temporary differences for which deferred tax is recognized.

***(j) Minority interest***

Some of the above described adjustments are related to subsidiaries in which Magyar Telekom's share of ownership is less than 100 percent. In these cases the minority interests take their share of the adjustments.

Further, the Company had several call options for the remaining shares of certain consolidated subsidiaries. Co-owners of subsidiaries also had call and put options for shares held by Magyar Telekom in certain consolidated subsidiaries. The recognition and measurement of these options differed in certain cases under IFRS and U.S. GAAP. The differences between the recognition and measurement of these options resulted in U.S. GAAP adjustments in 2003 and 2004, which were accounted for in the minority interest lines of the reconciliation.