

# Magyar Telekom

The 2011 financial year



Life is for sharing



# To our shareholders

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As the market leader, we uniquely bring together the needs of our customers with the latest in technology, whether in communications, information or entertainment. Everything we do starts with the customer. Our goal is to turn modern communications into experience which makes a difference in people's lives. We are here to make Magyar Telekom everybody's favorite service provider.

Magyar Telekom is the principal provider of fixed line telecommunications services in Hungary, with approximately 1.8 million fixed voice access lines as of December 31, 2011. We are also Hungary's largest mobile telecommunications services provider, with almost 5.3 million mobile subscribers (including users of prepaid cards) as of December 31, 2011. We are also the principal telecommunications service provider in Macedonia and Montenegro and alternative service provider in Bulgaria, Romania and in the Ukraine. We provide fixed line and mobile telecommunications, Internet and television products and services for consumers and information and communication technology ("ICT") solutions for business and corporate customers.

Magyar Telekom Távközlési Nyilvánosan Működő Részvénytársaság (in English, Magyar Telekom Telecommunications Public Limited Company) is a limited liability stock corporation incorporated and operating under the laws of Hungary. Magyar Telekom Telecommunications Public Limited Company (the "Company" or "Magyar Telekom Plc.") with its subsidiaries form Magyar Telekom Group ("Magyar Telekom" or "the Group"). We operate under a commercial name, Magyar Telekom Nyrt. or Magyar Telekom Plc.

Our ordinary shares are listed on the Budapest Stock Exchange ("BSE") and the Company also maintains an American Depositary Receipt program on a Level I basis with American Depositary Shares ("ADSs") traded on OTC markets. The ADSs were delisted from the New York Stock Exchange on November 12, 2010. On November 14, 2011 Magyar Telekom also filed with the U.S. Securities and Exchange Commission (the "SEC") a Form 15F to terminate registration of its shares and ADSs in the US, which became effective on February 12, 2012. The Company maintains its primary listing on the BSE and continues to make English translations of its annual reports, financial statements and investor releases.

Our headquarters is located at 55. Krisztina krt., 1013 Budapest, Hungary.

As of December 31, 2011, the share capital of Magyar Telekom Plc. was HUF 104,274,254,300, consisting of 1,042,742,543 Series "A" ordinary shares. On April 12, 2011, the shareholders approved the payment of cash dividends of HUF 52,117 million, equal to HUF 50 per share, for the year ended December 31, 2010.

In this annual report the terms "Magyar Telekom", the "Group", the "Company", "we", "us" and "our" refer to Magyar Telekom Plc. and, its direct and indirect subsidiaries as a group; the term "Magyar Telekom Plc." refers to Magyar Telekom Plc. without its subsidiaries; the term "TMH" refers to the mobile operations of Magyar Telekom Plc.; the term "DT" refers to Deutsche Telekom AG; the term "DT Group" refers to DT and its subsidiaries as a group.

## Selected financial data of Magyar Telekom Group

	Year ended December 31,		
	2009	2010	2011
	(in HUF millions, except per share amounts)		
<b>Consolidated comprehensive income data</b>			
Amounts in accordance with IFRS			
Revenues	643,989	609,579	597,617
Operating profit	147,133	112,094	63,167
Profit attributable to the owners of the parent	77,618	64,378	(7,457)
EBITDA <sup>(1)</sup>	249,053	212,966	196,082
EBITDA (adjusted for special items) <sup>(2)</sup>	262,808	248,304	244,983
EBITDA margin (%)	38.7	34.9	32.8
EBITDA margin (adjusted for special items) (%)	40.8	40.7	41.0
<b>Consolidated financial position data</b>			
Amounts in accordance with IFRS			
Total assets	1,166,377	1,109,006	1,098,028
Net assets	605,420	594,712	556,091
Common stock	104,275	104,275	104,275
Total equity of the owners of the parent	538,480	531,512	488,015
Net debt	269,429	289,446	288,377
<b>Consolidated cash flows data</b>			
Amounts in accordance with IFRS			
Net cash from operating activities	193,795	164,670	168,781
Free cash flow <sup>(3)</sup>	82,043	77,495	92,026
Net cash used in investing activities	(130,299)	(52,848)	(77,752)
Net cash used in financing activities	(96,560)	(130,589)	(93,228)
<b>Employees</b>			
Number of employees (closing full equivalent)	10,828	10,258	10,111
<b>Magyar Telekom share – key figures</b>			
Weighted average number of shares (basic and diluted)	1,041	1,041	1,042
Earnings per share (basic and diluted in HUF)	74.54	61.83	(7.15)
Dividend per share (HUF)	74	50	50

(1) EBITDA: Earnings before net financial result, taxes, depreciation and amortization.

(2) EBITDA adjusted for special items: EBITDA excluding investigation-related costs, severance payments and accruals and the special telecommunications tax.

(3) Free cash flow: operating cash flow and investing cash flow adjusted for proceeds from / payments for other financial assets.

## Key operating statistics of Magyar Telekom Group

Telekom Hungary	Dec 31, 2010	Dec 31, 2011	% change
<b>Fixed line operations</b>			
<b>Voice services</b>			
Total voice access	1,688,405	1,604,035	(5.0)
Total outgoing traffic (thousand minutes)	2,860,882	3,049,192	6.6
Blended MOU (outgoing) <sup>(1)</sup>	144	166	15.3
Blended ARPA (HUF) <sup>(1)</sup>	3,518	3,138	(10.8)
<b>Data products</b>			
Retail DSL market share (estimated) (%) <sup>(2)</sup>	63	64	n.a.
Cable broadband market share (estimated) (%) <sup>(2)</sup>	20	22	n.a.
Number of retail DSL customers	476,923	499,923	4.8
Number of cable broadband customers	181,056	212,631	17.4
Number of fiber optic connections	19,109	31,611	65.4
Total retail broadband customers	677,088	744,165	9.9
Blended broadband ARPU (HUF)	4,243	3,950	(6.9)
Number of wholesale DSL access	130,965	107,215	(18.1)
<b>TV services</b>			
Number of cable TV customers	370,212	289,693	(21.7)
Number of satellite TV customers	254,188	281,312	10.7
Number of IPTV customers	124,374	226,385	82.0
Total TV customers	748,774	797,390	6.5
Blended TV ARPU (HUF)	2,949	3,048	3.4

(1) Including PSTN, VoIP  
and VoCable.

(2) Data relates  
to Magyar Telekom Plc.

Telekom Hungary	Dec 31, 2010	Dec 31, 2011	% change
<b>Mobile operations</b>			
Mobile penetration (%) <sup>(3)</sup>	120.2	117.3	n.a.
Mobile SIM market share (%) <sup>(2)</sup>	43.4	45.0	n.a.
Number of customers (RPC)	4,779,227	4,817,296	0.8
Postpaid share in the RPC base (%)	43.6	46.2	n.a.
MOU <sup>(4)</sup>	154	161	4.5
ARPU (HUF)	3,492	3,393	(2.8)
Postpaid	6,071	5,695	(6.2)
Prepaid	1,635	1,535	(6.1)
Overall churn rate (%)	20.2	19.5	n.a.
Postpaid (%)	14.9	14.5	n.a.
Prepaid (%)	24.0	23.6	n.a.
Ratio of non-voice revenues in ARPU (%)	18.8	21.0	n.a.
Average acquisition cost (SAC) per gross add (HUF)	6,616	6,449	(2.5)
Number of mobile broadband subscriptions	568,060	971,469	71.0
Mobile broadband market share based on total number of subscriptions (%) <sup>(2)</sup>	47.8	48.7	n.a.
Mobile broadband market share based on traffic generating subscribers (%) <sup>(2)</sup>	48.6	47.7	n.a.
Population-based indoor 3G coverage (%) <sup>(2)</sup>	65.4	66.0	n.a.

(2) Data relates

to Magyar Telekom Plc.

(3) Data relates to the mobile penetration in Hungary, including customers of all three service providers.

(4) Restated.

<b>T-Systems Hungary</b>	<b>Dec 31, 2010</b>	<b>Dec 31, 2011</b>	<b>% change</b>
<b>Fixed line operations</b>			
<b>Voice services</b>			
Business	43,795	42,137	(3.8)
Managed leased lines (Flex-Com connections)	3,454	2,360	(31.7)
ISDN channels	141,342	135,246	(4.3)
Total lines	188,591	179,743	(4.7)
Total outgoing traffic (thousand minutes)	331,189	282,873	(14.6)
MOU (outgoing)	206	188	(8.6)
ARPU (HUF)	4,983	4,578	(8.1)
<b>Data products</b>			
Number of retail broadband access	14,543	15,561	7.0
Retail DSL ARPU (HUF)	9,393	8,339	(11.2)
<b>Mobile operations</b>			
Number of customers (RPC)	429,191	447,930	4.4
Overall churn rate (%)	4.4	6.3	n.a.
MOU	289	288	(0.3)
ARPU (HUF)	5,354	4,918	(8.1)
Ratio of non-voice revenues in ARPU (%)	33.1	35.6	n.a.
Average acquisition cost (SAC) per gross add (HUF)	3,537	5,166	46.1
Number of mobile broadband subscriptions	56,390	77,045	36.6

Macedonia	Dec 31, 2010	Dec 31, 2011	% change
<b>Fixed line operations</b>			
<b>Voice services</b>			
Fixed line penetration (%)	17.2	15.9	n.a.
Total voice access	343,019	311,240	(9.3)
Total outgoing traffic (thousand minutes)	864,662	811,824	(6.1)
<b>Data and TV services</b>			
Retail DSL market share (estimated) (%)	84	83	n.a.
Number of retail DSL customers	130,127	137,563	5.7
Number of wholesale DSL access	21,091	23,847	13.1
Number of total DSL access	151,218	161,410	6.7
Number of IPTV customers	30,123	40,129	33.2
<b>Mobile operations</b>			
Mobile penetration (%)	122.8	122.8	n.a.
Market share of T-Mobile Macedonia (%)	51.3	50.0	n.a.
Number of customers (RPC)	1,295,285	1,265,243	(2.3)
Postpaid share in the RPC base (%)	32.3	32.0	n.a.
MOU	135	142	5.2
ARPU (HUF)	2,690	2,533	(5.8)
<b>Montenegro</b>			
<b>Fixed line operations</b>			
<b>Voice services</b>			
Fixed line penetration (%)	26.6	26.4	n.a.
Total voice access	171,684	168,361	(1.9)
Total outgoing traffic (thousand minutes)	369,511	332,934	(9.9)
<b>Data and TV services</b>			
Retail DSL market share (estimated) (%)	86	85	n.a.
Number of DSL access	68,540	78,164	14.0
Number of IPTV customers	40,042	48,834	22.0
<b>Mobile operations</b>			
Mobile penetration (%) <sup>(5)</sup>	199.5	186.9	n.a.
Market share of T-Mobile Crna Gora (%) <sup>(5)</sup>	37.0	34.7	n.a.
Number of customers (RPC) <sup>(5)</sup>	457,813	401,958	(12.2)
Postpaid share in the RPC base (%)	33.4	32.3	n.a.
MOU	105	117	11.4
ARPU (HUF)	2,430	2,521	3.7

(5) Data published  
by the Montenegrin Agency  
for Electronic  
Communications  
and Postal Services (EKIP).

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## Letter to our shareholders



### Dear Shareholders,

The year 2011 was a successful year for Magyar Telekom. We saw several positive signs beginning to emerge in the underlying business trends as many of the strategic initiatives that we launched in the last few years are starting to bear fruit. As a result, declines in revenues and underlying EBITDA (EBITDA excluding severance expenses, investigation-related costs and the telecom tax) were more moderate than expected in 2011 and we have outperformed on our previously announced guidance for declines of 3-5% and 4-6%, respectively. The better than expected revenue decline of 2% for 2011 was driven by our strong operational performance assisted by a more favorable than anticipated business environment especially in our non-traditional markets such as mobile internet, TV and SI/IT. The good revenue performance was coupled with a 1.3% decline in underlying EBITDA which also led to margin improvement on an underlying level, reflecting our continued strong focus on cost efficiency. Our stringent approach to managing expenses was also reflected in our investment activities and capital expenditure for 2011 decreased by 9%, well ahead of our anticipated saving of 5%.

In the Hungarian fixed line market, our main challenge has been to slow down the level of customer churn. To achieve this, our efforts have concentrated on moving more and more customers onto 2Play and 3Play packages and our efforts mean that around half of our fixed line customers now take a multi-play package. The rise in the popularity of our interactive TV services was a key factor behind the increased take-up of our bundled products. In addition to the unique offering of IPTV via our cable network, at the end of November 2011 we introduced a special hybrid technological solution: satellite TV with an internet connection, which combines the benefits of IPTV's interactivity with satellite's better accessibility. We also achieved extremely positive results with a new strategic initiative called "Hoppá", introduced in the beginning of 2011. With this package, all Hungarian fixed line numbers and T-Mobile numbers can be called unlimited for a fixed monthly tariff. More than a quarter of our total fixed voice customers subscribed to this package by the end of 2011, with the great majority on two-year contracts. Beyond the positive trend in our churn figures, usage has also increased, which we believe reflects an improved perception of our fixed line voice service.

In the Hungarian mobile market, we managed to increase slightly our mobile voice market share to 45% despite a highly penetrated market and strong competition. Nonetheless, we were not immune from the weak wider market conditions generally as lower tariff levels and the cut in mobile termination rates hit our voice revenues markedly. I would also like to highlight our achievements in the mobile broadband market. In 2011, the sales focus completely shifted to smartphones such that smartphone penetration and the attached sales of mobile packages showed a spectacular increase during the year, supporting the growth in non-voice revenues. Certainly, this rise in the popularity of smartphone usage drives demand for fast and stable mobile broadband services, and we continued to invest in modernizing our mobile network. HSPA+ based mobile internet services with a nominal download speed of 21 Mbps already became available at 600 locations by the end of 2011. Further to this achievement, we became the first operator in Hungary to launch commercial LTE services, as at 1 January 2012. According to current plans, coverage will be expanded to the whole of Budapest by the end of 2012.

In order to support our traditional telecommunications services, Magyar Telekom operates in a number of non-core areas, such as energy, e-health, finance and insurance to support customer retention and slow down the erosion of high margin revenues. We sell electricity and gas at a discount compared to the universal service price charged to those residential customers who are existing or future subscribers to T-Home services. We are glad to see that our energy business serves as a very effective retention tool, as customers with energy subscriptions are 80% less likely to move away from other Magyar Telekom services. We believe that the retail energy business will be a key driver of our revenue turnaround going forward.

In the T-Systems Hungary segment, revenues increased by 4% driven by the strong performance of the SI/IT business. While in 2010, the majority of our corporate clients remained cost cautious and postponed their SI/IT investments, this trend reversed in the second half of 2011 as these businesses began to release deferred budgets, generating notable revenue streams at T-Systems. Despite the increase in private sector revenue streams, public orders remained at a subdued level, and the restrictive measures imposed by the government are still blocking any new public IT deals.

2011 was a challenging year for our Macedonian subsidiary, due to the unfavorable economic environment and fiercer than expected mobile competition. Nonetheless, T-Mobile Macedonia managed to maintain its clear market leading position with a 50% market share. Still, the revenue plans of the Macedonia segment prepared by the Company in 2011 had to be reduced. Even though we and the local management will try to compensate for the loss in cash flows with stricter cost cutting and planned reduction of capital expenditures, it will not be possible to fully compensate for the decline in revenues. As a result, an impairment loss was recognized for the Macedonia segment in 2011.

In Montenegro, we further strengthened our leading position in the pay-TV market and we also became the leader in the mobile post-paid market by the year end, which should help to stabilize the outlook for our mobile voice revenues.

Looking ahead, I do not expect 2012 to be an easy year for Magyar Telekom. The economic outlook remains full of challenges, with leading indicators suggesting a deterioration in outlook in all three countries we are operating in against a backdrop of a wider European economy continuing to struggle with debt related and economic issues. These factors will have a direct impact on our consumers whether individuals, businesses or in the public sector. Existing competition will not get any easier either as we will be in fact facing some new competitors. Although we expect revenues to stabilize this year thanks to our new revenue sources, these new revenue streams have lower profitability and are expected to have an impact on our profit margins. Consequently, while we foresee revenues to be in the range of flat to a maximum decline of 2% year-on-year, we expect underlying EBITDA to deteriorate by 4-6% in 2012. Capital expenditure, not including any spectrum acquisitions, is expected to remain flat to support our ongoing network modernisation and internal projects to improve operational efficiency.

It is our intention that our dividend policy continues to provide an attractive level of remuneration for our shareholders. As such, our Board of Directors proposed a dividend payment of HUF 50 per share for the financial year 2011, for approval at the Annual General Meeting.

While 2012 will be a challenging year for Magyar Telekom, I believe that we start the year better prepared to face the challenges of the current demanding economic and competitive environment than we might otherwise have been had we not taken the strong and decisive actions of the past few years. I also believe that we are in a more favorable position than ever before to capitalize on the opportunities available to us from the new revenue sources that have come onstream and I therefore look forward to the challenges of the year ahead with confidence.

Budapest, April 16, 2012



**Christopher Mattheisen**  
Chairman and Chief Executive Officer

# Management report

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## Management report

Group revenues in 2011 declined by 2.0% to HUF 597.6 bn compared with 2010, surpassing our and the market's expectations. This fall in sales reflected the prevailing weak performance of voice revenues. Despite the success of our flat-priced "Hoppá" package in Hungary, group level retail voice revenues dropped by 13.9% as fixed-to mobile and multi-play migration continued to cut deep into fixed voice sales. On the mobile front, MTR cuts and the saturation of the market led to a 6.4% decline in voice revenues. These negative trends were largely offset by outstanding revenue generation from the SI/IT, TV and mobile broadband businesses. Equipment sales also rose significantly as a result of higher demand for smartphones. In addition, the retail energy service launched in Hungary at the end of 2010 contributed HUF 4.5 bn to 2011 revenue performance. With respect to our international subsidiaries, the deteriorating economic environment and strong competition in Macedonia led to an 8.0% fall in revenues in forint terms. In Montenegro, revenues decreased modestly by 0.5% in forints as the rise in both fixed and mobile internet revenues and dynamically increasing IPTV sales offset the negative effects of declining voice revenues.

EBITDA decreased by 7.9% to HUF 196.1 bn, with an EBITDA margin of 32.8% in 2011. This decline was mainly driven by the one-off amount of HUF 21.9 bn charged in relation to the settlement with the SEC and DOJ, of which HUF 16.2 bn hit our EBITDA. Underlying EBITDA (i.e. EBITDA excluding special telecom tax, investigation-related costs and severance payments) decreased by 1.3% to HUF 244.9 bn, such that the underlying EBITDA margin increased by 30 basis points to 41.0%. The small growth in underlying EBITDA margin reflects our efforts to maintain operating efficiency despite the negative revenue trends.

Despite the strong underlying EBITDA performance, we reported a net loss attributable to owners of the parent company of HUF 7.5 bn in 2011. This headline loss is primarily due to three one-off items: the settlement with the SEC and DOJ that had a total impact of HUF 21.9 bn; the impairment relating to the Macedonia segment amounting to HUF 31.4 bn; and the Hungarian Parliament's enactment of the higher income tax rate from 2013 leading to an increase in deferred tax expense of HUF 15.0 bn.

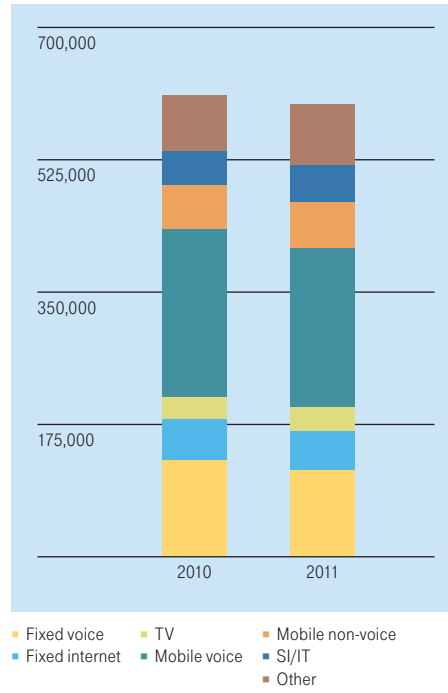
Investment in tangible and intangible assets (capex) decreased by HUF 8.0 bn to HUF 83.8 bn in 2011. On a segmental basis, Telekom Hungary accounted for HUF 65.6 bn of total capex while HUF 4.3 bn is related to T-Systems Hungary. In Macedonia and Montenegro, capex for 2011 was HUF 10.0 bn and HUF 4.1 bn, respectively.

Magyar Telekom introduced a new reporting structure from the beginning of 2011. The Group's new operating segments are Telekom Hungary (which includes the former CBU, the small- and medium sized business (SMB) customers of the former BBU and the relevant parts of the Headquarters and Technology Units) and T-Systems Hungary (which includes the former BBU, without the SMB customers, that have been classified within Telekom Hungary, as well as the relevant parts of the Headquarters and Technology Unit). The Macedonia and Montenegro segments remain unchanged.

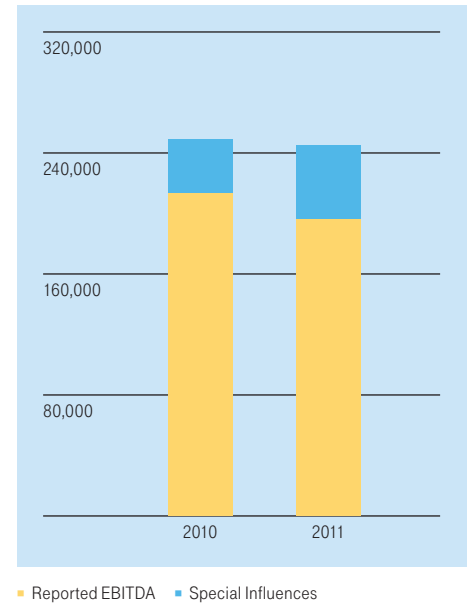
The 31.8% year-on-year increase in depreciation and amortization reflects a one-off non-cash accounting measure concerning our Macedonian operation. Magyar Telekom recognized an impairment loss of HUF 31.4 bn relating to the goodwill on the Macedonia segment based on the fair value less cost to sell calculations. The main reason for the impairment is a 7-19% reduction in the 10-year revenue growth plans of the Macedonia segment prepared in 2011, compared to the plans prepared a year before. This was due to the unfavourable economic environment and fiercer than expected mobile competition resulting in significant pricing pressure and increasing level of handset subsidies.

On December 29, 2011 Magyar Telekom announced that it has entered into final settlements with the DOJ and the SEC to resolve their investigations relating to the Company regarding certain contracts relating to the activities of the Company and/or its affiliates in Montenegro and Macedonia. The aggregate amount payable by the Company in settlement of the DOJ's and SEC's investigations is USD 90.8 million (HUF 21.9 bn) which was fully provided for by the end of 2011 and paid in January 2012.

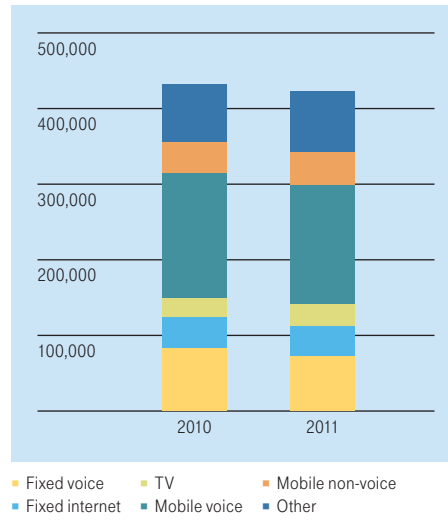
Magyar Telekom Group revenue breakdown (in HUF millions)



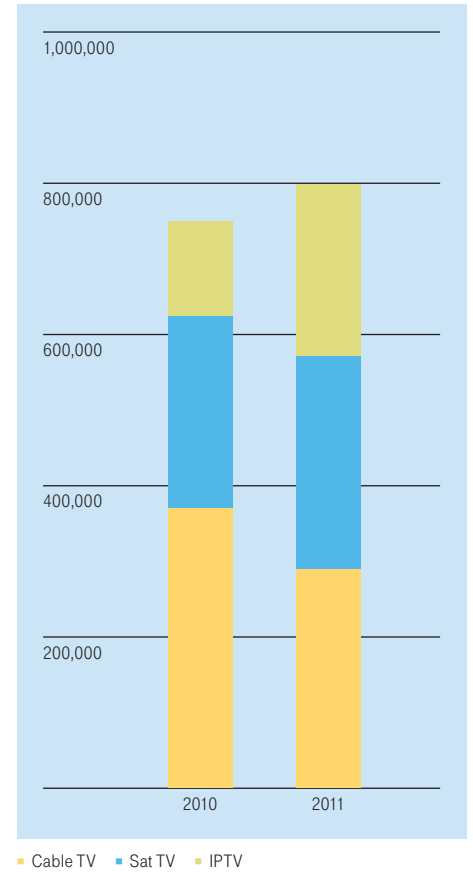
Reported and underlying EBITDA (in HUF millions)



Telekom Hungary revenue breakdown (in HUF millions)



Telekom Hungary TV subscriptions

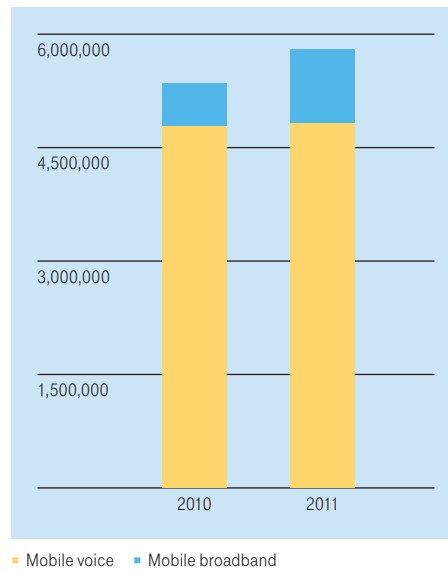


## Telekom Hungary

Telekom Hungary provides voice, broadband and TV services on both fixed line and mobile networks for residential, small office home office (SoHo), and small- and medium-sized business customers in Hungary. Also, all of our energy operation is included in the Telekom Hungary segment.

Revenues decreased by 2.1% to HUF 422.8 bn in 2011, mainly driven by the weaker revenue generation ability of our voice businesses as crisis effects continued to weigh heavily on Hungarian households. Reported EBITDA declined by 11.4% to HUF 128.2 bn; however, this does not reflect our operational performance as it includes one-offs related to the DOJ and SEC investigation settlements. Underlying EBITDA actually declined by 1.1%, thus underlying EBITDA margin increased by 30 basis points to 40.6% in 2011.

Telekom Hungary mobile subscribers (pcs)



In the fixed line market, the effects of the recession, mobile substitution and cable competition all put downward pressure on the traditional voice business. Fixed voice revenues declined by 13.3% in 2011 but the introduction of our flat-priced package called "Hoppá" has already positively reshaped revenue generation fundamentals. By the end of the year, more than a quarter of our fixed voice customers had migrated to the Hoppá package, 90% of whom signed a two-year contract. Fixed voice churn thus decreased from 8.8% in 2010 to 5.0% in 2011. Moreover, the Hoppá package is strongly incorporated into our bundling strategy and more than half of our fixed voice customers were subscribed to at least two of our services by the end of the year. While Hoppá did contribute to a 10.8% drop in average revenue per access, its retention and bundling benefits will pay off in the years to come.

Fixed broadband revenues also continued to be under some pressure, albeit the extent of decline at 2.9% for 2011 is a clear slow-down compared to previous years. As household-based broadband penetration is still around only 55%, this market continues to present significant growth opportunity. In 2011, we succeeded in increasing our subscriber base by 9.9%. Despite this, tough competition especially from cable providers, and strong migration to bundled packages had a negative effect of 6.9% on ARPU.

In the TV market, the positive trends prevailed in 2011 as revenues increased by 10.5% due to the expansion of our subscriber base and a positive change in our customer mix. The rise in the popularity of our IPTV services was especially apparent, as the number of IPTV customers grew by 82.0% to over 226,000 due to strong migration from cable TV customers. Moreover, subscriptions to satellite TV increased by 11% as we are able to reach more households via this technology. TV ARPU increased by 3.4% thanks to migration to more expensive interactive packages which more than offset the negative revenue impact of an increasing multiplay ratio. Looking forward, there is strong potential in our new Hybrid TV offer, which combines the benefits of IPTV's interactivity with satellite's better accessibility.

Towards the end of 2010, Magyar Telekom entered the retail energy resale business, which fits well into our general multiplay strategy. By the end of 2011, the number of gas and electricity point of deliveries surpassed 35,000 and the business generated HUF 4.5 bn in revenues. Although the energy resale business has a low margin content relative to our other services, it has considerable retention benefits as customers with energy subscriptions are ca. 80% less likely to churn from other Magyar Telekom services.

Hungarian mobile revenues were affected by several factors, which resulted in a moderate decrease in revenues to HUF 236.6 bn. Retail voice revenues declined by 2.1%, driven mainly by the 2.8% decrease in ARPU as more of our customers join closed user groups. However, this phenomenon was accompanied by some positive trends, namely the 4.5% rise in average usage and the increase in the share of post-paid subscriptions to 46.2% by the end of 2011. Furthermore, our total number of customers increased by 0.8% in 2011 in a generally saturated market, which led to a 1.6 percentage point increase in our market share to 45.0%. The 13.2% decline in voice wholesale revenues reflected the 16.1% cut in mobile termination rates in December 2010.

The developments in mobile voice revenues are strongly related to the realignment in the mobile broadband market as 2011 saw a steep increase in the popularity of smartphones in Hungary, driving non-voice revenues 7.2% higher despite flat messaging revenues. In previous years, the main driver behind the mobile broadband expansion was the increase in dongle-based subscriptions, but the market is changing rapidly as at least half of Magyar Telekom's 971,000 mobile broadband subscriptions were handset-based at year-end. Within the post-paid segment, more than four out of five phones sold were smartphones at the end of 2011, compared to two out of five a year earlier. Moreover, 70% of our new smartphone customers asked for a mobile internet package attached.

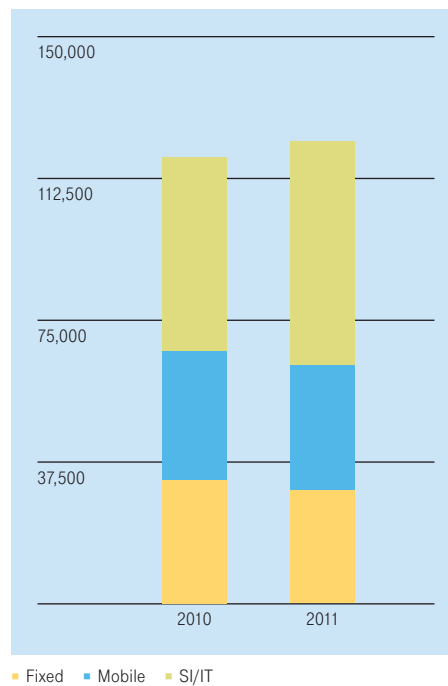
One of the key ingredients of maintaining our competitive edge in mobile is the continuous improvement in the quality of our network. We continued our network modernization program in 2011 and now offer HSPA+ service with 21 Mbps download speed in 600 locations. Furthermore, as planned, Magyar Telekom was the first to offer commercial LTE services as of 1 January 2012. The fourth generation technology currently covers some 40% of Budapest's population, but we expect to cover the whole capital by the end of the year and will evaluate further investment locations based on our experience in Budapest.

## T-Systems Hungary

T-Systems Hungary offers fixed line services including fixed voice, data, system integration and IT together with mobile services for corporate and public sector clients.

Revenues at T-Systems Hungary increased by 3.7% to HUF 122.2 bn in 2011. The prevailing hardships in the fixed voice and mobile voice markets were more than offset by the 15.2% increase in SI/IT revenues. Underlying EBITDA rose by 13.2% to HUF 22.5 bn. Consequently, the underlying EBITDA margin increased by 1.5 percentage points to 18.4%.

T-Systems Hungary revenue breakdown  
(in HUF millions)



The economic environment in Hungary remained challenging in 2011 keeping telecommunication spending amongst our business customers at depressed levels. Although internet and TV revenues improved somewhat in 2011, this was unable to counterbalance falling voice and data revenues and fixed line revenues thus declined by 7.9%. The 11.6% decline in fixed voice revenues reflected strong fixed-to-mobile substitution as we lost 4.7% of our customers while decreasing usage drove ARPU levels down by 8.1%.

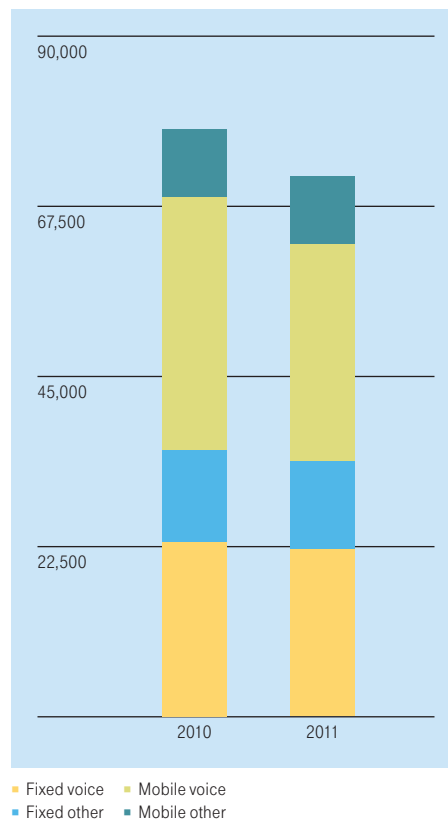
Mobile revenues decreased by 2.6% to HUF 33.1 bn as the aforementioned trends in the residential segment were similar to what we experienced in the corporate segment. The effects of the 7.0% decline in voice revenues were somewhat offset by the 3.3% rise in non-voice revenues as mobile broadband subscriptions rose by more than a third.

T-Systems Hungary's 2011 SI/IT revenues rose by 15.2% to HUF 59.1 bn. Although this performance is positive in light of previous years' weaker results, some of the drivers behind the improved figures are temporary in nature. As a general observation, the economic recession hit the 2009-2010 SI/IT market severely, but corporations and public institutions could not postpone necessary investments further without endangering operations. As another one-off factor, the consolidation of Daten-Kontor Group into T-Systems Hungary since February 2011 also contributed positively to better results.

## Macedonia

Economic concerns and intense competition dampened the performance of all of our operating segments in Macedonia, leading to a revenue decline of 8.0% to HUF 71.4 bn, with underlying EBITDA decreasing by 6.5%. Thus, the underlying EBITDA margin increased slightly to 53.2%. The results of our Macedonian operations in forint terms were positively impacted by the 0.9% year-on-year weakening of the forint against the Macedonian denar on average.

Macedonia revenue breakdown  
(in HUF millions)



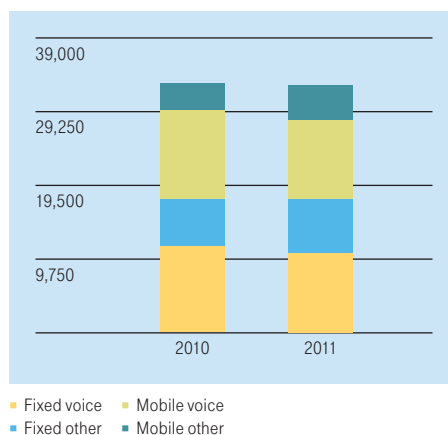
Fixed line retail voice revenues declined by 12.9% to HUF 33.7 bn, driven by strong competition from alternative operators and increasing mobile substitution. Although TV revenues were up by 19.2% thanks to a rise in the popularity of IPTV, and the decline in broadband revenues was limited at 1.2%, this could not compensate for negative results in the voice segment and total fixed line revenues decreased by 4.2%.

Mobile revenues in Macedonia decreased by 11.3% to HUF 37.6 bn. The strong competition that put downward pressure on mobile voice revenues through lower tariff levels and a lower average subscriber base could not be offset by the increase seen in usage. The penetration rate remained stable at 122.8% and T-Mobile Macedonia maintained its clear market leader position, although its market share declined from 51.3% to 50.0% by the end of 2011. Non-voice revenues also decreased as higher mobile internet sales could not compensate for the decrease in messaging revenues.

## Montenegro

Revenues in Montenegro declined modestly by 0.5% while underlying EBITDA increased by 2.5%, implying an improvement in the underlying EBITDA margin from 37.4% to 38.6%. In line with the results from Macedonia, the Montenegrin results were also positively impacted by the 0.9% year-on-year strengthening of the forint against the euro on average.

Montenegro revenue breakdown  
(in HUF millions)



Fixed line voice revenues in forint terms were down by 8.8% due to significantly lower outgoing traffic and wholesale voice revenues on account of decreasing volumes of terminated and transited international and mobile incoming traffic. However, fixed voice churn of 1.9% was not as intense as in other segments, albeit usage decreased considerably. Thanks to our strong focus on broadband and IPTV services, the number of customers grew by 14.0% and 22.0% respectively and revenues generated by these businesses increased at a similar rate. In total, fixed line revenues decreased by only 0.5%.

Mobile revenues in Montenegro decreased by 0.6% to HUF 15.1 bn. Although the mobile subscriber base decreased by 12.2%, this was basically due to the regulator's decision to register all pre-paid users and had little effect on our market position. On the contrary, in the higher ARPU post-paid segment, the Montenegrin subsidiary took the leading position from Telenor. In line with other segments, another important revenue source was non-voice revenues, which increased by two thirds in 2011.

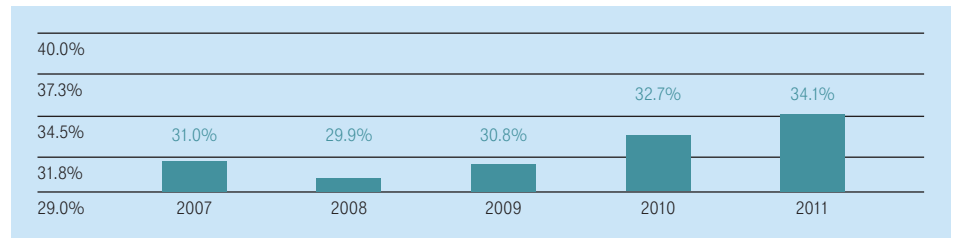
## Cash flow generation, dividend payment

Net cash generated from operating activities increased from HUF 164.7 bn to HUF 168.8 bn in 2011. The lower EBITDA and net financial result was offset by better working capital management especially on the liabilities side. These positive trends were strengthened by lower interest and other financial charges and income tax paid. Free cash flow increased from HUF 77.5 bn to HUF 92.0 bn in 2011 as an increase in operating cash flow was coupled with lower capital expenditures.

Net debt decreased slightly from HUF 289.4 bn to HUF 288.4 bn by the end of 2011 compared to the end of 2010 as the total dividend payment remained lower than the free cash flow level. The net debt ratio (net debt to total capital) was 34.1% at the end of 2011.

The Board of Directors proposed a dividend payment of HUF 50 per ordinary share for the 2011 financial year for approval at the Annual General Meeting. The proposed dividend level of HUF 50 per share is in line with Magyar Telekom's dividend policy of maintaining its net debt ratio within the targeted range of 30-40%.

Net debt to total capital ratio



## Outlook

Despite prevailing economic headwinds in all our countries of operation, Magyar Telekom's revenues and underlying EBITDA performance were stronger than expected and we have overaccomplished our 2011 guidance of declines of 3-5% and 4-6%, respectively. This good performance was in great part due to our success in finding new revenue sources coupled with strong cost-cutting focus, and most of these positive trends will likely have a positive effect on our 2012 results as well. Nonetheless, we expect 2012 to be an even more challenging year as the deterioration in the economy will be stronger than it was in 2011, putting pressure on all our customers. We expect our revenues to fall by 2% the most, but because of the lower margin content of our new revenue sources, underlying EBITDA is expected to decline by 4-6% in 2012. CAPEX, excluding spectrum acquisitions, is expected to remain in line with 2011 to support our ongoing network modernisation and internal projects to improve efficiency.

## Our management

### Board of Directors

Under Hungarian laws, the Board of Directors is responsible for all matters relating to the Company's management and course of business not otherwise reserved for the General Meeting or for other corporate bodies by the Articles of Association or by the Hungarian laws. The Board of Directors is required to report annually to the shareholders at the General Meeting and quarterly to the Supervisory Board on our business administration, state of assets and business policy.

Pursuant to our Articles of Association, the Board of Directors consists of a minimum of six and a maximum of eleven members elected by the General Meeting of the shareholders for a term of three years. On December 31, 2011, there were nine members of the Board of Directors. Six of the directors were nominated by MagyarCom and three of the directors were elected upon proposal by other shareholders of the Company.

Meetings of the Board of Directors are held at least four times a year. Meetings of the Board of Directors require the presence of six members for a quorum. Each member has one vote. The Board of Directors passes resolutions by a simple majority vote.

On December 31, 2011, members of the Board of Directors, their principal occupations and the years of their original election were as follows:

Name	Born	Principal occupation	Member since
Christopher Mattheisen	1961	Chairman and Chief Executive Officer of Magyar Telekom Plc.	2006
Dr. Ferri Abolhassan	1964	Director Production and Member of the Board of Management, T-Systems Int. GmbH, Deutsche Telekom AG	2010
Dr. István Földesi	1949	International business consultant	2003
Dietmar Frings	1959	Vice President Human Resources Compensation and Benefits and Labor Law, Deutsche Telekom AG	2010
Dr. Mihály Gálik	1946	Professor of the Media, Marketing Communication and Telecommunications Department at the Faculty of Business Administration of the Corvinus University of Budapest	2006
Thilo Kusch	1965	Chief Financial Officer of Magyar Telekom Plc.	2006
Dr. Klaus Nitschke	1961	Senior Vice President, Head of the Pay TV activities in Deutsche Telekom AG's European footprint	2010
Frank Odzuck	1959	Chief Executive Officer of Zwack Unicum Plc.	2006
Dr. Ralph Rentschler	1960	Finance Europe, Financial Director Europe, Deutsche Telekom AG	2003

Other principal directorships of members of the Board of Directors:

Name	Position held	Company
Christopher Mattheisen	Member of the Board of Directors	Makedonski Telekom
	Member of the Board of Directors	T-Mobile Macedonia
	Member of the Board of Directors	Joint Venture Association
Dr. Ferri Abolhassan	Member of the Board of Directors	T-Systems International GmbH
	Chairman of the Supervisory Board	T-Systems GEI GmbH
	Chairman of the Management Board Production	T-Systems International GmbH
	Chairman of the Board of Directors	T-Systems ITC IBERIA, S.A.U.
Dr. István Földesi	President	Inter-Access, Inc., USA
Dietmar Frings	None	
Dr. Mihály Gálik	None	
Thilo Kusch	None	
Dr. Klaus Nitschke	Chairman of the Supervisory Board	T-Mobile Netherlands
	Member of the Board of Directors	T-Mobile Macedonia
	Member of the Board of Directors	Makedonski Telekom
Frank Odzuck	Member of the Board of Directors	Zwack Unicum
Dr. Ralph Rentschler	Member of the Board of Directors	Slovak Telekom
	Member of the Supervisory Board	Hrvatski Telekom, Croatia
	Member of the Supervisory Board	DeTe Fleet Services GmbH
	Member of the Supervisory Board	T-Mobile Netherlands Holding B.V.
	Member of the Board of Directors	T-Mobile Czech Republic, a.s.

### Biographies of members of the Board of Directors



#### Christopher Mattheisen

Mr. Mattheisen studied economics at Indiana University of Bloomington and at Columbia University. He first came to Hungary in 1990 to start a strategic planning and business consulting company. In 1993, in his capacity as a marketing manager of U.S. West International, Mr. Mattheisen helped launch various Hungarian, Polish and Czech mobile service operators. He worked as the marketing and sales director of TMH between 1993 and 1996. Between 1997 and 1999, he ran sales and marketing activities of MediaOne in London and later worked in Britain as a business, sales and marketing director of BT's Cellnet. In September 2002, Mr. Mattheisen became Chief Officer of Residential Services of Magyar Telekom and in January 2005, Chief Officer of the Wireline Lines of Business (T-Com, including Residential Services, Internet and Network divisions). From December 6, 2006, Mr. Mattheisen has been the Chief Executive Officer of Magyar Telekom, from December 21, 2006, he has been the Chairman of the Company's Board of Directors.



#### Dr. Ferri Abolhassan

Dr. Abolhassan joined IBM in California in 1989 and completed his doctoral work in Research & Development in massive parallel computing at Saarland University in Saarbrücken. Between 1992 and 2000, he worked at SAP Retail Solutions as a Sales Director and as a Managing Director. Between 2001 and 2004, he was Co-Chairman and Chief Executive Officer at IDS Scheer AG. He was a member of top management at SAP AG as Executive Vice President. In 2008, he joined T-Systems International GmbH and he has been a Member of the Board of Directors of T-Systems and Chief of Systems Integration. From December 1, 2010, Dr. Abolhassan has been responsible for the New Production Unit as a member of the Executive Board at T-Systems.



#### Dr. István Földesi

Dr. Földesi received a degree in economics in 1972 and graduated with a Ph.D. in 1974. He spent twenty years as a diplomat in London, Madrid and Washington D.C. At the end of the 1980s, he served as an advisor to the Prime Minister and participated in round table negotiations resulting in political and economic changes. In 1991, he became an advisor to the Organization for Economic Co-operation and Development (OECD). He has been working as an international business advisor since 1992. From 1994 to 1999, Mr. Földesi was a member of the Board of Directors of Magyar Telekom and until 1996 he acted as Chairman of the Board. In 2003, he was reappointed as a member of the Board of Directors of Magyar Telekom.



#### Dietmar Frings

Mr. Frings acquired a degree in Business Administration at Federal University for Applied Services in Mainz in 1982. Between 1982 and 1986, he worked in managing functions in the Regional Office Branches at German Railways and between 1986 and 1989 at the Federal Ministry of Transport, and then as consultant of the Parliamentary State Secretary. He joined Deutsche Telekom in 1991 as a specialist for human resources issues, responsible for human resources services, recruitment and organizational change at Deutsche Telekom Headquarters. Subsequently, he has been in several positions within human resources. Between 1998 and 2001, he was responsible for the Labor Relations Management in Germany within the Human Resources Board Member Support Unit. After that, he was the Vice President and Head of the German Employers Association for eight years, at the same time being in charge of International Labor Relations. Since April 1, 2011, he has been Vice President Human Resources Compensation & Benefits and Labor Law for DT.



#### Dr. Mihály Gálik

Dr. Gálik is a senior university lecturer with a Ph.D in economics. He spent nearly two decades in the media, working for Hungarian Radio, where he held several positions involving high responsibility, including that of Managing Director. Afterwards, his professional career has been linked to the Budapest University of Economics (currently called Corvinus University of Budapest). For three years, he was a senior lecturer, while in the last fourteen years he headed several departments at the university. He is author of some 100 scientific publications including five textbooks. He was also a recipient of the Széchenyi Professor Scholarship. Since January 1, 2011, he has been a Professor at the Institute of Behavioral Sciences and Communication Theory of the Corvinus University of Budapest.



#### Thilo Kusch

Mr. Kusch studied communication engineering and business administration at Technische Universität Berlin. From 1989 to 1992, he successfully established and ran his own company selling PCs and PC networks to residential and small business customers. From 1992 to 1998, he worked in a leading position in Arthur D. Little's Telecoms, IT, media and entertainment practice as a management consultant and from 1998 to 2001, he was telecommunications equity analyst with Dresdner Kleinwort Wasserstein. He joined Deutsche Telekom Group in 2001 as Senior Director in charge of IPO preparations and investor relations for T-Mobile International. Since April 2002, he was a Senior Executive Vice president of Deutsche Telekom, in charge of investor relations. He was appointed Chief Financial Officer of Magyar Telekom in September 2006.



#### Dr. Klaus Nitschke

Dr. Nitschke has a degree from Cologne University in Molecular Biology. He acquired a Bachelor of Arts degree from Boston University and in 1992, a PhD degree as Doctor rerum naturalium from the Max-Planck Institute in Cologne. His career started in 1992 as a Top Management Consultant at Dicke & Associates. In 1999, together with his Partners he sold the company to Deloitte Consulting. From 2000 to 2002, he continued his career with Bertelsmann AG as Chief Operating Officer of BOL AG and as Vice President, being responsible for building up a MVNO. In 2002, he joined Deutsche Telekom where he has been in various management positions. He was first assigned as Area Manager for the Central European subsidiaries of Deutsche Telekom: Magyar Telekom, Hrvatski Telekom and Slovak Telekom. Between 2003 and 2005, he led the Strategy department of Deutsche Telekom's fixed line business in Germany. From 2005 to 2009, he worked as a Managing Director to build up a Product & Development unit which was later reintegrated into Deutsche Telekom. He then was assigned to lead the Strategy department of Deutsche Telekom's European Business, focused on substantial Pay TV- and ICT projects and was acting as Area Manager till 2011. Today he is heading the Pay TV activities in Deutsche Telekom's European footprint.



### Frank Odzuck

Mr. Odzuck obtained an economics degree in 1983 in Budapest. He was the managing director of the Hungarian operations of Eduscho and Eduscho-Tchibo for 8 years and later the managing director of Nestlé-Schöller Hungary Ltd. Since 2003, he has been the CEO of Zwack Unicum Plc., listed on the Budapest Stock Exchange. The company, producing and marketing a genuine "Hungaricum", is one of the best-known international companies in Hungary (Underberg, Diageo).



### Dr. Ralph Rentschler

After receiving a doctorate degree in economics, Dr. Rentschler worked for four years for Robert Bosch GmbH as an expert advisor on business principles and methods. His areas of responsibility included investment analysis and cost accounting. He was Head of Group Controlling and Planning and Reporting Departments at Carl Zeiss from 1992 to 1997. His areas of responsibility included production and investment controlling, controlling of affiliated companies, M&A and strategic planning. Later he became Commercial Manager of the Brand Optics Division at Carl Zeiss, where he managed Accounting, Controlling, Data Processing and Purchasing. Dr. Rentschler joined Deutsche Telekom in 2001 and became CFO of the group-wide Fixed Net division. From July 2009, Dr. Rentschler has taken over the position as the Financial Director of the Board Division Southern and Eastern Europe in addition to his position as the CFO of the Fixed Net business. From July 2010, Dr. Rentschler took over the position of the Financial Director Europe.

## Management Committee

Pursuant to the Rules of Procedure of the Board of Directors, the Board of Directors established a Management Committee in 2000, which is empowered to carry out the day-to-day operations in accordance with the annual business plan.

Members of the Management Committee are elected for an indefinite period.

On December 31, 2011, the Management Committee consisted of nine chief officers of Magyar Telekom. The members were as follows:

Name	Born	Current position	Member since
Christopher Mattheisen	1961	Chairman and Chief Executive Officer	2006
Attila Keszég	1966	Chief Sales and Services Officer	2010
István Király	1965	Chief Marketing Officer	2010
Thilo Kusch	1965	Chief Financial Officer	2006
István Maradi	1964	Chief Technology and IT Officer	2007
Dr. Balázs Máthé	1968	Chief Legal and Corporate Affairs Officer	2010
Róbert Pataki	1971	Chief Strategy and Corporate Development Officer	2009
Róbert Budafoki	1966	Chief Operating Officer, Business Services Business Unit	2010
Éva Somorjai	1966	Chief Human Resources Officer	2007

## Other principal directorships of members of the Management Committee

Name	Position held	Company
Christopher Mattheisen	See above	
Attila Keszég	None	
István Király	Member of the Board of Directors	IQSYS Informatikai és Tanácsadó Zrt.
	Member of the Board of Directors	Origo Média és Kommunikációs Szolgáltató Zrt.
Thilo Kusch	See above	
István Maradi	Managing Director	Centro-plane Ltd.
Balázs Máthé	None	
	Member of the Supervisory Board	FHB Kereskedelmi Bank Co., Ltd.
Róbert Pataki	Chairman of the Board of Directors	Origo Zrt.
	Chairman of the Board of Directors	Telekom New Média Zrt.
	Chairman of the Board of Directors	Investel Zrt.
	Chairman of the Board of Directors	Cronogorski Telekom
	Member of the Board of Directors	Makedonski Telekom
	Member of the Board of Directors	T-Mobile Macedonia
Róbert Budafoki	None	
Éva Somorjai	None	

## Biographies of Chief Officers

**Christopher Mattheisen**

See "Biographies of Members of the Board of Directors" above.

**Attila Keszég**

Mr. Keszég graduated from the Budapest University of Technology and Economics as a qualified mechanical engineer before attending an MBA course specializing in financial and management studies. He started his career in 1992 at Hemingway Holding, then he worked for Dove Mid Europe. In 1994, he joined Pepsi Cola Hungary first as Key Accounts Director, then Project Manager, later Unit Manager Central Hungary managing field sales, delivery and warehousing. From 1999, he worked as Sales Director of Pepsi Cola Hungary and from 2001, as Sales Director for Traditional Trade Central and Eastern Europe responsible for the Hungarian, Polish, Czech and Slovak markets. From 2005, he was the General Manager of Red Bull Hungary. From September 1, 2010, he has been Chief Sales and Services Officer of Magyar Telekom.

**István Király**

Mr. Király graduated from the Institute of International Relations in Moscow with a major in international economic relations in 1989. He got his MBA qualification from Oxford Brookes University in 2000. He joined the telecom industry in 1992 at Kontrax, later worked for CGE (later Vivendi, today Invitel). From 1995 to 2004 he filled various management functions at Pannon GSM (today: Telenor) including positions like Marketing Director (1999-2003) and Chief Commercial Officer (2003-2004). He joined Magyar Telekom in 2004 as a Business Development Director, and was appointed to be Strategy and Marketing Director in the Business Services Business Unit in 2008. As a result of the organizational changes effective from July 1, 2010, he has been nominated to the position of Chief Marketing Officer of Magyar Telekom.



### Thilo Kusch

See “Biographies of Members of the Board of Directors” above.



### István Maradi

Mr. Maradi graduated in 1989 from the Technical University of Budapest with a degree in communications engineering, specializing in GSM and mobile communication, then in 2000 obtained an MBA degree at the Open University of London. He started his career in Matáv PKI Research Institute as mobile telecommunications researcher. Then he participated in the start-up of Westel Rádiótelefon Ltd. with responsibility for network design. In the initial period of the company's operations he worked as design engineer, then as radio engineer, and from 1992 as director for network operations. From 1995, he was director of operations and core network planning at Westel 900 Rt. From 2001 to 2006, he worked as Chief Development Officer, Chief Information Officer and Deputy General Manager of T-Mobile Hungary. From 2006 to 2007, he worked for Cisco CEE as a market analyst in charge of business development support for the local Cisco offices in 17 European countries. From April 1, 2007, he has been Chief Information Officer of Magyar Telekom and from January 1, 2008, Chief Technology and IT Officer.



### Dr. Balázs Máthé

Dr. Máthé received his law degree from Janus Pannonius University, Pécs in 1995. His previous studies included EU Law Studies at the Università degli Studi di Trento, Italy and a few semesters at the Faculty of Arts (History and Languages) of Janus Pannonius University. Prior to joining Magyar Telekom, he worked as an attorney at various international law firms for over a decade, including five years at one of the leading global law firms, Linklaters, where he was a Partner and the Head of the Corporate Department in Budapest. As an attorney, he specialized in cross border mergers and acquisitions and corporate governance matters. He joined Magyar Telekom as Group Legal Director in 2007. He was appointed Chief Legal and Corporate Affairs Officer of Magyar Telekom as of July 1, 2010.



### Róbert Pataki

Mr. Pataki graduated as an economist from the Corvinus University in Budapest and then completed studies in International Finances and Marketing Management at the University of Erasmus in Rotterdam. He started his career as an investment analyst at Project Finance International Ltd. in The Hague in 1995 and he worked as a financial analyst for Nutricia Netherlands BV in Rotterdam in 1996. He joined Accenture (Andersen Consulting) in 1996 and until 2001 he worked for Accenture's Strategic Services, first as a strategic consultant, later as a senior manager responsible for the telecommunications and e-commerce sectors. From 2001, he continued his professional career with A.T. Kearney as a dedicated account manager providing consultancy services to leading Hungarian telecommunications companies; later in 2003, he became senior manager of A.T. Kearney's European Telecommunications Team responsible for major European projects in the field of mobile communications and Internet services. He has been Chief Strategist of Magyar Telekom since September 2006. As of April 1, 2009, he was appointed Chief Operating Officer of Alternative Businesses and Corporate Development Business Unit by keeping his tasks as Chief Strategist of Magyar Telekom as well. Due to organizational changes within the company, he has worked as Chief Strategy and Corporate Development Officer from September 2009.

**Róbert Budafoki**

Mr. Budafoki graduated at the Budapest University of Technology in electrical engineering. He started his career at KFKI in 1991 as computer systems engineer. From 1992 he worked for Olivetti as systems engineer, later product and account manager. In 1995 he joined Cisco Systems Hungary as one of its founders and became General Manager in 2001 and General Manager Consumer Business and Marketing Central and Eastern Europe in 2006. From 2008 he was the founder CEO of Central Europe On-Demand (CEOD) which provides software and cloud computing services for business customers in eleven countries of the Central and South East European region (Austria, Bulgaria, Cyprus, Czech Republic, Hungary, Poland, Romania, Serbia, Slovakia, Slovenia, Turkey). He was appointed to the Chief Operating Officer position in charge of heading the Business Services Business Unit (T-Systems) of Magyar Telekom, effective from June 1, 2011.

**Éva Somorjai**

Ms. Somorjai completed her studies at the College for Commerce and Catering. From 1989, she worked at the international directorate of Magyar Hitelbank. From 1991 through 1994, she was the administrative and financial manager of a real estate investment company in Melbourne, Australia. Between 1994 and 2001, she worked in various management positions in the financial and human resources area of Pepsi Cola's Central European division. In 1999, she was appointed human resources director of the international organization and personnel development area, from 2000 she filled the position of human resources director of the Hungarian company. She has been working for Magyar Telekom since October 2001. Since 2002, she served as Director of the Group HR Branch. From April 1, 2007, she has been Chief Human Resources Officer of Magyar Telekom.

## Management overview

### Basis of presentation

The strategies and expectations referred to in the following discussions are considered forward-looking statements and may be strongly influenced or changed by shifts in market conditions, new initiatives we implement and other factors. We cannot provide assurance that the strategies and expectations referred to in these discussions will come to fruition. Forward-looking statements are based on current plans, estimates and projections, and therefore, you should not place too much reliance on them. Forward-looking statements speak only as of the date they are made, and we undertake no obligation to update any forward-looking statements in light of new information or future events. Forward-looking statements involve inherent risks and uncertainties, most of which are difficult to predict and are generally beyond our control. We caution you that a number of important factors could cause actual results or outcomes to differ materially from those expressed in, or implied by, the forward-looking statements.

The Consolidated Financial Statements of Magyar Telekom have been prepared in accordance with IFRS as issued by IASB.

The preparation of financial statements in conformity with IFRS requires the use of certain critical accounting estimates. It also requires management to exercise its judgment in the process of applying the Group's accounting policies. The areas involving a higher degree of judgment or complexity, or areas where assumptions and estimates are significant to the Consolidated Financial Statements are disclosed in Note 4 to the Consolidated Financial Statements.

We established our current management structure in Hungary based on customer segments that require different technology and marketing strategies, and support functions. The Group's operating segments are: Telekom Hungary, T-Systems Hungary, Macedonia and Montenegro.

The movement of HUF against the Macedonian Denar ("MKD") and EUR can significantly affect all revenue and expense lines of our Macedonian and Montenegrin subsidiaries.

### Exchange rate information

The Euro strengthened by 11.6% against the Hungarian Forint ("HUF") year on year (from 278.75 HUF/EUR on December 31, 2010 to 311.13 HUF/EUR on December 31, 2011). The average HUF/EUR rate increased from 276.46 in 2010 to 279.08 in 2011.

The U.S. Dollar ("USD") appreciated by 15.4% against the Hungarian Forint year on year (from 208.65 HUF/USD on December 31, 2010 to 240.68 HUF/USD on December 31, 2011). The average HUF/USD rate decreased from 209.33 in 2010 to 199.58 in 2011.

The Macedonian Denar ("MKD") strengthened by 0.9% against the Hungarian Forint year on year (from 4.53 HUF/MKD on December 31, 2010 to 5.06 HUF/MKD on December 31, 2011). The average HUF/MKD rate slightly increased from 4.50 in 2010 to 4.54 in 2011, affecting all revenue and expense lines of our Macedonian operations to a small extent.

### Economic environment

The telecommunications industry is undergoing a major change globally. Worldwide trends are driving towards an integrated telecommunications, information, media and entertainment market. These trends together with local specifics create new set-up in our eco-system both in terms of infrastructure, servicing and new types of business models.

Market delivers moderate growth with strong restructuring between segments that puts pressure on margin levels. We expect that the traditional telecommunications market will no longer deliver sizeable revenue growth in Hungary. The fixed voice market as a major revenue and profit source is declining; mobile is no longer able to compensate this decline. However, we expect that new core segments, especially mobile broadband, broadcasting and IT services will deliver sizable revenue growth in the coming years. The fixed market is characterized by 3Play bundles, with TV being a core element of service offerings, while the mobile market is driven by fierce competition in broadband and content services. An increasing technology platform-based competition can be observed in the domestic market, where our competitors are extensively deploying next-generation countrywide fixed and mobile networks. The battle for customer contact has pushed prices down. We expect continued consolidation in the fixed arena, especially in the cable market. In mobile, new entrants are expected as virtual

network operators (MVNOs), but also, based on the first instance decision of the National Media and Infocommunications Authority in the spectrum auction process, a new infrastructure player, the consortium of Magyar Posta, MFB and Magyar Villamos Művek, is also very likely to enter the market.

Latest macroeconomic forecasts lag significantly behind previous assumptions, especially in terms of consumer consumption and public spending. Market development is challenged by significant uncertainties in macroeconomic outlook putting further pressure on market players.

The introduction of the tax reform resulted in a rather unfavorable investment climate. The weakness of domestic demand entails negative changes in the economic structure and a decline in services. Decrease in corporate tax rate has not yet generated an increase in either consumption or investments. The new flat personal income tax rate system increased savings at higher income categories. The crisis taxes are impacting telecom operators' financial stability and investment intensity having a negative effect on overall telecom market growth. GDP is expected to reach the pre-crisis level only after 2014.

### Regulatory developments

For description of the most significant regulatory developments in Hungary, Macedonia and Montenegro, see Note 1.3 to the Consolidated Financial Statements.

Our strategies are designed to enable us to exploit and develop our extended customer base, significantly improve efficiency and capture growth opportunities.

### Strategy

As a result of our focused strategic efforts, Magyar Telekom has maintained leading positions in its Hungarian fixed line, mobile, Internet and ICT businesses in 2011. We successfully improved customer retention and delivered strong volume figures. Also, we gradually extended our network and offering capabilities proactively leveraging various partnering models as well. We continue our transformation to become the most highly regarded service company in an extended market of telecommunications and related industries.

Even with foreseen macroeconomic and market challenges we believe our corporate strategy – FIX, TRANSFORM, INNOVATE – will deliver turnaround in financials and continued stable cash generation in the long run. Our strategy enables us to exploit and develop our extended customer base, significantly improve efficiency and capture growth opportunities. The strategic objective in the short/mid-term is to fix critical factors within the core business (simplified and focused lean operation, lower cost structure, end-to-end responsibilities) and to further strengthen our positions in core connectivity segments (voice, broadband, interactive TV), while conscious revenue restructuring efforts secure sustainable revenue mix. Innovation clearly supports monetization of our customer contacts and new services. Growth in our new core segments, such as mobile broadband, broadcasting and IT services, is expected to gradually compensate for lower revenues from traditional telecommunications, while non-core areas, such as energy, e-health, finance and insurance services, support customer retention and new revenue streams.

We aim to move further toward content and media services to support traditional access services, build new revenue streams and exploit new revenue sources.

## Outlook and public targets

The telecommunications industry is undergoing significant changes globally. We have observed several long-term trends which are changing the structure of the Hungarian telecommunications market. These long-term trends include changes in technology (e.g., IP-based broadband products and solutions, emerging wireless broadband technologies), customer requirements (e.g., increase in mobile usability of content services and terminal devices, 4Play solutions and the growing need for customized content) and competition and regulation (e.g., low entry barriers, new business models, convergence in the telecommunications and media broadcast industry).

To adapt to these changes in the market, we have redefined the focus areas of our corporate strategies to better exploit our position as an integrated telecommunications operator with a full range of services, as well as to ensure our long-term competitiveness. Our strategies are designed to enable us to capitalize on and develop our extended customer base, significantly improve efficiency and capture growth opportunities.

Magyar Telekom's current plans and outlook are based on our best knowledge and expected circumstances. Nevertheless, we cannot predict the behavior of our competitors. Therefore, a stronger than assumed impact of alternative operators, new market entrants and new solutions in any country where we are present could result in a negative impact on our business performance.

Each of our business segments is affected by its unique business environment, and we are subject to circumstances and events that are unforeseen or beyond our control. The European economy is slowing down and showing signs of recession risk in 2012. Major uncertainties surrounding the future of the euro and the debt crisis escalated for several euro-zone members. The Hungarian economy was impacted heavily by the second wave of the financial crisis. GDP projections for 2012 were reduced significantly and analyst and government forecasts indicate GDP growth of just half percent in 2012. The unemployment rate remains very high, at above ten percent, and the volatility of the Hungarian currency is expected to continue. The Hungarian government has experienced difficulties in financing the budget deficit through the financial markets at the end of 2011. As a result, negotiations were reopened with international financial institutions, such as the International Monetary Fund ("IMF") and the European Central Bank ("ECB") to receive precautionary loan facilities.

In order to balance the government budget, the government implemented several measures to decrease the deficit to 2.5% of GDP in 2012. The most significant of these was the 2 percentage point VAT increase, from 25% to 27%. The special telecommunications tax, which came into effect in 2010, is expected to have a negative impact of more than HUF 24 billion on our EBITDA in 2012. Our T-Systems Hungary segment was also affected by heavy spending cuts by the government, our largest business customer. Despite these measures and a negative business environment, we expect that our core business units will be able to continue to generate strong cash flows from operations, although the special telecommunications tax will impact our dividend policy.

## Revenues

The following reflects our current expectations with respect to our plans and initiatives:

In our fixed line operations, we expect further declines in voice revenues due to continued line reduction and fixed line unit price erosion driven by mobile substitution and increased competition in the fixed line market, including competition from VoIP or VoCable providers. Mobile substitution remains the main driver of churn and we expect that average mobile per minute fees will continue to be lower than average fixed line per minute fees in 2012. As indicated in our strategy, to mitigate the decrease in fixed line voice revenues we are now moving from a traditional traffic-based revenue structure to an access-based revenue structure, which will allow us to substitute declining traffic revenues with content, entertainment and bundled access revenues. Based on draft directives from the National

We are combining our product portfolio in order to provide all services for every customer demand on every platform.

Media and Infocommunications Authority ("NMA"), fixed line interconnection tariffs are expected to reduce further from December 2011 by 20% (ex post facto directive expected in May, 2012), and by an additional 20% in 2013 (with the extension to VoIP and VoCable), putting further pressure on our fixed line revenues.

We aim to move further toward content and media services to support traditional access services, build new revenue streams and exploit new revenue sources. As the market is shifting towards multi-play offers, we are combining our product portfolio in order to provide all services for every customer demand on every platform. By having the full range of telecommunications services, we are capable of offering 4Play packages, unique in the Hungarian market.

In the saturated fixed line market TV remains the key driver. Building on our large variety of platforms (cable, IP, DVB-S), we are targeting to reach those customers who currently have less than three of our services. In 2011, we increased the number of our Revenue Producing Customers ("RPC") more than our competitors, as a result, we gained additional market share. We are aiming to expand further our RPC figures in 2012; however margins are under pressure due to significant competition. To strengthen our position in the TV market, we are continuously innovating our product portfolio (such as interactive SAT TV).

In mobile operations in Hungary, market penetration is now saturated, and we expect declining voice revenues in 2012. We expect further growth in mobile broadband and future growth potential of value-added and data services, but this positive impact will not offset the decline in voice revenues.

To satisfy customer demand with high quality mobile broadband services, Magyar Telekom filed an auction bid with the NMA, for unused spectrum in the 900 MHz frequency band. The spectrum can be utilised in a technology-neutral manner, allowing for the installation and operation of GSM, UMTS, LTE and/or WiMAX mobile networks. The filing date of auction bids was December 8, 2011.

Mobile interconnection tariffs are expected to be reduced by 20% in 2012, and by an additional 25% in 2013. Fixed-to-mobile and mobile-to-mobile termination tariffs as well as mobile termination fees are expected to be reduced further in the future.

Magyar Telekom is continuously seeking business opportunities beyond our core services. A significant step was made in this direction upon our entrance into the retail energy market through a strategic partnership with E.on. This new revenue stream will enable us to maintain flat Hungarian revenue in 2012, however the margins will nevertheless decline.

To maintain sustainable competitiveness in the corporate sector, we have committed to developing further our IT competencies by focusing on complex service offerings through managed services, system integration and outsourcing through consultant services to corporate customers. Expanding our business operations into these new areas of lower profitability has a dilutive effect on the company's profitability both in the fixed line business and at the Magyar Telekom Group level.

In Macedonia, competition is increasing both in the fixed line and mobile segment. Our main competitors in the fixed line segment are ONE and two major cable TV operators (Telekabel and CableTel), which target the retail voice market with 3Play offers (ONE is capable of offering 4Play as well), aggressive pricing and marketing communication. Fast growth in fixed broadband, the roll-out of new platforms (FTTx) and combined fixed-mobile products may only partially offset the decline in fixed voice revenues.

We also expect more intensive regulatory measures in Macedonia in the future. In addition to our existing obligations (RIO, RUO, Naked DSL, Number Portability, Cost-based pricing, Accounting separation, Access to specific network elements, Wholesale Line Rental, Wholesale Digital Leased Line, Minimal set of leased lines, Bitstream Access), new regulations are expected to come into effect

in relation to asymmetric mobile termination (from the end of 2013, symmetric MTRs are expected) and ex ante control of retail prices. A further decline in wholesale fees (e.g., IC, leased lines, WLR) is also expected.

In the mobile segment the competition is also very strong with three players in the market. Mobile voice revenues are expected to decline, only partially offset by the fast growth in mobile broadband based on the new 3G technology. T-Home services included in T-Mobile bundled offers were launched during 2010. Demand for mobile data services (e.g., IP-VPN, DLL, Metro Ethernet) is expected to decrease due to unfavorable market conditions.

In Crnogorski Telekom, we are also expecting difficulties due to competition and regulation in the near future. Fixed wholesale revenues are expected to be the most impacted by regulatory actions (reducing international termination rates to rates at the national level), while mobile revenues are also expected to decline due to gradual termination fee cuts. Growth in fixed and mobile broadband cannot entirely compensate for the losses in the voice market. Competitors are also putting pressure on prices with 2Play and 3Play offers.

In the Montenegrin market, new regulatory actions are expected related to prepaid registration (i.e., the obligation to register each prepaid customer with the regulator) and SIM changes, cost-based pricing, wholesale obligation and number portability.

Magyar Telekom's revenues and underlying EBITDA performance were stronger than expected and we have overaccomplished our 2011 guidance.

### Expenses

We are entirely committed to improving internal operational efficiency in all of our business segments. To accomplish our goals despite the intensifying competitive environment, we expect to partially offset decreasing revenue with strict cost control. We will continue our group-wide efficiency project Save for Service ("S4S"). This multi-year project yielded substantial savings in 2011, and will continue in the coming years. The target for S4S in 2012 is to overhaul cross-functional, end-to-end processes, and to exploit all cost saving opportunities with better optimization and re-organization of processes irrespective of current organizational borders.

We have reached an agreement with trade unions on wage development, headcount reduction and decreases in additional employee allowances at the parent company for 2012. The key elements of the agreement are the following: reduction of headcount by 250 employees in addition to executive termination and retirement and no wage increase in 2012 (however, to meet the Government's expectation to compensate employees with below average wages for adverse tax law changes, benefits in kind will be increased for affected employees). These measures will reduce our Total Workforce Management ("TWM") related costs.

In line with global market developments and the liberalization of the Hungarian energy market, we have experienced rapid growth in energy prices above the inflation level. We expect energy prices to remain high in 2012, impacting us negatively.

We are entirely committed to improving internal operational efficiency in all of our business segments.

#### **Total investments in tangible and intangible assets**

Compared to previous years, the key priorities of capex spending have not changed. Investments in new products and platforms (e.g., FTTx, LTE) remain our key strategic goals although the overall investment level is decreasing. Broadband expansion is supported by large scale modernization of the mobile network with Ericsson as the vendor. As part of the network modernization, Ericsson will replace the current 2G and 3G wireless base stations to unique, multi-standard equipments developed for GSM/EDGE, WCDMA/HSPA Evolution and LTE technologies.

We will increase investments in the IT area to reach our goals to become an ICT leader in Hungary, while expansion into new segments (e.g., energy sector) will also demand additional investments.

Striving for further improvement in customer orientation, the strategic priority for 2012 and beyond is the successful implementation of a new CRM system. We are targeting the complete overhaul of the current customer management system of the Company. The goals of the project include not just the replacement of outdated billing systems but to bring a new approach to the entire customer management process by integrating fixed and mobile portfolios.

In 2011, we succeeded in decreasing our total level of investments in tangible and intangible assets compared to 2010, despite the volatility of the Hungarian currency during the year.

According to our strategy, we are committed to further strengthening and leveraging our presence in the South-Eastern Europe region. Therefore, we are continuously seeking further value-creating acquisition and investment targets.

## Development of business in the Group

### Revenue and EBITDA targets

In 2011 our revenues and underlying EBITDA decreased more moderately than our previous estimates of a 3-5% and 4-6%, respectively. The revenue decline was 2.0% and underlying EBITDA was down by 1.3%, primarily due to our strong focus on cost efficiency. We also outperformed our capex plans of a 5% decrease and reached a saving of 8.7%. Our free cash flow (defined as operating cash flow and investing cash flow adjusted for proceeds from / payments for other financial assets) for 2011 was HUF 92.0 billion, an improvement of HUF 14.5 billion compared to the previous year.

For 2012, however, expectations for a deteriorating economic environment, recession and declines in disposable income are strengthening. In addition, while our initiatives for finding new revenue sources are showing results and we expect to stabilise revenues, these new revenue streams have lower profitability and will thus dilute our profit margins. Therefore, while we foresee revenues to only decline by up to 2%, underlying EBITDA is expected to deteriorate by 4-6% in 2012. Capex is expected to remain at the same level as in 2011, to support our internal efficiency projects and the ongoing network modernization

### Revenues

The following table sets forth information regarding our revenues:

	Year ended December 31,		2011/2010
	2010	2011	
	(in HUF millions)		(% change)
Fixed line revenues	249,633	240,552	(3.6)
Mobile revenues	315,173	308,518	(2.1)
SI/IT revenues	44,773	48,547	8.4
<b>Total revenues</b>	<b>609,579</b>	<b>597,617</b>	<b>(2.0)</b>

### Fixed Line Revenues

The following table sets forth information regarding our fixed line revenues:

	Year ended December 31,		2011/2010
	2010	2011	
	(in HUF millions)		(% change)
Voice-retail	106,623	91,798	(13.9)
Voice-wholesale	21,317	21,790	2.2
Internet	53,755	52,560	(2.2)
Data	27,710	27,050	(2.4)
TV	28,549	31,787	11.3
Equipment	4,091	3,852	(5.8)
Other fixed line revenues	7,588	11,715	54.4
<b>Total fixed line revenues</b>	<b>249,633</b>	<b>240,552</b>	<b>(3.6)</b>

The table below sets forth information regarding total revenue generating fixed access lines in Hungary, Macedonia and Montenegro:

	Year ended December 31,		(% change)
	2010	2011	2011/2010
<b>Number of fixed lines at our Hungarian operations</b>			
Residential	1,215,393	1,104,380	(9.1)
Business	175,822	164,771	(6.3)
Payphone	11,912	10,852	(8.9)
Total	1,403,127	1,280,003	(8.8)
ISDN channels	349,108	319,112	(8.6)
Total	1,752,235	1,599,115	(8.7)
<b>Number of fixed lines at our Macedonian operations</b>			
Residential	281,436	253,230	(10.0)
Business	29,255	27,552	(5.8)
Payphone	889	882	(0.8)
Total	311,580	281,664	(9.6)
ISDN channels	32,328	30,458	(5.8)
Total	343,908	312,122	(9.2)
<b>Number of fixed lines at our Montenegrin operations</b>			
Residential	137,156	134,933	(1.6)
Business	17,476	17,134	(2.0)
Total	154,632	152,067	(1.7)
ISDN channels	17,052	16,294	(4.4)
Total	171,684	168,361	(1.9)

Total revenues amounted to HUF 597.6 billion in 2011 as compared to HUF 609.6 billion in 2010, representing a 2.0% decline year on year. The drivers of this decrease are the following:

#### Fixed voice-retail revenues

Voice-retail revenues consist of revenues from subscriptions, domestic and international outgoing traffic revenues generated on PSTN, VoIP, VoCable and public lines as well as value-added revenues. Fixed line voice-retail revenues decreased by 13.9% and amounted to HUF 91.8 billion in 2011 compared to HUF 106.6 billion in 2010, mainly driven by lower PSTN subscription fee revenues and lower outgoing traffic revenues.

Revenues from subscriptions consist of revenues from monthly subscription fees for price plans. Revenues from subscriptions are principally a function of the number and mix of residential, business and ISDN access lines and corresponding charges. Subscription fee revenues decreased from HUF 64.4 billion in 2010 to HUF 55.3 billion in 2011 due to lower number of our fixed line subscribers mainly in Hungary.

Domestic outgoing traffic revenues consist of traffic charges for local, domestic long distance and fixed line to mobile calls placed by our subscribers. Domestic outgoing traffic revenues are a function of rates, the total number of telephone calls, the distribution of call duration, the time of day and the mix between more costly domestic long distance or fixed line to mobile calls and less expensive local calls.

The following table sets forth the total minutes of domestic telephone traffic that our fixed line subscribers generated, including calls from the fixed line network to mobile subscribers:

	Year ended December 31,		2011/2010
	2010	2011	
	(in thousands of minutes)		(% change)
Magyar Telekom Plc.	3,135,694	3,277,178	4.5
Makedonski Telekom	703,012	588,299	(16.3)
Crnogorski Telekom	326,344	296,591	(9.1)

In 2011, the continuous decline in the number of revenue producing fixed lines and lower average prices (due to flat rate packages, such as "Hoppá") led to lower domestic outgoing traffic revenues in Hungary. We offered several price discounts to customers choosing different flat-rate and optional tariff packages. Our "Hoppá" tariff package was very successful in 2011, generating more than 406,000 subscribers by the end of December 2011. The vast majority of customers choosing this package signed a 2-year loyalty contract, therefore this offer proved to be a very useful tool to decrease fixed line customer churn in Hungary. Our integrated fixed and mobile offer, the "Paletta" tariff package reached 43,000 customers at December 31, 2011.

Domestic outgoing traffic revenues decreased also at Makedonski Telekom and Crnogorski Telekom throughout the period primarily due to decreased customer number and lower usage as a consequence of increasing mobile substitution.

International outgoing traffic revenues are a function of rates and the number, duration and mix of calls placed by our fixed line subscribers to destinations outside Hungary in the case of Magyar Telekom Plc., outside Macedonia in the case of Makedonski Telekom and outside Montenegro in the case of Crnogorski Telekom.

The following table sets forth information concerning outgoing international traffic<sup>(1)</sup>:

	Year ended December 31,		2011/2010
	2010	2011	
	(in thousands of minutes)		(% change)
Magyar Telekom Plc.	56,377	54,888	(2.6)
Makedonski Telekom	16,798	15,074	(10.3)
Crnogorski Telekom	43,166	36,343	(15.8)

(1) Excludes minutes from calls placed by subscribers of other local telephone operators and mobile service providers. Our revenues relating to these calls are included in revenues from domestic incoming traffic.

International outgoing fixed line traffic revenues decreased in 2011 at Magyar Telekom Plc. and also at our foreign subsidiaries resulting from lower volumes of minutes and loss of lines.

Revenues from value-added and other services mainly consist of fees for digifon services, premium rate and blue/green numbers as well as directory assistance.

Value added and other service revenues showed a 50.6% increase and amounted to HUF 5.1 billion in 2011 compared to HUF 3.4 billion in 2010, mainly due to revenues from the reconnection of customers previously suspended due to non-payment. At Magyar Telekom Plc., the largest part of the provision made for KAP loyalty points was reversed based on experienced customer behavior related to the usage of these loyalty points in 2011, also contributing to the increase.

Magyar Telekom is continuously looking for business opportunities beyond our core services.

### Fixed voice-wholesale revenues

Voice-wholesale revenues consist of domestic and international incoming traffic revenues. Fixed line voice-wholesale revenues increased by 2.2% reaching HUF 21.8 billion in 2011 compared to HUF 21.3 billion in 2010, mainly due to the increase in international incoming traffic revenues.

Domestic incoming fixed line traffic revenues decreased from HUF 8.1 billion in 2010 compared to HUF 7.9 billion in 2011. The drop in revenue from other domestic fixed line operators is due to lower call origination and termination revenues at Magyar Telekom Plc. as a result of decreased traffic in Hungary. These decreases were partly offset by higher revenue from other domestic fixed line operators at Makedonski Telekom resulting from higher termination fees of international traffic in its network due to deregulation. At Magyar Telekom Plc., the increase in revenues from mobile operators was mainly due to higher mobile-to-international traffic volume, partly compensated by reduced termination fees.

International incoming fixed line traffic revenues increased by 5.2% in 2011 and amounted to HUF 13.9 billion compared to HUF 13.2 billion in 2010. Higher international incoming traffic revenue at Makedonski Telekom was driven by higher international termination fees, which was slightly offset by lower settlement rate and decreased traffic. Incoming international voice traffic revenue increased also at Magyar Telekom Plc., primarily due to higher volume of incoming international minutes, partly compensated by lower average fees applied. These increases were somewhat offset by the decrease in international incoming traffic revenues at Crnogorski Telekom caused by lower volumes of international incoming and transit traffic.

### Internet revenues

Internet revenues of the fixed line operations decreased to HUF 52.6 billion in 2011 compared to HUF 53.8 billion in 2010. In Hungary, the number of DSL connections slightly decreased from 623,723 at December 31, 2010 to 621,491 at December 31, 2011 as the lower number of wholesale connections was largely offset by the increase in the number of retail DSL subscribers. Cablenet customer base and the number of fiber connections increased but the broadband volume increase could not compensate for the effect of lower average revenue per user ("ARPU") resulting from lower prices forced by intense competition. The migration towards T-Home double- and triple-play packages also put downward pressure on blended ARPU level. Magyar Telekom Plc. accounted for an estimated 64% retail DSL market share and a 22% cable broadband market share at December 31, 2011. Decreased Internet revenues in Hungary were somewhat compensated by the higher revenues at Crnogorski Telekom due to the increased number of DSL connections.

The following table sets forth information concerning broadband customer figures in Hungary, Macedonia and Montenegro:

	Year ended December 31,		(% change)
	2010	2011	2011/2010
<b>Hungarian operations</b>			
Retail DSL customers	492,758	514,276	4.4
Wholesale DSL access	130,965	107,215	(18.1)
Total DSL access	623,723	621,491	(0.4)
Cable broadband customers	181,056	212,631	17.4
Fiber optic connections	19,109	31,611	65.4
<b>Macedonian operations</b>			
Retail DSL customers	130,127	137,563	5.7
Wholesale DSL access	21,091	23,847	13.1
Total DSL access	151,218	161,410	6.7
<b>Montenegrin operations</b>			
Retail DSL customers	68,540	78,164	14.0

#### Data revenues

Data revenues decreased from HUF 27.7 billion in 2010 to HUF 27.1 billion in 2011. Lower narrowband data revenue at Magyar Telekom Plc is due to the network rationalization efforts of other service providers resulting in migration to cheaper products. The decrease in Flex-Com leased lines revenues driven by volume decrease also contributed to the drop in data narrowband revenues at Magyar Telekom Plc. These decreases were partly offset by higher data broadband revenue at Combridge owing to the increased revenue of Combridge's operation in Serbia, which was launched in the second half of 2010.

### TV revenues

TV revenues amounted to HUF 31.8 billion in 2011 as compared to HUF 28.5 billion in 2010. The increase is mainly attributable to higher IPTV revenues driven by growing IPTV subscriber base both in Hungary and at our foreign subsidiaries in 2011. The fast growth of IPTV customer base was helped by our development of high speed Internet access (mainly ED3), demonstrating the increasing popularity of interactive television. The growth in satellite TV revenues was due to the higher number of satellite TV customers which reached 281,312 at December 31, 2011, and due to the increase in satellite TV ARPU year on year. These increases were partly offset by lower Cable TV revenues driven by lower subscriber base and decreased ARPU in Hungary.

The following table sets forth information concerning our TV customer figures in Hungary, Macedonia and Montenegro:

	Year ended December 31,		(% change)
	2010	2011	2011/2010
<b>Hungary</b>			
Cable TV customers	370,212	289,693	(21.7)
Satellite TV customers	254,188	281,312	10.7
IPTV customers	124,374	226,385	82.0
Total TV customers	748,774	797,390	6.5
<b>Makedonski Telekom</b>			
Number of IPTV customers	30,123	40,129	33.2
<b>Crnogorski Telekom</b>			
Number of IPTV customers	40,042	48,834	22.0

### Fixed line equipment sales

Revenues from fixed line equipment decreased by 5.8% in 2011 compared to 2010 resulting from decreased equipment revenues at Novatel EOOD as there were no IRU (long-term right of use) sales in 2011. The decrease at Makedonski Telekom was due to lower sales volume of computers, TV sets, ADSL modems and telephone sets. These decreases were partly mitigated by higher equipment sales revenues at Magyar Telekom Plc. due to the higher sale of Tablet PCs and TV sets in 2011. Higher equipment sales revenue at Crnogorski Telekom as a result of introducing the sale of TV sets from October 2011, also mitigated these decreases.

### Other fixed line revenue

Other fixed line revenues increased by 54.4% in 2011 compared to 2010. Other revenues include construction, maintenance, rental, energy trade and miscellaneous revenues. The increase in Hungary was mainly due to the significant revenues generated from the retail energy trade business in 2011, slightly compensated by lower revenues from telephone book publishing.

**Mobile revenues**

The following table sets forth information regarding our mobile revenues:

	Year ended December 31,		2011/2010
	2010	2011	
	(in HUF millions)		(% change)
Voice-retail	185,967	177,226	(4.7)
Voice-wholesale	36,815	31,728	(13.8)
Voice-visitor	4,217	3,590	(14.9)
Voice	226,999	212,544	(6.4)
Non-voice	57,789	62,146	7.5
Equipment	22,691	25,999	14.6
Other mobile revenues	7,694	7,829	1.8
<b>Total mobile revenues</b>	<b>315,173</b>	<b>308,518</b>	<b>(2.1)</b>

The following table provides information concerning TMH, T-Mobile Macedonia and T-Mobile Crna Gora:

	Year ended December 31,		(% change)
	2010	2011	2011/2010
<b>T-Mobile Hungary</b>			
Total number of subscribers	5,208,418	5,265,226	1.1
MOU	168	172	2.4
ARPU (HUF)			
Total subscriber	3,732	3,655	(2.1)
Postpaid subscriber	6,066	5,672	(6.5)
Prepaid subscriber	1,699	1,619	(4.7)
Ratio of non-voice revenues in ARPU (%)	20.8	22.8	n.a.
Average acquisition cost (SAC) per gross addition (HUF)	6,531	6,285	(3.8)
Number of mobile broadband subscriptions	624,450	1,048,514	67.9
<b>T-Mobile Macedonia</b>			
Total number of subscribers	1,295,285	1,265,243	(2.3)
MOU	135	142	5.2
ARPU (HUF)	2,690	2,533	(5.8)
<b>T-Mobile Crna Gora</b>			
Total number of subscribers <sup>(1)</sup>	457,813	401,958	(12.2)
MOU	105	117	11.4
ARPU (HUF)	2,430	2,521	3.7

Mobile revenues amounted to HUF 308.5 billion for the year ended December 31, 2011 compared to HUF 315.2 billion in 2010 (2.1% decrease). The decrease in mobile revenues resulted mainly from lower voice revenues at the mobile operations of Magyar Telekom (T-Mobile Hungary, TMH) and at our foreign subsidiaries. These decreases were offset by higher broadband and equipment revenues at TMH.

(1) Data published by the Montenegrin Agency for Electronic Communications and Postal Services (EKIP).

To maintain sustainable competitiveness in the corporate sector, we have committed to further developing our IT competencies by focusing on complex service offerings.

#### **Voice-retail revenue**

Voice-retail revenues consist of revenues from subscriptions, voice-retail traffic and roaming voice revenues.

Within mobile telecommunications services, voice revenues represent the largest component of revenues, which amounted to HUF 212.5 billion in 2011. At TMH, voice-retail traffic revenues dropped in the prepaid segment due to lower customer base, declined average usage per customer per month ("MOU") and lower retail tariffs forced by strong competition. Lower voice-retail revenues at T-Mobile Macedonia ("T-Mobile MK") were mainly resulting from lower customer number and lower average price per minute.

Mobile penetration reached 117.3% in Hungary and TMH accounted for 45.0% market share in the highly competitive mobile market at December 31, 2011 based on the total number of SIM cards. TMH's customer base increased by 1.1% year over year. The proportion of postpaid customers increased to 50.8% at December 31, 2011 from 48.2% a year earlier.

#### **Voice-wholesale revenues**

Voice-wholesale revenues consist of domestic and international incoming traffic revenues.

The decrease in voice-wholesale revenues in Hungary reflects decreased termination fees (16% decrease from December 1, 2010), slightly offset by higher customer base and higher incoming MOU. At T-Mobile Crna Gora ("T-Mobile CG"), lower voice-wholesale revenues were due to reduced interconnection tariffs towards domestic operators and also due to lower volume of incoming minutes in the postpaid segment.

#### **Voice-visitor revenues**

Visitor revenues declined at TMH due to regulated tariff reduction and lower usage. At our foreign subsidiaries decreased visitor revenues were driven by the higher discounts given.

#### **Non-voice revenues**

Higher non-voice revenues were primarily due to TMH's higher mobile Internet revenues. This increase was partially offset by lower messaging revenues. Non-voice revenues represented 22.8% of total ARPU in 2011. By December 31, 2011 TMH had 1,048,514 mobile broadband customers and accounted for a 48.7% market share based on total number of subscriptions in the mobile broadband market.

#### **Equipment**

Mobile equipment and activation revenues increased by 14.6% in 2011 compared to 2010, mainly at TMH. Higher retention revenues resulted from higher average handset prices reflecting an increased sales ratio of higher priced smartphones and lower prepaid handset subsidy. The increase at our foreign subsidiaries was primarily attributable to the higher number of handsets sold.

### Other mobile revenues

Other mobile revenues remained broadly stable year on year.

### SI/IT Revenues

The following table sets forth information regarding our SI/IT revenues:

	Year ended December 31,		2011/2010
	2010	2011	
	(in HUF millions)		(% change)
SI and IT revenues	44,773	48,547	8.4

System Integration ("SI") and IT revenues increased by 8.4% from HUF 44.8 billion in 2010 to HUF 48.5 billion in 2011. Increased infrastructure revenues at Magyar Telekom Plc. were driven mainly by significantly higher project revenues in 2011. The inclusion of Daten-Kontor revenues in 2011 and the higher application revenue at IQSYS due to revenues from sale of Digital table in 2011 also contributed to the increase. These increases were offset by considerably less government projects at KFKI in 2011 and declined outsourcing revenues at Dataplex mainly due to lower revenues from the invoicing of energy cost (reduced prices and consumption) in 2011.

### Operating Expenses

The following table sets forth information regarding our operating expenses:

	Year ended December 31,		2011/2010
	2010	2011	
	(in HUF millions)		(% change)
Voice-, data- and Internet-related payments	65,247	60,598	(7.1)
Material cost of telecommunications equipment sold	41,037	44,595	8.7
SI/IT-related payments	21,624	24,890	15.1
Other direct costs	29,519	30,964	4.9
Direct costs	157,427	161,047	2.3
Employee-related expenses	93,884	91,823	(2.2)
Depreciation and amortization	100,872	132,915	31.8
Hungarian telecommunications and other crisis taxes	26,970	25,350	(6.0)
Other operating expenses	121,780	129,707	6.5
<b>Total operating expenses</b>	<b>500,933</b>	<b>540,842</b>	<b>8.0</b>

### Voice-, data- and Internet-related payments

Voice-, data- and Internet-related payments decreased to HUF 60.6 billion in 2011 compared to HUF 65.2 billion in 2010, predominantly resulting from lower voice-related payments to domestic mobile operators in Hungary driven by lower mobile termination fees applied from December 2010 and also by declined traffic. Drop in payments to mobile operators at Makedonski Telekom was mainly due to lower traffic volumes. At Crnogorski Telekom, the decrease is mainly due to lower traffic volumes and decreased tariffs from April 2011.

### Material cost of equipment sold

The material cost of telecommunications equipment increased by 8.7%, from HUF 41.0 billion in 2010 to HUF 44.6 billion in 2011. In 2011, the dynamic growth in the sale of higher category handsets (i.e. smart phones) at Magyar Telekom Plc. and at our foreign subsidiaries resulted in higher cost of equipment sales.

### SI/IT-related payments

SI/IT-related payments increased by 15.1% in 2011 and amounted to HUF 24.9 billion. SI/IT-related payments increased at ISH in line with higher outsourcing revenues generated in 2011. The inclusion of Daten-Kontor's outpayments in 2011 also contributed to the increase.

### Other direct costs

Other direct costs include HUF 0.9 billion content-related payments, HUF 10.9 billion TV-related payments, HUF 11.0 billion agent commissions and HUF 8.1 billion other revenue-related payments in 2011. Increased other direct costs at Magyar Telekom Plc. are mainly due to energy costs appearing in line with the launch of retail energy trade in H2 2010. Higher TV-related payments at Magyar Telekom Plc. and at Makedonski Telekom, due to higher TV subscriber base, also contributed to the increase. These increases were partly offset by lower agent commissions year over year. The decline in agent commissions at T-Mobile MK is due to decreased sale through dealers and at Magyar Telekom Plc. due to drop in agent activity and lower commission fees per transaction.

### Employee-related expenses

Employee-related expenses in 2011 amounted to HUF 91.8 billion compared to HUF 93.9 billion in 2010 (a decrease of 2.2%). This decrease was mainly attributable to the 1.4% lower employee figure at MT Group-level year on year (from 10,258 on December 31, 2010 to 10,111 on December 31, 2011) and decreased income tax payable on fringe benefits due to modified legislation in Hungary. The inclusion of the employees of Daten-Kontor after its consolidation in 3Q 2011 partially offset these decreases, together with higher bonus payments and higher provision made for the future lay-offs at Magyar Telekom Plc.

### Depreciation and amortization

Depreciation and amortization increased by 31.8% in 2011 compared to 2010. The significant growth is resulting from the HUF 31.4 billion goodwill impairment recognized in our Macedonian segment based on the fair value less cost to sell (FVLCS) calculations. The main reason for the impairment is that the 10-year revenue plans of the Macedonia segment prepared in 2011 had to be reduced by 7-19% compared to the plans prepared a year before due to the unfavorable economic environment and fiercer than expected mobile competition resulting in significant pricing pressure and an increasing level of handset subsidies in Macedonia. This increase was slightly offset by decreased amortization at Magyar Telekom Plc., mainly due to the amortization effect of the change in estimated useful life of certain assets and the higher amount of assets that were fully written off.

### Hungarian telecommunications and other crisis taxes

On October 18, 2010 the Hungarian Parliament approved an act imposing a special tax ("crisis tax") on a number of sectors including the telecommunications sector. Special tax for the full year 2010 (amounting to HUF 27.0 billion) was recognized in December 2010 among other operating expenses, while it is booked on a monthly basis in 2011 amounting to HUF 25.4 billion.

### Other operating expenses

Other operating expenses include mainly materials and maintenance, marketing, service fees, fees and levies, rental fees, bad debt expense and consultancy.

Other operating expenses increased by 4.2% to HUF 155.1 billion in 2011 from HUF 148.8 billion in 2010. The majority of the increase in other operating expenses is caused by the HUF 16.2 billion provision booked in 2011 in connection with the investigation based on the agreement with the SEC and the DOJ. Higher rental fees at Magyar Telekom Plc. were predominantly due to the rental fee of set top boxes from June 2010. These increases were partly offset by decreased consultancy fee due to lower expenses recognized relating to the CRM and Finance Streamlining projects and also due to lower investigation-related costs in 2011 at Magyar Telekom Plc. The decrease in marketing expenses at Magyar Telekom Plc. result from the rescheduling of these spendings. Decreased bad debt expenses at Magyar Telekom Plc. are mainly the result of the substantial efforts made for debt collecting in 2011. Materials and maintenance decreased at Magyar Telekom Plc., predominantly driven by lower IT support costs (renegotiated hardware and software support contracts).

### Other operating income

The following table sets forth information concerning other operating income:

	Year ended December 31,		2011/2010
	2010	2011	
	(in HUF millions)		(% change)
Gain on sale of PPE, Intangible assets and assets held for sale	327	1,940	493.3
Income received for the relocation and reconstruction of our own network	1,233	1,166	(5.4)
Penalty interest collected	853	964	13.0
Government grants received/receivable for the compensation of expenses	-	811	n.a.
Other operating income	1,035	1,511	46.0
<b>Total other operating income</b>	<b>3,448</b>	<b>6,392</b>	<b>85.4</b>

Other operating income increased from HUF 3.4 billion in 2010 to HUF 6.4 billion in 2011 mainly due to the gains from disposal of real estates at Magyar Telekom Plc. A government grant received for the Norwegian project at Mindentudás Egyeteme in 2011 also contributed to the increase. Higher other operating income at Makedonski Telekom was mainly due to release of provision for legal cases and also due to increased gain from sale of fixed assets in 2011.

### Operating profit

Operating margin for the year ended December 31, 2011 was 10.6% compared to 18.4% in 2010. The decrease was mainly due to the 2.0% revenue decline, the HUF 31.4 billion goodwill impairment and the HUF 16.2 billion provision made in relation to the investigation in 2011.

### Interest income

The following table sets forth information concerning interest income:

	Year ended December 31,		2011/2010
	2010	2011	
	(in HUF millions)		(% change)
Finance lease interest income	1,334	1,150	(13.8)
Other interest income	3,604	2,483	(31.1)
<b>Total interest income</b>	<b>4,938</b>	<b>3,633</b>	<b>(26.4)</b>

In 2011, bank interest income declined due to lower interest received on loans given and on bank deposits mainly at our foreign subsidiaries in line with lower average amount of loans also had a negative effect on net financial results.

### Interest expense

The following table sets forth information concerning interest expense:

	Year ended December 31,		2011/2010
	2010	2011	
	(in HUF millions)		(% change)
Interest expense to DT	18,397	17,492	(4.9)
Other interest expense	4,660	3,476	(25.4)
Finance lease interest expense	529	922	74.3
Accretion interest on provisions	704	1,578	124.1
less: borrowing costs capitalized	(506)	(284)	43.9
<b>Total interest expense</b>	<b>23,784</b>	<b>23,184</b>	<b>(2.5)</b>

The 2.5% decrease in interest expenses in 2011 resulted mainly from lower interest paid on loans received in line with lower average interest rate and lower average amount of loans at Magyar Telekom Plc.

**Other finance expense – net**

The following table sets forth information concerning other finance expense – net:

	Year ended December 31,		2011/2010
	2010	2011	
	(in HUF millions)		(% change)
Fee expense	4,236	4,174	(1.5)
Net foreign exchange losses / (gains)	2,855	21,095	638.9
Losses / (gains) on the subsequent measurement of financial instruments at fair value through profit and loss (derivatives) contracted with related parties	(1,410)	(11,303)	(701.6)
Losses / (gains) on the subsequent measurement of financial instruments at fair value through profit and loss (derivatives) contracted with third parties	998	(4,359)	n.m.
Losses / (gains) on the derecognition of financial instruments at fair value through profit and loss contracted with related parties	1,996	2,581	29.3
Losses / (gains) on the derecognition of financial instruments at fair value through profit and loss contracted with third parties	592	723	22.1
Losses / (gains) on the derecognition of AFS financial instruments (Reclassifications from Other comprehensive income)	-	-	-
<b>Total other finance expense – net</b>	<b>9,267</b>	<b>12,911</b>	<b>39.3</b>

The increase in net other finance expenses primarily result from higher net foreign exchange loss realized in 2011, as the weakening of HUF against EUR was more intensive in 2011. In 2011, Magyar Telekom Plc. booked HUF 1.1 billion as interest and HUF 4.5 billion forex loss on the provision for litigation in connection with the investigation. Lower net forex gain at Makedonski Telekom and Stonebridge was due to the less favorable movement of EUR/MKD which also contributed to the increase in 2011. These impacts were partly offset by higher gain on derivative transactions due to changes in interest and exchange rates at Magyar Telekom Plc.

See Notes 3, 16 and 17 to the Consolidated Financial Statements for certain quantitative and qualitative information about financial instruments.

**Income tax – Total**

The following table sets forth information concerning our income tax expense:

	Year ended December 31,		2011/2010
	2010	2011	
	(in HUF millions)		(% change)
Income tax expense	6,583	27,538	318.3

Income tax expense increased significantly despite the lower profit before tax of the Group year on year. The main driver is the elimination of the enacted reduction of the Hungarian corporate tax rate from 19% to 10% effective from 2013, which resulted a large one-off deferred tax expense. The non deductibility of the DOJ penalty from the corporate income tax base also increased the tax expense in 2011.

For more details on tax rates, tax credits and deferred taxes see Note 9 to the Consolidated Financial Statements.

Magyar Telekom introduced a new reporting structure from the beginning of 2011. The Group's operating segments are: Telekom Hungary, T-Systems Hungary, Macedonia and Montenegro.

### Development of business in the operating segments

Magyar Telekom introduced a new reporting structure from the beginning of 2011 following the introduction of its new management structure on July 1, 2010. The Group's new operating segments are Telekom Hungary (which includes the former CBU, the SMB customers of the former BBU and the relevant parts of the former Headquarters and former Technology Units)" and T-Systems Hungary (which includes the former BBU, without the SMB customers, that have been classified within Telekom Hungary, as well as the relevant parts of the Headquarters and Technology Unit).

The Group also has full-scale mobile and fixed line telecommunications operations in Macedonia and Montenegro, which represent two additional reporting segments of the Group. We hold a 100% interest in Stonebridge Communications AD, which controls Makedonski Telekom, the leading fixed line telecommunications services provider and, through its subsidiary T-Mobile Macedonia, the leading mobile telecommunications operator in Macedonia. We also hold a 76.53% ownership in Crnogorski Telekom, the principal fixed line telecommunications services provider and the second largest mobile telecommunications operator in Montenegro. There have been no changes to the Macedonia and Montenegro segments.

Comparative information has been provided for 2010, including a minimum level of estimates as the new structure was gradually introduced in the second half of 2010, going into effect in full from January 1, 2011.

The revenues and expenses of the segments include both primary and secondary results. The primary revenues are derived from external parties, while the secondary ones are allocated from the other segments. Similarly, the primary expenses are paid to external parties, while the secondary ones are charged by the other segments. All secondary revenues and expenses are eliminated in the Group's financial statements.

Magyar Telekom has been subject to the special telecommunications tax introduced in Hungary in Q4 2010, charged on the companies' annual revenues, retrospectively from January 1, 2010. As introduced in Q4 2010, this tax in 2010 only hit the Q4 results of both the Group and the segments. The presented EBITDA of the Hungarian segments (Telekom Hungary and T-Systems Hungary), however, include the special telecommunications tax both in 2010 and 2011.

EBITDA for each segment could, in principle, be reconciled to the segment's operating profit, the most directly comparable financial measure according to IFRS, by adding depreciation and amortization. However, depreciation and amortization is not allocated to the segments (it is not a segment measure); therefore the reconciliation cannot be prepared and presented on a segment basis. Accordingly, we provide a reconciliation of the total segment EBITDA to consolidated profit for the period of the Group.

The following tables set forth revenues and EBITDA by segment, as reported to the Management Committee of the Company:

	Year ended December 31,		2011/2010 (% change)
	2010	2011	
	(in HUF millions)		
<b>Revenues</b>			
Total Telekom Hungary revenues	432,054	422,794	(2.1)
Less: Telekom Hungary revenues from other segments	(38,873)	(35,506)	8.7
<b>Telekom Hungary revenues from external customers</b>	<b>393,181</b>	<b>387,288</b>	<b>(1.5)</b>
Total T-Systems Hungary revenues	117,869	122,237	3.7
Less: T-Systems Hungary revenues from other segments	(11,780)	(15,783)	(34.0)
<b>T-Systems Hungary revenues from external customers</b>	<b>106,089</b>	<b>106,454</b>	<b>0.3</b>
Total Macedonia revenues	77,598	71,359	(8.0)
Less: Macedonia revenues from other segments	(134)	(130)	3.0
<b>Macedonia revenues from external customers</b>	<b>77,464</b>	<b>71,229</b>	<b>(8.0)</b>
Total Montenegro revenues	32,874	32,697	(0.5)
Less: Montenegro revenues from other segments	(44)	(42)	4.5
<b>Montenegro revenues from external customers</b>	<b>32,830</b>	<b>32,655</b>	<b>(0.5)</b>
Total consolidated revenue of the segments	609,564	597,626	(2.0)
Measurement differences to Group revenue	15	(9)	n.m.
<b>Total revenue of the Group</b>	<b>609,579</b>	<b>597,617</b>	<b>(2.0)</b>
<b>Segment results (EBITDA)</b>			
Telekom Hungary	144,909	128,223	(11.5)
T-Systems Hungary	14,756	18,444	25.0
Macedonia	40,248	37,914	(5.8)
Montenegro	11,370	11,453	0.7
<b>Total EBITDA of the segments</b>	<b>211,283</b>	<b>196,034</b>	<b>(7.2)</b>
Measurement differences to Group EBITDA	1,683	48	(97.1)
<b>Total EBITDA of the Group</b>	<b>212,966</b>	<b>196,082</b>	<b>(7.9)</b>
Total EBITDA of the Group	(100,872)	(132,915)	(31.8)
<b>Total Operating profit of the Group</b>	<b>112,094</b>	<b>63,167</b>	<b>(43.6)</b>
Net financial result	(28,113)	(32,462)	(15.5)
Share of associates' and joint ventures' profits / (losses)	(27)	12	n.a.
<b>Total Profit before income tax of the Group</b>	<b>83,954</b>	<b>30,717</b>	<b>(63.4)</b>
Income tax expense	(6,583)	(27,538)	(318.3)
<b>Total Profit for the year of the Group</b>	<b>77,371</b>	<b>3,179</b>	<b>(95.9)</b>

Negative trends were largely offset by outstanding revenue generation performance of the SI/IT, TV and mobile broadband businesses, and equipment sales also rose considerably.

Magyar Telekom signed a purchase agreement to acquire Daten-Kontor Kft., Globe Banking Software (Globe), and Budakalász Kábel TV Kft. in 2011. For further information about our acquisitions in 2011, see Note 5.1 to the Consolidated Financial Statements.

For the investments in capital expenditures for 2010 and 2011 by our reportable segments, see Note 32.1.1 to the Consolidated Financial Statements.

### Telekom Hungary segment

The Telekom Hungary segment operates in Hungary providing mobile, fixed line telecommunications and TV distribution services (including marketing, sales and customer relations activities) to residential and small businesses telecommunications customers with several million customers mainly under the T-Mobile and THome brands. The Telekom Hungary segment is also responsible for the wholesale mobile and fixed line services in Hungary, and performs strategic and cross-divisional management and support functions including Procurement, Treasury, Real estate, Accounting, Tax, Legal, Internal Audit and similar shared services and other central functions of the Group's management. This segment is also responsible for the Group's points of presence in Bulgaria, Romania and in Ukraine providing wholesale services to local companies and operators. In addition, the Telekom Hungary segment is responsible for the operations and development of the mobile, fixed line and cable TV network as well as IT management in Hungary.

The following table sets forth information regarding the Telekom Hungary segment:

	Year ended December 31,		2011/2010 (% change)
	2010	2011	
	(in HUF millions)		
Voice revenues	82,374	71,425	(13.3)
Internet revenues	41,886	40,679	(2.9)
TV revenues	25,551	28,229	10.5
Other fixed line and SI/IT revenues	42,799	45,870	7.5
Total fixed line and SI/IT revenues	192,610	186,203	(3.3)
Voice revenues	164,095	157,147	(4.2)
Non-voice revenues	41,767	44,764	7.2
Other mobile revenues	33,582	34,680	3.3
Total mobile revenues	239,444	236,591	(1.2)
<b>Total revenues</b>	<b>432,054</b>	<b>422,794</b>	<b>(2.1)</b>
Hungarian telecommunications and other crisis taxes	(22,834)	(21,485)	5.9
<b>EBITDA</b>	<b>144,909</b>	<b>128,223</b>	<b>(11.4)</b>

The following tables set forth key non-financial information regarding the Telekom Hungary segment:

Fixed Line Services	Year ended December 31,		(% change)
	2010	2011	2011/2010
<b>Market data</b>			
Retail DSL market share (%) (estimated) <sup>(1)</sup>	63	64	n.a.
Cable broadband market share (%) (estimated) <sup>(1)</sup>	20	22	n.a.
<b>Voice services</b>			
Total voice access	1,688,405	1,604,035	(5.0)
Total outgoing traffic (thousand minutes)	2,860,882	3,049,192	6.6
Blended MOU (outgoing) <sup>(2)</sup>	144	166	15.1
Blended ARPA (HUF) <sup>(2)</sup>	3,518	3,138	(10.8)
<b>Data products</b>			
Number of retail DSL customers	476,923	499,923	4.8
Number of cable broadband customers	181,056	212,631	17.4
Number of fiber optic connections	19,109	31,611	65.4
Total retail broadband customers	677,088	744,165	9.9
Blended broadband ARPU (HUF)	4,243	3,950	(6.9)
Number of wholesale DSL access	130,965	107,215	(18.1)
<b>TV services</b>			
Number of cable TV customers	370,212	289,693	(21.7)
Number of satellite TV customers	254,188	281,312	10.7
Number of IPTV customers	124,374	226,385	82.0
Total TV customers	748,774	797,390	6.5
Blended TV ARPU (HUF)	2,949	3,048	3.4

(1) Data relates to Magyar Telekom Plc.

(2) Including PSTN, VoIP and VoCable.

Mobile Services	Year ended December 31,		(% change)
	2010	2011	2011/2010
<b>Market data</b>			
Mobile penetration (%) <sup>(1)</sup>	120.2	117.3	n.a.
Mobile SIM market share (%) <sup>(2)</sup>	43.4	45.0	n.a.
Mobile broadband market share based on total number of subscriptions (%) <sup>(2)</sup>	47.8	48.7	n.a.
Mobile broadband market share based on subscriptions with data transfer (%) <sup>(2)</sup>	48.6	47.7	n.a.
Population-based indoor 3G coverage (%) <sup>(2)</sup>	65.4	66.0	n.a.
<b>Mobile operations</b>			
Number of customers (RPC)	4,779,227	4,817,296	0.8
Postpaid share in the customer base (%)	43.6	46.2	n.a.
MOU <sup>(3)</sup>	154	161	4.5
ARPU (HUF)	3,492	3,393	(2.8)
Postpaid	6,071	5,695	(6.2)
Prepaid	1,635	1,535	(6.1)
Overall churn rate (%)	20.2	19.5	n.a.
Postpaid (%)	14.9	14.5	n.a.
Prepaid (%)	24.0	23.6	n.a.
Ratio of non-voice revenues in ARPU (%)	18.8	21.0	n.a.
Average acquisition cost (SAC) per gross add (HUF)	6,616	6,449	(2.5)
Number of mobile broadband subscriptions	568,060	971,469	71.0

(1) Data relates to the mobile penetration in Hungary, including customers of all three service providers.

(2) Data relates to Magyar Telekom Plc.

(3) Restated.

## Revenues

Revenues in the Telekom Hungary segment decreased by 2.1% year over year mainly driven by lower fixed line and mobile voice revenues, declining fixed line Internet revenues, partly compensated by higher other fixed line and TV revenues as well as higher mobile Internet and equipment revenues.

Fixed line voice-retail revenues experienced a decline mainly due to lower PSTN subscription fee revenues resulting from the decrease in the average number of fixed lines. The decrease was also due to lower outgoing traffic revenues due to the loss of lines and price discounts reflecting the unfavorable economic environment and also competition with VoIP and VoCable operators. The increasing popularity of flat rate packages (e.g., Hoppá) led to lower ARPA but, on the other hand, it proved to be a successful tool in preventing PSTN churn. While PSTN revenues continued to decrease, the increase in VoIP and VoCable revenues driven by an enlarging customer base and higher traffic slightly mitigated these decreases.

Internet revenues decreased by 2.9% in 2011 compared to 2010. The decrease reflects mainly the lower DSL revenues due to much lower number of wholesale connections and lower prices forced by intense competition mainly from cable and mobile operators. The migration towards double- and triple-play packages also had a negative effect on blended ARPU level. This decrease was partly offset by the increase in retail DSL subscriber base and by the higher number of Cablenet customers.

Decreased fixed line voice and Internet revenues were partly compensated by higher other fixed line revenue at Magyar Telekom Plc. driven by significant revenues generated from the retail energy trade business (introduced in 2010).

Higher IPTV and satellite TV revenues driven by a larger customer base and higher ARPU also compensated for the decrease. The IPTV customer base increased by 82.0% to 226,385, while the number of satellite TV customers increased by 10.7% to 281,312 by the end of December 2011. These increases were partly offset by lower Cable TV revenues influenced by the decreased customer base due to migration from Cable TV to IPTV technology and, to a lesser extent, by lower ARPU.

Mobile revenues slightly decreased year over year due to lower voice-retail revenues mainly attributable to lower outgoing tariff levels and lower voice-wholesale revenues due to the decrease in wholesale termination fees applied from December 1, 2010. These decreases were mostly compensated by higher non-voice revenues in line with wider usage of mobile Internet and by the increase in equipment revenues driven by higher average handset prices in retention.

## EBITDA

In 2011, EBITDA of the Telekom Hungary segment decreased by 11.4% year over year as lower total revenues together with higher other operating expenses (influenced by the provision made in connection with the investigation in 2011) were only partially offset by declining voice-related payments and higher other operating income.

## T-Systems Hungary segment

T-Systems Hungary provides mobile and fixed line telecommunications, info-communications and system integration services (including marketing, sales and customer relations activities) mainly under the T-Systems and T-Mobile brands to key business partners (large corporate customers and public sector).

The following table sets forth key financial information regarding the T-Systems Hungary segment:

	Year ended December 31,		2011/2010
	2010	2011	
	(in HUF millions)		(% change)
Voice revenues	11,223	9,926	(11.6)
Data revenues	15,920	14,391	(9.6)
Other fixed line revenues	5,451	5,717	4.9
Total fixed line revenues	32,594	30,034	(7.9)
Voice revenues	17,759	16,523	(7.0)
Non-voice revenues	8,824	9,112	3.3
Other mobile revenues	7,411	7,487	1.0
Total mobile revenues	33,994	33,122	(2.6)
SI/IT revenues	51,281	59,081	15.2
<b>Total revenues</b>	<b>117,869</b>	<b>122,237</b>	<b>3.7</b>
Hungarian telecommunications and other crisis taxes	(4,136)	(3,865)	6.6
<b>EBITDA</b>	<b>14,756</b>	<b>18,444</b>	<b>25.0</b>

The following table sets forth information regarding the key operating statistical figures of T-Systems Hungary segment:

	Year ended December 31,		(% change)
	2010	2011	2011/2010
<b>Fixed Line Services</b>			
<b>Voice services</b>			
Business PSTN lines	43,795	42,137	(3.8)
Managed leased lines (Flex-Com connections)	3,454	2,360	(31.7)
ISDN channels	141,342	135,246	(4.3)
Total lines	188,591	179,743	(4.7)
Total outgoing traffic (thousand minutes)	331,189	282,873	(14.6)
MOU (outgoing)	206	188	(8.6)
ARPU (HUF)	4,983	4,578	(8.1)
<b>Data products</b>			
Number of retail broadband access	14,543	15,561	7.0
Retail DSL ARPU (HUF)	9,393	8,339	(11.2)
<b>Mobile Services</b>			
Number of customers (RPC)	429,191	447,930	4.4
MOU	289	288	(0.3)
ARPU (HUF)	5,354	4,918	(8.1)
Overall churn rate (%)	4.4	6.3	n.a.
Ratio of non-voice revenues in ARPU (%)	33.1	35.6	n.a.
Average acquisition cost (SAC) per gross add (HUF)	3,537	5,166	46.1
Number of mobile broadband subscriptions	56,390	77,045	36.6

## Revenues

Total revenues of T-Systems Hungary slightly increased in 2011 compared to 2010 due to higher SI/IT revenues, Internet and mobile equipment revenues. These increases were partly offset by lower data revenues and lower mobile voice revenues.

Fixed line voice-retail revenues decreased reflecting the erosion both in the customer base and traffic, while lower fixed line data revenues were influenced mainly by decreased prices due to fierce competition.

Mobile voice revenues decreased by 7.0% year over year predominantly due to lower voice-retail revenues as a result of lower average per minute fee and decreased outgoing MOU, partly compensated by higher average customer base. Increased non-voice revenues were driven by higher Internet revenues reflecting increased mobile broadband customer base. Equipment revenues also increased due to higher average handset prices boosted by the growing popularity of smartphones.

The 15.2% increase in SI/IT revenues mainly resulted from higher infrastructure revenues at Magyar Telekom Plc. T-Systems driven by significantly higher project revenues in 2011. The inclusion of Daten-Kontor revenues in 2011 and higher application revenues at IQSYS due to digital table sales in 2011 also contributed to the increase. These increases were partly offset by considerably less government projects at KFKI in 2011.

**EBITDA**

The EBITDA level of T-Systems Hungary increased by 25.0% deriving mainly from significantly higher SI/IT revenues. Decreased voice-related payments, declined employee-related expenses and lower other operating expenses also contributed to the EBITDA increase, partly offset by higher SI/IT-related payments.

**Macedonia**

The following table sets forth information regarding the Macedonian operations:

	Year ended December 31,		2011/2010
	2010	2011	
	(in HUF millions)		(% change)
Total fixed line and SI/IT revenues	35,194	33,733	(4.2)
Total mobile revenues	42,404	37,626	(11.3)
<b>Total revenues</b>	<b>77,598</b>	<b>71,359</b>	<b>(8.0)</b>
<b>EBITDA</b>	<b>40,248</b>	<b>37,914</b>	<b>(5.8)</b>

The currency translation effect on the results of our Macedonian operations was relatively small (0.9% on average) year over year.

The following tables set forth information regarding the key operating statistical figures of Macedonia:

Fixed line services	Year ended December 31,		(% change)
	2010	2011	2011/2010
<b>Market data</b>			
Fixed line penetration (%)	17.2	15.9	n.a.
Retail DSL market share (estimated) (%)	84	83	n.a.
<b>Voice services</b>			
Total voice access	343,019	311,240	(9.3)
Total outgoing traffic (thousand minutes)	864,662	811,824	(6.1)
<b>Data products</b>			
Number of retail DSL customers	130,127	137,563	5.7
Number of wholesale DSL access	21,091	23,847	13.1
<b>Total DSL access</b>	<b>151,218</b>	<b>161,410</b>	<b>6.7</b>
<b>TV services</b>			
Number of IPTV customers	30,123	40,129	33.2

Mobile services	Year ended December 31,		(% change)
	2010	2011	2011/2010
<b>Market data</b>			
Mobile penetration (%)	1 22.8	1 22.8	n.a.
T-Mobile Macedonia's market share (%)	51.3	50.0	n.a.
<b>Mobile operations</b>			
Number of customers (RPC)	1,295,285	1,265,243	(2.3)
Postpaid share in the customer base (%)	32.3	32.0	n.a.
MOU	135	142	5.2
ARPU (HUF)	2,690	2,533	(5.8)

### Revenues

Excluding the currency translation effects, total fixed line and SI/IT revenues decreased primarily as a result of lower voice-retail revenues reflecting the loss of fixed lines and lower traffic affected by strong competition and mobile substitution. This decrease was largely offset by higher international incoming revenues due to higher volume of traffic and increased termination fees, and, to a smaller extent, by the increase in TV revenues due to the enlarging IPTV subscriber base.

Mobile revenues in local currency decreased mainly resulting from lower voice-retail revenues due to lower per minute fees. Visitor revenue decreased as a result of the discount given to other roaming partners. Non-voice revenues also decreased as the decline in visitor non-voice revenue due to lower usage and higher given discounts in 2011 and the lower data revenues due to SMS promotions were only partly compensated by higher mobile Internet revenues resulting from increased traffic. These decreases were somewhat compensated by higher equipment revenues mainly driven by increased number of handset sold in retention. Higher voice-wholesale revenue was primarily a result of increased traffic volume due to the larger subscriber base of VIP and higher price for international interconnection. T-Mobile MK had a 50.0% share in the Macedonian mobile market and mobile penetration was 122.8% at the end of 2011.

In 2011 our revenues and underlying EBITDA decreased more moderately than our previous estimates, primarily due to our strong focus on cost efficiency.

### EBITDA

EBITDA of our Macedonian operations decreased by 5.8% in HUF terms mainly as a result of lower total revenues, largely offset by the decrease in other operating expenses, lower direct costs as well as decreased employee related expenses.

## Montenegro

The following table sets forth information regarding the Montenegrin operations:

	Year ended December 31,		2011/2010
	2010	2011	
	(in HUF millions)		(% change)
Total fixed line and SI/IT revenues	17,666	17,576	(0.5)
Total mobile revenues	15,208	15,121	(0.6)
<b>Total revenues</b>	<b>32,874</b>	<b>32,697</b>	<b>(0.5)</b>
<b>EBITDA</b>	<b>11,370</b>	<b>11,453</b>	<b>0.7</b>

The results of our Montenegrin operations were positively affected by the 0.9% strengthening of the EUR against the HUF on average year over year.

The following table sets forth information regarding the key operating statistical figures of Montenegro:

	Year ended December 31,		(% change)
	2010	2011	2011/2010
<b>Fixed line services</b>			
<b>Market data</b>			
Fixed line penetration (%)	26.6	26.4	n.a.
Retail DSL market share (estimated) (%)	86	85	n.a.
<b>Voice services</b>			
Total voice access	171,684	168,361	(1.9)
Total outgoing traffic (thousand minutes)	369,511	332,934	(9.9)
<b>Data products</b>			
Number of DSL access	68,540	78,164	14.0
<b>TV services</b>			
Number of IPTV customers	40,042	48,834	22.0
<b>Mobile services</b>			
<b>Market data</b>			
Mobile penetration (%) <sup>(1)</sup>	199.5	186.9	n.a.
T-Mobile Crna Gora's market share (%) <sup>(1)</sup>	37.0	34.7	n.a.
<b>Mobile operations</b>			
Number of customers (RPC) <sup>(1)</sup>	457,813	401,958	(12.2)
Postpaid share in the customer base (%)	33.4	32.3	n.a.
MOU	105	117	11.4
ARPU (HUF)	2,430	2,521	3.7

(1) Data published by the Montenegrin Agency for Electronic Communications and Postal Services (EKIP).

Magyar Telekom has maintained leading positions in its Hungarian fixed line, mobile, Internet and ICT businesses in 2011.

### Revenues

Excluding the currency translation effects, total fixed line revenues slightly decreased. Lower voice-retail revenues due to declining outgoing traffic and lower voice-wholesale revenues due to lower volume of terminated and transited international incoming traffic were mainly counterbalanced by higher Internet revenues driven by increased DSL connections and higher TV revenues thanks to the increased IPTV subscriber base.

Mobile revenues in EUR decreased by a small extent year on year as lower voice-wholesale revenues were mainly counterbalanced by higher non-voice revenues.

In the second quarter of 2010, it was determined that a number of prepaid mobile fill-up vouchers had been misappropriated at Crnogorski Telekom. Accordingly, we reversed previously recognized revenues of EUR 0.8 million and recognized a provision of EUR 0.4 million in relation to VAT and other costs associated with the misappropriated vouchers, resulting in a negative EBITDA impact totaling EUR 1.2 million.

Excluding this EUR 0.8 million one-off impact on mobile revenues, prepaid voice-retail revenues decreased due to the lower customer base, while postpaid revenues declined due to lower ARPU. Voice-wholesale revenues also decreased resulting from the decrease in interconnection tariffs for domestic operators and lower incoming traffic in postpaid segment. Higher non-voice revenues due to increased usage of Internet and content services had a positive effect on total mobile revenues.

### EBITDA

EBITDA of our Montenegrin operations remained broadly stable expressed in HUF, since total operating expenses decreased in line with the revenue decline.

## Cash flow analysis

The following table sets forth information concerning our cash flows:

	Year ended December 31,		2011/2010
	2010	2011	
	(in HUF millions)		(% change)
Net cash flows			
From operating activities	164,670	168,781	2.5
Used in investing activities	(52,848)	(77,752)	(47.1)
Used in financing activities	(130,589)	(93,228)	28.6
Exchange gains on cash and cash equivalents	338	809	139.3
Change in cash and cash equivalents	(18,429)	(1,390)	92.5
Cash and cash equivalents, beginning of year	34,270	15,841	(53.8)
Cash and cash equivalents, end of year	15,841	14,451	(8.8)

Our primary source of liquidity are cash flows from operating activities. Net cash generated from operating activities amounted to HUF 168.8 billion in 2011, while it was HUF 164.7 billion in 2010. The lower EBITDA was fully offset by the favorable changes in working capital.

Net cash flows from investing activities are primarily driven by capital expenditures and acquisitions of businesses. Net cash used in investing activities amounted to HUF 77.8 billion in 2011, while it was HUF 52.8 billion in 2010 reflecting the change in other financial assets, partly offset by lower investments in tangible and intangible assets and higher proceeds from sale of real estates.

Free cash flow, defined as operating cash flow and investing cash flow adjusted for proceeds from / payments for other financial assets, increased from HUF 77.5 billion in 2010 to HUF 92.0 billion in 2011. This increase was mainly due to the favorable changes in working capital and lower capex, partly offset by the lower EBITDA.

Net cash flows from financing activities primarily relate to our borrowing activities and dividend payments. Net cash used in financing activities decreased from HUF 130.6 billion in 2010 to HUF 93.2 billion in 2011 due to significantly lower dividends paid and lower amount of loan repayments made in 2011.

# Corporate governance and social responsibility

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## Corporate governance report

Magyar Telekom Plc. is a public limited company listed on the Budapest Stock Exchange. In 2004, the Budapest Stock Exchange issued its Corporate Governance Recommendations ("the Recommendations") containing suggestions related to the corporate governance practice of companies listed on the Budapest Stock Exchange, taking account of the most commonly used international principles, of experiences gathered in Hungary, and of the characteristics of the Hungarian market as well as the Companies Act. The Recommendations were updated in 2007 and 2008.

In line with the current regulations, the Board of Directors and the Supervisory Board of Magyar Telekom Plc. approved the Corporate Governance Report of the Company prepared based on the Corporate Governance Recommendations and submitted it to the Annual General Meeting. The report – along with other corporate governance related documents - is posted on the Corporate Governance section of our website:

[http://www.telekom.hu/investor\\_relations/corporate\\_governance/corporate\\_governance\\_documents](http://www.telekom.hu/investor_relations/corporate_governance/corporate_governance_documents)

The Corporate Governance Declaration on Compliance with the Corporate Governance Recommendations, and in case of specific recommendations the possible deviations and their explanations are included in the report. Points 1, 2, 3, 4 and 5 of the above report include the description and operation of the Board of Directors, the Supervisory Board, the relevant committees and executive management. Point 6 of the report includes a description of our internal controls and risk management procedures, while point 8 of the report describes our disclosure policies and insider trading guidelines.

The General Meeting of the shareholders has the sole right to approve and amend the Articles of Association (section 6.2. [a]) unless otherwise provided by law.

The detailed rules on the competencies and operation of the Board of Directors are detailed in 7.4 of our Articles of Association and in the Rules of Procedure of the Board of Directors, which are also posted on the Corporate Governance section of our website. The rules of competence regarding the capital increase and purchase of treasury shares are detailed in Sections 6.2 (b) and (s) as well as 7.4.1 (l) and (m) of our Articles of Association.

We continue our transformation to become the most highly regarded service company in an extended market of telecommunications and related industries.

### Board of Directors

Under Hungarian laws, the Board of Directors is responsible for all matters relating to the Company's management and course of business not otherwise reserved for the General Meeting or for other corporate bodies by the Articles of Association or by the Hungarian laws. The Board of Directors is required to report annually to the shareholders at the General Meeting and quarterly to the Supervisory Board on our business administration, state of assets and business policy.

See further information about the Board of Directors above, in Our management.

### Management Committee

Pursuant to the Rules of Procedure of the Board of Directors, the Board of Directors established a Management Committee in 2000, which is empowered to carry out the day-to-day operations in accordance with the annual business plan.

See further information about the Management Committee above, in Our management.

## Supervisory Board

The Supervisory Board carries out its activities based on Section 8 of the Articles of Association and its Rules of Procedures approved by the General Meeting of the shareholders. The Supervisory Board has to examine every important report on business policy and every submission made on matters falling into the exclusive competence of the General Meeting. The General Meeting may pass resolution on the annual report prepared in accordance with the Act on Accounting and the use of the profit after income tax only upon receipt of the written report of the Supervisory Board, whereas the proposal of the Board of Directors on the payment of dividends and the Company's corporate governance report can only be submitted to the General Meeting with the prior approval of the Supervisory Board.

Pursuant to the Articles of Association, the Supervisory Board consists of a minimum of three and a maximum of fifteen members elected by the General Meeting for a term of three years. The Workers' Council nominates one third of the Supervisory Board members. Meetings of the Supervisory Board have a quorum if two-thirds of the elected members are present.

On December 31, 2011, the members of the Supervisory Board, their principal occupation and the years of their original election were as follows:

Name	Name	Principal Occupation	Member since
Dr. László Pap	1943	Budapest University of Technology, Professor	1997
Dr. János Bitó	1936	Chairman of the Thesis and Final Examination Board at Pázmány Péter Catholic University, Information Technology Faculty	2010
Attila Bujdosó	1967	President of the Telecommunications Trade Union	2010
Dr. János Illéssy	1962	Managing Director, Lebona Kft.	2006
Dr. Sándor Kerekes	1948	Director of Institute of Environmental Sciences Corvinus University Budapest	2006
Konrad Kreuzer	1948	Chairman of the Board of Directors of E.ON Hungary Zrt.	2006
Tamás Lichnovszky	1962	Chairman of the Central Workers' Council	2010
Martin Meffert	1960	Responsible for Corporate Governance issues at Magyar Telekom, at Makedonski Telekom, at Crnogorski Telekom and at the Headquarters of Deutsche Telekom AG.	2009
Dr. Károly Salamon	1954	Chairman - Chief Executive Officer of MKB General Insurance Zrt. and MKB Life Insurance Zrt.	2010
Zsoltné Varga	1969	Quality Manager, Magyar Telekom Plc.	2008
György Varju	1946	Central Workers' Council expert	2005
Dr. Konrad Wetzker	1950	Chairman, Corvinus School of Management	2011

The members' mandate lasts until May 31, 2013.

## Other Principal Directorships of Members of the Supervisory Board

Name	Position held	Company
Dr. László Pap	Member of the Supervisory Board	Viking Zrt.
Dr. János Bitó	None	
Attila Bujdosó	None	
Dr. János Illéssy	None	
Dr. Sándor Kerekes	Chairman of the Advisory Board	Zöld Iránytű Alapítvány
	Member of the Supervisory Board	Tomori Pál Főiskola
	Member of the Advisory Board	Vezetőképzésért Alapítvány
	Member of the Advisory Board	Lélegzet Alapítvány
Konrad Kreuzer	Chairman of the Board of Directors	E.ON Slovensko
	Chairman of the Supervisory Board	E.ON Észak-dunántúli Áramszolgáltató Zrt.
	Chairman of the Supervisory Board	E.ON Dél-dunántúli Áramszolgáltató Zrt.
	Chairman of the Supervisory Board	E.ON Tiszántúli Áramszolgáltató Zrt.
	Chairman of the Supervisory Board	E.ON Közép-dunántúli Gázszolgáltató Zrt.
	Chairman of the Supervisory Board	E.ON Dél-dunántúli Gázszolgáltató Zrt.
	Chairman of the Board of Directors	Zapadoslovenska Energetika, Slovakia
	Member of the Board of Directors	Budapest Airport Zrt.
Member of the Supervisory Board	E.ON Bulgaria EAD	
Tamás Lichnovszky	None	
Martin Meffert	None	
Dr. Károly Salamon	None	
Zsoltné Varga	None	
György Varju	Member of the Supervisory Board	Dimenzió Insurance and Self-Aid Association
Dr. Konrad Wetzker	Member of the Board of Directors	E-Star Alternatív Nyrt.
	Member of the Board of Directors	Wildhorse Energy Ltd.

## Biographies of Members of the Supervisory Board

**Dr. László Pap**

Dr. Pap graduated from the Budapest Technical University with a degree in telecommunications. He received a PhD in 1980 and Doctor of Sciences in 1992. He has been a professor in the Electrical Engineering and Informatics Faculty at Budapest Technical University since 1992. From 1992 to 2008 he served as Head of the Telecommunications Department and from 2001 to 2004 as Strategic Vice Rector. He is a full member of the Hungarian Academy of Sciences and has obtained numerous patents for his inventions. He is the Honorary President of the Scientific Society of Telecommunications, a member of the Telecommunications Systems Committee of the Hungarian Academy of Sciences, a member of the editorial board of the periodical World of Nature and Wireless Networks, an expert of the Hungarian Space Research Governmental Committee and the president of the Scientific Committee of Space Research.

**Dr. János Bitó**

Dr. Bitó graduated from the Faculty of Natural Sciences at József Attila University of Sciences in 1958, and received a Doctor rerum naturalium in 1960. In 1967, he received a PhD, and in 1971, a Doctor of Science in technical sciences. He has taught in many Hungarian and foreign universities. Between 1971 and 2002, he worked as a technical, research and development director, managing director or chief officer at a number of companies and institutions, and as senior advisor to a minister. Between 1965 and 2005, he accomplished considerable achievements in scientific research and development. He is a member of a number of scientific organizations, including the Committee on Information Science and the Committee on Automation and Computer Science of the Hungarian Academy of Sciences. At present he is the Chairman of the Thesis and Final Examination Board at Pázmány Péter Catholic University, Information Technology Faculty.

**Attila Bujdosó**

Mr. Bujdosó holds a degree in electrical engineering from Kandó Kálmán Technical College of Budapest, Faculty of Electrical Engineering. Since 1985, he has been working at Magyar Telekom and its legal predecessors. Until 1998, he worked as an exchange maintenance technician, then as a technical coordinator and an administrative operator. He has been a member of various trade unions since 1985: between 1985 and 1990 a member of the Postal Workers' Trade Union, between 1990 and 1993 a member of the Telecommunications Workers' Trade Union, between 1993 and 2004 a member of the Hungarian Telecommunications Branch Trade Union, from 2004 a member, and since July 1, 2008, the president of the Telecommunications Trade Union. Between 2005 and 2007, he was a member of the Workers' Council and between July 1, 2008 and December 31, 2010 he was a member of the Presidency of MSZOSZ (National Confederation of Hungarian Trade Unions).

**Dr. János Illéssy**

Dr. Illéssy is an electrical engineer with a degree from the Budapest Technical University and has received MBA and PhD degrees from the University of Pittsburgh, USA. He spent over 15 years with Pannonplast, a plastics producer listed on the Budapest Stock Exchange, as consultant, controller, CFO and then Chairman-CEO. Between 2001 and 2003 he worked as CFO for the Hungarian subsidiary bank of BNP Paribas. Between 2004 and 2007 he was the CFO and member of the Board of Directors of BorsodChem. Currently, he is the managing director of Lebona Kft. and teaches Financial Economics at the Institute of International Business Relations and also at the Business School of Central European University as an Adjunct Professor.

**Dr. Sándor Kerekes**

Professor Kerekes holds an MSc in Chemistry and Economics. He received a PhD degree in Economics in 1984 and Doctor of Sciences (the highest degree awarded by the Hungarian Academy of Sciences) in 2003. In 1994, he participated in the Advanced Management Program at Harvard Business School. For 15 years, he was member or Chairman of the Board of Directors or Supervisory Boards of various Hungarian mid-size companies. Since 1986, he has served as the Head of Department and later as the director of Corvinus University and its legal predecessors. Between 1994 and 1997 and between 2002 and 2006 he served as the Dean of Business Administration Faculty of Corvinus University. He is the Director of the Institute of Environmental Sciences and was Vice Rector of Academic Affairs of Corvinus University until December 14, 2011. He is member of the editorial boards of various papers (e.g., *Economy and Society*, *Vezetéstudomány*) and the author of many books and articles.

**Konrad Kreuzer**

Mr. Kreuzer is a lawyer with a degree in Business Administration. After serving in various positions at the Universities of Munich and Konstanz and in the Ministry of Domestic Affairs of the State of Bavaria, he joined Bayernwerke utilities as the Head of the Law and Property Department. Since 1997, he has served as the Chairman of the Board of Directors of E.ON in Hungary. His current responsibilities are Legal Affairs, Gas Business and International Affairs.

**Tamás Lichnovszky**

Mr. Lichnovszky received a Bachelor's degree as licensed signal officer and telecommunications engineer in 1984 from Zalka Máté Military Technical College and as manager engineer in 2002 from the Budapest Technical College. In 2010, he received a post-graduate degree in complementary legal studies from the Pázmány Péter Catholic University. He has been working at Magyar Telekom and its legal predecessor in technical and customer service areas since 1990. He has been an elected member of the Workers' Council since 1998 and from March, 2011 he is the Chairman of the Central Workers' Council.

**Martin Meffert**

Mr. Meffert holds a degree in Telecommunications Engineering from the University of Applied Sciences and a degree in Economics from the Business and Administration Academy in Koblenz, Germany. He started his career in 1985 as a telecommunications network planner and later satellite services specialist in the regional directorate of Deutsche Bundespost in Koblenz. Between 1990 and 1998 he served in the Ministry of Telecommunications in Bonn at the departments of satellite systems and international network projects. In 1999, he joined the fixed line business of Deutsche Telekom responsible for cooperation and alliance management for various regions in South and Eastern Europe. Since the formation of the Board Area Europe within the Group Headquarters of Deutsche Telekom in 2010, he takes care of the Corporate Governance of Magyar Telekom, Makedonski Telekom and Crnogorski Telekom.

**Dr. Károly Salamon**

Dr. Salamon graduated in 1977 from the Kandó Kálmán Technical College of Budapest with a bachelor of science of Electrical Engineering, and in 1983 from Eötvös Lóránd University of Sciences with a master of science of Mathematics. He received an MBA degree at the University of Pittsburgh in 1991 and then he received a PhD from the University of Economics in Budapest in 1993. Between 1977 and 1990, he worked as a design engineer, then as a development engineer and later as a project leader at different companies. From 1990, he worked for Ernst and Young International Audit and Consulting Company as a partner. Between 1995 and 2005, he was the Chief Financial Officer, then from 2006 to 2008 the Chairman-Chief Executive Officer of Allianz Hungária Biztosító Zrt. From 2008, he was the general director of MIS Ltd. He has been the Chairman-Chief Executive Officer of MKB General Insurance Zrt. and MKB Life Insurance Zrt. since July 1, 2010.

**Zsoltné Varga**

Mrs. Varga graduated from the College of Transport and Telecommunications at Győr in 1991. She has been working for Magyar Telekom (and its legal predecessor) since 1991. From 1991 to 1996, she was an engineer in the technical area, later she was head of a T-Pont shop. Currently, she works as a quality manager. In 1998, she became an elected member of the Workers' Council and she is member of the Central Workers' Council. Since 2004 she has been a member and from 2009 deputy chairwoman of Deutsche Telekom's European Workers' Council.

**György Varju**

Mr. Varju has been working for Magyar Telekom and its legal predecessor since 1977. Until 1998, he acted as an on-site construction manager. Since 1993, to March, 2011 he was an elected Workers' Council official, between February, 2010 and March, 2011 he was Chairman of the Central Workers' Council. At present he is a Central Workers' Council expert.

**Dr. Konrad Wetzker**

Dr. Wetzker graduated from the University of Economic Science Karl Marx in Budapest in 1975, in mathematical analysis of the national economy. He earned his PhD in 1979, then in 1988 Doctor of Science. Between 1975 and 1989 he worked in applied research and was the leader of various research teams. Between 1989 and 1990 he was the President of the Institute for Applied Research in Berlin, and also a member of different Committees managing the economic part of the reunification in Germany. From 1991 until 2010 he worked for the Boston Consulting Group, in Düsseldorf, and from 1996 in Budapest, as Principal, Partner, Senior Partner and Chairman of Hungary, mainly for energy players, financial institutions, and in telecommunications and infrastructural industries. He worked for more than 50 international companies in strategy, organization and internationalization projects. He took part in supporting the market entry of Western European Players, especially in Hungary, Slovakia, and Czech Republic. He is the co-founder of the Corvinus School of Management in Budapest, and since 2005 he is its chairman. Since 2011 he is senior advisor at the Corvinus University of Budapest. He gives lessons at various universities (e.g. Harvard, University of Cambridge) and is the author of almost 100 publications (e.g. books and articles).

## Audit Committee

The Audit Committee executes its duties pursuant to the Articles of Association Point 8.7, and its own Rules of Procedures. The members of the Audit Committee have been elected from the independent members of the Supervisory Board.

On December 31, 2011, the members of the Audit Committee, their principal occupation and the years of their original election were as follows:

Name	Born	Principal Occupation	Member since
Dr. János Illéssy	1962	Managing Director, Lebona Kft.	2006
Dr. János Bitó	1936	Chairman of the Thesis and Final Examination Board at Pázmány Péter Catholic University, Information Technology Faculty	2010
Dr. Sándor Kerekes	1948	Director of Institute of Environmental Sciences Corvinus University Budapest	2006
Dr. László Pap	1943	Budapest University of Technology, Professor	1997
Dr. Károly Salamon	1954	Chairman - Chief Executive Officer of MKB General Insurance Zrt. and MKB Life Insurance Zrt.	2010

## Remuneration Committee

The Remuneration Committee makes proposals to the Board of Directors with respect to appointment and dismissal, as well as remuneration of chief officers, including establishment and assessment of bonus targets. The Remuneration Committee meets at least three times a year.

The Remuneration Committee consists of three members. The members are elected by the Board of Directors from its members.

On December 31, 2011, the members of the Remuneration Committee, their principal occupation and the years of their original election were as follows:

Name	Principal Occupation	Member since
Dr. Ralph Rentschler	Finance Europe, Financial Director Europe, Deutsche Telekom AG	2003
Dietmar Frings	Vice President Human Resources Compensation and Benefits and Labor Law, Deutsche Telekom AG	2011
Frank Odzuck	Chief Executive Officer of Zwack Unicum Plc.	2006

## Compensation of Directors and Officers

At December 31, 2011, the aggregate compensation of the members of the Board of Directors in their capacity as Board members was HUF 14.0 million in the following breakdown:

Name	Position held	Compensation
Dr. István Földesi	Member of the Board of Directors	HUF 4.68 million
Dr. Mihály Gálik	Member of the Board of Directors	HUF 4.68 million
Frank Odzuck	Member of the Board of Directors	HUF 4.68 million

At December 31, 2011, the aggregate compensation of the members of the Supervisory Board in their capacity as Supervisory Board members was HUF 55.5 million in the following breakdown:

Name	Position held	Compensation
Dr. János Illéssy	Member of the Supervisory Board	HUF 3.53 million
	Chairman of the Audit Committee	HUF 5.28 million
Dr. Sándor Kerekes	Member of the Supervisory Board	HUF 3.53 million
	Member of the Audit Committee	HUF 2.64 million
Dr. László Pap	Chairman of the Supervisory Board	HUF 5.38 million
	Member of the Audit Committee	HUF 2.64 million
Konrad Kreuzer	Member of the Supervisory Board	HUF 3.53 million
Zsoltné Varga	Member of the Supervisory Board	HUF 3.53 million
György Varju	Member of the Supervisory Board	HUF 3.53 million
Dr. János Bitó	Member of the Supervisory Board	HUF 3.53 million
	Member of the Audit Committee	HUF 2.64 million
Dr. Károly Salamon	Member of the Supervisory Board	HUF 3.53 million
	Member of the Audit Committee	HUF 2.64 million
Attila Bujdosó	Member of the Supervisory Board	HUF 3.53 million
Tamás Lichnovszky	Member of the Supervisory Board	HUF 3.53 million
Dr. Konrad Wetzker	Member of the Supervisory Board (from April 2011)	HUF 2.55 million

At December 31, 2011, the aggregate compensation of the members of the Management Committee (MC) was HUF 1,064 million.

Currently two of the MC members have an employment contract for a fixed duration. Pursuant to Hungarian legislation, if an employment contract is terminated before the end of its term, the average compensation received by the employee prior to such termination is payable for the remaining period up to 12 months. In case an employment contract for an undetermined duration is terminated, the notice period is normally six months, and severance is between 10 and 16 months.

In addition to the above, the affected persons are bound by the non-compete clause, under which the employee is barred from entering into employment with any Hungarian or international competitor of Magyar Telekom and is required to refrain from providing direct or indirect services or activities of any kind to such companies for a definite period (not longer than one year) upon termination of his/her employment. Furthermore, such employee is barred from any action aimed to recruit employees of Magyar Telekom for any other company. This limitation entails certain compensation which is proportional with the above obligation. If the employee is in breach of the agreement, he/she will reimburse the net amount of compensation to the employer. In addition, the employee will be liable for a payment of compensation to the employer.

The MC members from foreign countries may be entitled to housing subsidies.

In line with the Company's remuneration guidelines, the company provides contribution-based personal pension scheme and the personal insurance scheme on behalf of the MC members. In addition, the MC members are entitled to the use of company cars.

For information about our Mid-term Incentive Plan (MTIP), see Note 24.1 to the Consolidated Financial Statements. For information about the Matching Share Plan, see Note 24.4 to the Consolidated Financial Statements. For further information about the compensation of key management and Deutsche Telekom's Stock Option Plan, see Note 34.4 to the Consolidated Financial Statements.

## Share ownership of Management

The following table sets out information relating to holdings of ordinary shares by our directors and executive officers at December 31, 2011:

Name	Position	No. of Shares Owned
Christopher Mattheisen	CEO, Chairman of the Board of Directors	19,041
Thilo Kusch	CFO, Member of the Board of Directors	3,500
Dr. Mihály Gálik	Member of the Board of Directors	1,000
Tamás Lichnovszky	Supervisory Board Member	7,790
Zsoltné Varga	Supervisory Board Member	1
György Varju	Supervisory Board Member	320
Éva Somorjai	Chief Human Resources Officer	2,300
<b>Total</b>		<b>33,952</b>

## Employees

In line with Magyar Telekom's corporate strategy we renewed our HR principles and strategic priorities. In 2011 we prepared for a total paradigm change in terms of all HR related activities. A new Human strategy was elaborated that generates a complete structural change influencing the Company, the employees and the HR team.

- Human strategy from the Company's aspect
  - Efficient company – continuous and proportionate decrease of Total Workforce Management (TWM) cost
  - Competitive company – competitive edge based on human capital through training development and career management
  - Energized company – international, diverse and healthy organization that experiences success
- Human strategy from the employees' aspect
 

People development will be carried through enhancing employee experience that is a major element of our strategy. The stages of Telekom employment cycle were identified in 2011 and we matched appropriate HR tools with each stage in order to develop all of our employees:

  - Employer brand building – we create a livable and likeable workplace, which is satisfactory for our employees and attractive on the labor market. We are going to be among the "Top 3 Best Employer" and be among the "Top 5 Most Desired Employer" in Hungary.
  - Selection – we create a diverse workplace with maintaining the healthy level of internal succession rate and encouraging atypical staffing. We also plan to increase the ratio of women in management to 30%.
  - Agreements – we establish transparent, flexible and reliable frameworks of conditions. We maintain a balanced partnership with employee representative bodies and identical contracts will be concluded with people in identical employment pools.
  - Orientation – we make our new colleagues real members of the team by sharing our knowledge, culture and experience with them. Our Orientation program will be renewed in order to have an informative and efficient event for the new employees. We introduce a buddy program to make assimilation into the corporate culture easier.
  - Remuneration – We introduce a transparent, simpler and consistent job grading model, which reflects primarily the respective values of jobs, and provides for market comparison, as a basis for a competitive remuneration policy.
  - Training development, organizational development – our qualified employees provide us a competitive edge. Following the international best practice we spend two percent of personnel expenditure on training and development. Ten percent of all training will be provided from internal resources.
  - Work-life balance – Our energized employees make us successful. We are going to introduce and run a complex stress management that helps preserving mental and physical condition of our employees.
  - Fair dismissal – when we dismiss an employee, we do it in a fair manner. We make it clear for employees that retaining one's marketability is one's own responsibility.

Our company's practice is adapted to Hungarian legislative norms. 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.

### Headcount

We had 10,111 employees as of December 31, 2011. The following table provides information concerning the number of full-time employees, including full-time equivalents, of Magyar Telekom Plc. and its consolidated subsidiaries:

	At December 31,		
	2009	2010	2011
Magyar Telekom Plc.	6,459	6,076	6,097
Magyar Telekom Plc. and its consolidated subsidiaries	10,828	10,258	10,111

The following table provides information on the breakdown of Magyar Telekom's employees by segment:

	At December 31,		
	2009	2010	2011
Hungary	6,152	6,084	6,124
T-Systems	1,709	1,662	1,594
Macedonia	1,754	1,698	1,668
Montenegro	876	814	725
All other	337	0	0
<b>Total</b>	<b>10,828</b>	<b>10,258</b>	<b>10,111</b>

### Total Workforce Management

From 2009, Magyar Telekom introduced a Total Workforce Management (TWM) system. This scheme focuses on the total labor cost and not solely on headcount number and employee-related expenses. As a result, it enables us to increase the flexibility and efficiency with which all human resource-related expenses are managed, including contracted or temporary employees as well as outsourcing and entrepreneurial contracts.

### Workforce Reduction and Redeployment

Centralization, technological improvements and attrition have allowed us to reduce the size of our workforce. While overall personnel levels are falling (disregarding the technical effects of acquisitions and Total Workforce Management), the number of highly skilled employees is increasing. We plan to further reduce the number of our employees.

In order to simplify and streamline its organization, Magyar Telekom has already implemented several integration steps. The merger with T-Mobile Hungary in March 2006, the integration of Emitel and the access business area of T-Online into the parent company from October 2007 and the integration of T-Kábel from October 2009 enabled the management to eliminate overlaps and simplify the processes and the operational structure of the Group. The decision on the change in the organizational model was a further step to ensure a more customer-focused approach and a lean management structure. With the aim to further improve efficiency and reduce headcount, management started negotiations with the trade unions and reached an agreement in October 2011.

In line with Magyar Telekom's corporate strategy we renewed our HR principles and strategic priorities. In 2011 a new Human strategy was elaborated.

According to the terms of the agreement, the Company plans to make 250 employees redundant in 2012. The majority have left the Company by the end of 2011. This figure does not include – among others – the employment termination of executives and employees retiring. In addition, to achieve further efficiency improvements, the organization will be simplified and the number of directors will be cut by 24%. Total severance expenses related to the headcount reduction will be approximately HUF 2.6 bn and the majority of these were accounted for in the fourth quarter of 2011. Furthermore due to change of the structure of the remuneration system HUF 1.0 bn was accounted.

The agreement with the trade unions also states there will be no general increase in the base salary for employees in 2012. However, to meet the Government's expectation to compensate employees with below average wages for adverse tax law changes, benefits in kind will be increased for effected employees. These additional employee benefits will be cut at managerial positions.

These efficiency improvement measures are necessary steps to mitigate the negative trends in the telecommunications industry being faced by Magyar Telekom. Increasing competition in all segments and a tougher regulatory (roaming regulation and reducing termination fees) and macroeconomic environment will put pressure on our performance in coming years.

#### **Employee Representation and Labor Relations**

Magyar Telekom Plc. has entered into a collective bargaining agreement with the Hungarian telecommunications trade unions (Távközlési Szakszervezet, TÁVSZAK and Magyar Távközlési Ágazati Szakszervezet, MATÁSZ). The agreement, which can be terminated by either party with three months' notice, applies to all Magyar Telekom Plc. employees except the CEO, regardless of their union membership status. Wage terms in the agreement must be renegotiated annually. Under the agreement, employees are generally entitled to prior notice before termination. Furthermore, employees are entitled to a specific amount of severance pay, which depends on the tenure of the employee. Employees are also entitled to welfare benefits as discussed below.

In addition to the collective bargaining agreement, employees of our Hungarian operations are generally covered by the Hungarian Labor Code, Law XXII of 1992, as amended, which imposes various restrictions on the involuntary termination of employment. The Hungarian Labor Code protects employee interests through two different labor organizations: the Trade Union and the Workers' Council.

The Trade Union, as the official representative of employee interests in negotiations relating to the terms of employment, has the right to be informed of all corporate measures that may significantly affect the interests of employees and to commence legal action against us for employment-related conduct that infringes an employment rule. In addition, the Workers' Council directly represents employee interests in dealings with management and decides jointly with management on matters involving employee welfare funds and institutions. The Workers' Council must be informed semi-annually on issues affecting our economic performance and changes in wages, employment conditions and working hours. The Workers' Council must also be consulted on corporate measures affecting employees.

Under the Act IV of 2006 on Business Associations (the Companies Act), employee representatives on the Supervisory Board are nominated by the Workers' Council in cooperation with the Trade Union. The composition of the Supervisory Board is approved by the AGM. At least one third of the members of the Supervisory Board must be employee representatives. On December 31, 2011, three members of the Supervisory Board were employee representatives. These members were Tamás Lichnovszky, Zsoltné Varga and György Varju.

We believe that our relations with our employees are good. We have not experienced any labor strikes or disruptions since our formation.

## Pensions and Benefit Programs

Magyar Telekom'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.

We provide employees with discounted telephone services, subsidized meals, interest-free loans to purchase real estate (such loans are not offered or extended to the Company's executive officers and directors), discount holiday facilities and other fringe benefits. In addition to our statutory contributions to governmental health, retirement and unemployment schemes, we contribute to the employees' voluntary pension fund and supplementary benefits fund, which provide private pension and health insurance benefits supplementing government pension and health benefits. We do not, however, guarantee payment by the benefits fund to its members. At the end of 2011, approximately 79% of all employees participated in the pension plan, 53% in the self-help plans and 80% in the health fund.

Our new Sustainability Strategy, encompassing five years (2011–2015), is to provide a competitive edge to the Company in the long run.

## Sustainability

The Company's 3-year sustainability strategy was closed last year. The key strategic objective of 2008–2010 was: 'While maintaining its position, Magyar Telekom's leading sustainability role should become clear and visible for employees and customers'. This was implemented alongside the following key challenges:

- Corporate governance and risk management: Magyar Telekom strives to maintain transparent and accountable operations, while ensuring compliance, anti-corruption and efficient risk management. Its goals include, for example, the development of our compliance system, as well as the improvement of environmental and social performance of our suppliers.
- Customer relations: The Company aims to increase awareness among its customers about its efforts made in order to promote sustainable development. The relevant set of objectives include, among others, popularizing electronic product and service order placement solutions, an increasing quality of service provision to customers, as well as familiarizing customers with the Group's sustainability initiatives.
- Strengthening the communication means available to society: It is important for Magyar Telekom that in addition to following technological development trends, the benefits offered by ICT solutions would be available for everyone. The Group's objectives include the continuance and development of its programs aimed at eliminating the digital divide, the provision of ICT services of special relevance in the context of sustainability, as well as the communication of the sustainability impacts of our products and strengthening our customers' sense of responsibility.
- Decreasing the environmental footprint: Telecommunication products and services – while enabling raw material and energy savings – also burden the environment. The Company's aim is to further decrease this burden. The key task is fighting climate change: the Company has set the target of decreasing its CO<sub>2</sub> emission by 10% by 2011. Magyar Telekom also wishes to help customers to decrease their emissions, while it supports them in adapting to the climate change.
- Human resources management: "Committed, professionals ready to take the initiative are the key success factor to Magyar Telekom Group's business effectiveness." (Magyar Telekom's HR Vision). In this spirit, the Company strives to further develop its human capital, attract and retain talent, as well as ensure equal opportunities and promote the establishment of work-life balance.
- Maintaining trust and credibility: In order to maintain social trust, every company must conduct its business transparently and upon consideration of all stakeholders' expectations. In light of this concept, Magyar Telekom's goal, among others, is to further strengthen the protection of children from adult content, as well as to join and to start major sustainability initiatives.

We determined 34 tasks as part of the strategy, which we further broke down to sub-tasks. Overall, the tasks were implemented with 94% success rate.

We measure our sustainability position by the Dow Jones Sustainability Index (DJSI) and by various prizes, while the visibility of our leading role is measured by residential and employee surveys. These help establish the following:

- In the professional evaluation, on the basis of the DJSI (in 2010, 72 points) we earned a position in the top third league worldwide and also topped this position with several awards. Besides, in the CSR 24/7 rating we took the first place in 2009 both in Hungary and in Central Europe. In 2010 we maintained our first place in Hungary, but OMV from Austria was better than us in the region. It is also a warning sign that, although we do not know their points, another Hungarian company has also made it to the DJSI.
- Awards in 2011: Green HR Award, CSR 24/7 Rating 1st place, "Business World for the Environment" (HBLF) 2nd place, Employee Volunteering Award, CEERIUS sustainability index membership.
- The awards we won during the term of the strategy are available on the following website: [http://www.telekom.hu/society\\_and\\_environment/prizes\\_ratings](http://www.telekom.hu/society_and_environment/prizes_ratings)
- In the residential survey 6-7% of the respondents name Magyar Telekom and its offered brands as leading sustainability company and products, but 90% of the respondents cannot specifically name any company. In the employee survey 18% name the Company as leading player, but 60% cannot name any company at all. In view of this, we do not consider this part of the main objective implemented.

Trends influencing the new sustainability strategy, adopted in 2011

- Professional evaluation of the previous strategic period
- The European Union's 'Europe 2020' strategy
- The EU's 3x20 climate package that lasts until 2020
- EU recommendation for the ICT sector: 20% CO<sub>2</sub> reduction by 2015
- Corporate trends, e.g. Climate Groups' 30% initiative
- Deutsche Telekom sustainability requirements
- Responsible investments and increase of their value
- Changing customer requirements

### Sustainability strategy 2011-2015

Our new Sustainability Strategy, encompassing five years (2011–2015), has been harmonized with the strategies of other corporate divisions. The main objective of the strategy is to make sustainability part of Magyar Telekom's identity, thus providing a competitive edge to the Company in the long run.

We wish to achieve this objective on the basis of our performance demonstrated so far, the responsible investment ratings and the principles followed during the last three years, with a more intensive communication of our commitment to our stakeholders, new and ambitious goals, adopting best practices, as well as forceful and targeted communication.

The strategy will be implemented through the tasks of 22 topics, along the following key priorities:

- Brand management: our goal is to raise awareness to the concept of sustainability and to enhance the sustainability perception of Magyar Telekom
- Innovation management: our goal is to increase innovations aimed at society and environment
- Climate strategy: our goal is to reduce the CO<sub>2</sub> emission of the group by 20% by 2015 (base year: 2004)
- Supplier standards: our goal is to develop a regulated sustainable supplier chain process
- Effects of telecommunication services: our goal is to increase the ratio of sustainable products and services, and to keep our customers informed

Magyar Telekom Group as the leading info-communication service provider of the region – in harmony with its Mission – is committed to the idea of sustainable development and within it to the environmental issues. The Company, realizing its role and potential in the information society, contributes to the decrease of negative environmental impacts in Hungary by performing our activities in a regulated and controlled way, fulfilling the EU requirements and complying with the international standards. The Magyar Telekom Group's environmental commitment and taken responsibilities are published in the Magyar Telekom Group Environmental Policy ([http://www.telekom.hu/static/sw/download/Magyar\\_Telekom\\_environmental\\_policy.pdf](http://www.telekom.hu/static/sw/download/Magyar_Telekom_environmental_policy.pdf)), which contains obligations for the group-members individually and for the Group all together.

Magyar Telekom Group as the leading ICT service provider of the region is committed to the idea of sustainable development and within it to the environmental issues.

#### Climate protection

- In 2011 Magyar Telekom purchased 51 GWh renewable energy from E.ON, as part of its total energy consumption, which accounts for almost 23% of the total volume used by Magyar Telekom Plc. In the new 5-year strategy, the goal in order to achieve the defined KPI is 46 GWh of green energy.
- In 2011, two 100% electric cars were purchased; they have been in operation since January 2012 in Magyar Telekom's fleet. One of the vehicles supports the mechanics of the Technical Services Directorate in their work, while the other one is available to the employees of Telekom, as a so-called key car. One of the important benefits of electronic cars is that no hazardous substances are emitted during their operation (0 g/km emission), and their fuel consumption is also low (electric energy equal to 1-1.5 liters of gas for 100 kilometers).
- Besides a five percent reduction of fuel consumption, the Sustainability Strategy for the 2011–2015 period defines two basic objectives: by the end of 2015, the average CO<sub>2</sub> emission of the vehicles must not exceed 157.7 g/km, and the ratio of hybrid and electronic cars among all vehicles of personal use should be increased to 20%. In order to promote the achievement of the above objectives, Magyar Telekom issued a regulation and subsidizes the procurement of hybrid benefit cars by a special allocated budget and has elaborated a system of incentives (bonus-malus) aimed at encouraging people to opt for low-CO<sub>2</sub> cars.
- In order to achieve its climate protection objectives, Magyar Telekom has launched a research and development project on its base station located in Iszkahegy, based on the utilization of wind and solar energy. During the project a wind-wheel with vertical axis will be mounted on the tower (planned implementation by the end of March 2012), and a solar cell following the sun was installed on the roof of the container near the tower. An additional goal is to continuously monitor the green power generation results and to analyze the possibility of expansion.

#### Voluntary programs

In 2011, the European Year of Volunteering we increased the social sensitivity of our employees by organizing voluntary programs. Similarly to previous years, the Jövő/Menő program offered voluntary work opportunities for those interested. The objective of the program is to ensure sustainable development for the handicapped small regions (the first location is the Mezőcsát small region). The objective of the Digital Bridge in Small Settlements program is to introduce and disseminate the achievements and opportunities of information and communications technology in regions where digital divide is present. Furthermore, as of 2011 we have encouraged the spreading of corporate volunteering by organizing charity team buildings. During the year 389 of our colleagues did 480 working days (3,840 working hours) of voluntary work, within the frame of which we granted to the society 19.9 million HUF of theoretical voluntary contribution.

#### Annual Sustainability Report

One of Magyar Telekom Group's commitments is that it annually publishes a report about its sustainability performance. Reports are prepared in accordance with the GRI G3 principles of Global Reporting Initiative (GRI) published in 2006, thus meeting the expectation that the reports comply with the principles of transparency and international comparability. Each year since 2007 Magyar Telekom achieved the highest compliance in accordance with the international principles, so its Sustainability report for the year 2010 continued to apply the principles on A+ level for the fourth time already. In 2011 independent assurance report with the GRI criteria was completed and certified by PricewaterhouseCoopers in accordance with ISAE 3000 international standard. Further details on the sustainability performance of the company can be found in the annual reports available on the site: [http://www.telekom.hu/society\\_and\\_environment/sustainability\\_reports](http://www.telekom.hu/society_and_environment/sustainability_reports).

## Research and development activities

In 2011 Magyar Telekom continued to strengthen the alignment of its innovation processes with the corporate strategy under the governance of the Innovation and Corporate Development Directorate. The cross-functional R&D Committee devised the R&D priorities based on the Group Strategy. The R&D Committee assesses and approves the research topics proposed by the business units according to this priority set.

The R&D Committee convenes regularly in order to discuss and decide on the approval of individual R&D proposals, initiated and executed within a project framework by the respective business units. During 2011, the Committee reviewed more than 100 proposals, out of which 55 have been approved, accounting for a total investment of HUF 512 million (including HUF 470 million reflected as operating expenses and HUF 42 million reflected as employee-related expenses).

The Company leverages the synergy effect of external and internal knowledge base by collaborating to well known innovation centers both within Hungary and abroad. Our main partners are the well known Hungarian Universities (Budapest University of Technology and Economics, Corvinus University of Budapest, University of Szeged) and the Hungarian Academy of Sciences.

Magyar Telekom has also participated in several international R&D projects, for example:

- the NAPA-WINE project, which started in 2008 and finished in 2011, supported by the European Union (FP7: Seventh Framework Program) together with established universities (e.g., Politecnico di Torino, Budapest University of Technology and Economics) and other significant telecommunications companies (e.g. France Telecom, Telekom Polska).
- The Optical Access Seamless Evolution which started in 2010 and will end in 2012 as a collaboration between major telecommunication operators, technology providers and universities from Europe supported also by the European Union (FP7: Seventh Framework Program).

## Risk management

It is our policy that all disclosures made by us to our security holders and the investment community would 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 the Disclosure Committee and developed and have continuously enhanced our risk management policies.

Our risk management includes identification, assessment and evaluation of risks, development of necessary action plans, and monitoring of performance and results. For risk management to be effective, we must ensure that management make business decisions with full understanding of all relevant risks.

In 1999, we established a formal risk management system. 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 internal regulation 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 throughout the Group. All of our subsidiaries, business units, divisions and entities are obliged to identify and report their operational risks on a quarterly basis. After evaluation of these risks, results are reported to our management, to the Board of Directors, to the Audit Committee, to the Disclosure Committee and to Deutsche Telekom.

As part of the integration into DT's risk management process, we enhanced our risk management procedures with a new element. For the sake of 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 and subsidiaries to report on a real-time basis any new material fact, information or risk that comes to their knowledge. Information thus submitted is monitored and evaluated by the risk management area and CFO is notified when a new material risk or information is identified.

An internal regulation has been issued to define responsibilities of each employee in risk monitoring and management. In addition, an e-learning course was introduced 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 the 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.

### Financial risk management

For information about our Financial risk management, see Note 3 to the Consolidated Financial Statements.

### Risk factors

We have identified several risk factors which may affect our business in the future. The risks described below are not the only risks we face. Additional risks not currently known to us or risks that we currently regard as immaterial also could have a material adverse effect on our financial condition or results of operations or the trading prices of our securities. The summary of our principal risks and uncertainties are described below:

#### **Our operations are subject to substantial government regulation, which can result in adverse consequences for our business and results of operations.**

The Electronic Communications Act of 2003 (Electronic Communications Act), which came into force in January 2004, was enacted by the Hungarian Parliament to achieve harmonization of the telecommunications regulatory regime in Hungary with the New Regulatory Framework (NRF) of the EU for electronic communications adopted in 2002, and to encourage further competition in the market.

The NRF has been subject to review by the EU since 2007. The agreed reforms to the NRF accepted in November 2009 are the result of three years of discussions with stakeholders, national regulators and users. Changes to the NRF were required to be implemented by national legislation by May, 2011. The Hungarian Electronic Communications Act was modified and entered into force August 3, 2011. The significant executive decrees were already published by the National Media and Infocommunications Authority of Hungary by the first quarter of 2012.

The National Media and Infocommunications Authority of Hungary (NMIA) was officially established on August 11, 2010 to ensure the undisturbed operation, in compliance with applicable legislation, of the media and the markets for electronic communications, postal and information technology services in Hungary in accordance with the Electronic Communications Act and Act I of 1996 on Television Broadcasting, as amended. The new, converged regulator performs the tasks of its predecessors: the National Communications Authority (NCA) and the National Radio and Television Commission (NRTC). According to the official announcement, the purpose of the merger, among others, is cost efficiency, more rational allocation of resources, more cost effective work, avoidance of duplication of work and better cooperation of the supporting activities within a single organizational structure. One of the primary responsibilities of the NMIA is to perform market analysis procedures under which it defines "relevant markets", or markets subject to the regulatory framework. The NMIA analyzes such markets for the level of competition and, if it finds a lack of sufficient competition in such markets, identifies service providers with significant market power (SMP), and imposes appropriate regulatory obligations on such providers to encourage competition.

The relevant markets examined by NMIA are the same as the relevant markets listed in the revised Recommendation of the European Commission on relevant product and service markets within the electronic communications sector (2007/879/EC, relevant markets 1-7/2007). As a result of the EU review, the number of relevant markets decreased from 18 to 7. Related to these relevant markets several market analysis procedures have been closed by NMIA. According to the current regulation, the NMIA must analyze the relevant markets once in three years. The following market analysis round has begun by the data provision requests. The current relevant product and service markets are: access to the public telephone network at a fixed location for residential and non-residential customers (1/2007); call origination on the public telephone network provided at a fixed location (2/2007); call termination on individual public telephone networks provided at a fixed location (3/2007); wholesale (physical) network infrastructure access at a fixed location (4/2007); wholesale broadband access (5/2007); wholesale terminating segments of leased lines (6/2007) and voice call termination on individual mobile networks (7/2007). Magyar Telekom is currently identified as having SMP in all of the 7 relevant markets.

The NMIA places the utmost importance on safeguarding customers' rights. One objective of the market surveillance procedures started by NMIA is the strengthening of consumer protection between electronic communication service providers and their consumers. During the NRF implementation, the regulations related to the general terms and conditions and the detailed rules of subscriber contracts were modified and became more rigorous. Due to stricter consumer protection rules further market surveillance procedures are expected.

The Hungarian Government wants to undertake a greater role in domestic ICT market through the following intentions: government purpose network and services, national mobile payment system, new mobile market entrant as a consortium of the state owned Hungarian Post (Magyar Posta), the Hungarian Electricity Works (MVM) and a unit of the Hungarian Development Bank (MFB). The exact details, timing and impact of the above mentioned concepts are not yet known. The Government intends to develop and restructure the operation of Government-related networks in order to be able to operate a high quality and safe electronic public administration. On November 7, 2011 the government announced its decision that MVM will take over the operation of the EKG Network (Uniformed Government Backbone Network) from Magyar Telekom. Services will be switched over to the new network continuously starting from December, 2011. According to the new operation model, services will be provided by National Infocommunications Services Zrt.

The European Commission (the Commission) has issued a recommendation on mobile termination rates by prescribing detailed cost accounting methodology to be applied over a set timeframe by the national regulatory authorities (NRAs). The latest final mobile termination resolution was published in August 2011 setting fees till Dec 2013.

On June 30, 2007 an EU regulation, the Roaming Regulation I. entered into force which regulates international roaming tariffs for wholesale and retail customers on the basis of a capped pricing system. After the first review of roaming prices development, the European Commission published a stricter Roaming Regulation II. on June 29, 2009. It applied to voice, SMS and data roaming fees and resulted in significant price decreases. Roaming Regulation II. is currently being reviewed. In 2011, the EU published several different draft versions of its Roaming Regulation III. proposal. Operators assume the implementation of intensive price decreases both on retail and wholesale levels, furthermore structural measures regarding roaming are expected by 2014.

In addition, our businesses in Macedonia and Montenegro are also subject to various regulatory developments. In 2011 relevant markets were defined by the Agency for Electronic Communications and Postal Services (EKIP) in Montenegro. New obligations from 2012 are publication of cost based reference offer and accounting separation submissions. These requirements may have an impact on the profitability of the company.

In Macedonia, in particular, the current and possible future SMP status of T-Mobile Macedonia and Makedonski Telekom in various markets may lead to additional obligations, such as lower mobile termination rates, national roaming, lower RUO and IC fees, access to ducts and specific network elements, universal service and requirements to publish general conditions and quality parameters of services. The activities of the Agency for Electronic Communications (AEC) related to retail price control will be enhanced.

We cannot fully anticipate the combined impact of these and other regulatory developments on our business and results of operations. Our business and results of operations may be adversely affected by these changes or similar regulatory developments or changes by our regulators.

**We are subject to more intense competition.**

The scope of competition and any adverse effect on our results depend on a variety of factors that we cannot assess with precision and are for the most part not within our control. Among such factors are business strategies and capabilities of new competitors, prevailing market conditions, as well as the effectiveness of our efforts to prepare for new market conditions. Specific risks in the fixed line market include continuous downward pressure on tariff levels, loss of customers as a result of unbundled access to the local loop, loss of fixed line customers as a result of introducing "naked" ADSL (i.e., without a subscription for a PSTN line), competition from alternative operators using new technologies (e.g., VoIP, VoCable) and migration to lower priced Internet price plans as a result of speed upgrades. In addition, the declining prices of mobile telecommunications services also lead to the migration of fixed line customers.

The most significant trend in the fixed line market is the increasing share of 2Play or 3Play offers (bundling voice, Internet and television services into one package) which usually results in discounts on purchased services for customers. In Hungary, cable penetration is above the European average. From a competition point of view, the unregulated cable television operators may be able to offer more flexible price structures to customers than the regulated market players can, such as Magyar Telekom. In the case of increasing price competition, this may narrow our ability to give adequate market responses against the competitors' actions.

In the mobile communications business, we already face intense competition. As all telecommunications markets have become increasingly saturated, the focus of competition has shifted from customer acquisition to retention. Significant customer defections could have an adverse effect on our results of operations, and customer acquisition and retention expenses are substantial. Due to the increased level of competition and new price plans, prices for mobile telephone services have been declining over the past several years and may continue to decline.

New market models using Internet-based messaging and communication services may adversely affect both of our fixed line and mobile voice and messaging services. Entry by MVNOs into the mobile telecommunications market may intensify the competition in Hungary. MVNOs are mobile operators that do not own their own spectrum or network infrastructure, and instead buy the use of the spectrum and network infrastructure from traditional mobile operators and provide mobile telecommunications services to consumers based on the purchased capacity. MVNOs are likely to target the lower segment of the market and such development will likely increase price-based competition. Currently there is no regulation in Hungary where incumbents would be obliged to provide regulation based access prices for MVNOs. We do not expect changes in this field in the near future.

For example, on November 20, 2009, Vodafone, in cooperation with Magyar Posta, launched a branded reseller mobile service, "Postafon", which is offered by Magyar Posta in several post offices. Telenor has also launched a new mobile service in cooperation with Red Bull (the producer of energy drinks) under the name "Red Bull Mobile". Also, on February 1, 2012 Lidl (discount supermarket chain) launched branded mobile services under the name "Blue Mobile" in co-operation with Magyar Telekom, and Tesco (retailer chain) launched "Tesco Mobile" MVNO service partnering with Vodafone on March 1, 2012. The entry pressure from other interested parties to the mobile market may increase in the future. If an MVNO is hosted by one of our competitors, Magyar Telekom could lose revenue as customers may be lost to the MVNO and the tariff level in the Hungarian mobile market may significantly decrease.

There is a frequency spectrum allocation risk and national roaming obligation risk due to the current frequency tenders/auctions announced by NMIA. As a consequence to the frequency tenders, mobile market competition may increase.

- **900 MHz:** The Office of the NMIA launched the bidding procedure for the right of use of a total amount of 10.8 MHz of unused spectrum in the 900 MHz frequency band in August, 2011. Due to the implementation of the modified GSM Directive, the spectrum can be utilized in a technology-neutral manner. Based on the final and non-appealable decision of the authority on March 9, 2012, there could be a new market entrant in the mobile market, which would be a consortium of the state-owned Hungarian Post (Magyar Posta), the Hungarian Electricity Works (MVM) and a unit of the Hungarian Development Bank (MFB). The new entrant has won 5 MHz in the 900 MHz band, and an option for 15 MHz in the 1800 MHz band and 15 MHz in the 2100 MHz. Pursuant to the final decision, Magyar Telekom won the right of use of two duplex frequency blocks of 1 MHz. Vodafone secured 2 MHz spectrum, while Telenor won 1.8 MHz.
- **26 GHz:** NMIA registered the five applicants for the tender of 26 GHz, among of them Magyar Telekom. The announced frequency package contains 26 blocks which support the build-up of 3G and 4G mobile networks and able to establish other data connection between network elements. Based on the authority's announcement on March 20, 2012, all applicants obtained authorizations for a range of the frequency band for a period of 15 years.
- **450 MHz:** The future of the 450 MHz band is still on the agenda of the Ministry of National Development and NMIA.

The final deadline of Digital Switchover (hereby the availability of Digital Dividend band, the 61-69 UHF frequency band for mobile utilization) was delayed until 2014 by the Hungarian Government. It does not support our network development goals, as the delay will not enable us to use this band to improve the quality of our services.

We also face intense competition in the market for Internet services, as well as in the data communications markets from other fixed line, mobile and cable television service providers. The share of Magyar Telekom DSL net additions has declined against competitors' cable Internet offerings. This could adversely affect our further broadband growth prospects and may lead to further tariff erosion.

Competitors' cable network acquisition activity was more intense than ours in 2011, they acquired more hybrid fiber coax (HFC) customers and integrated them into their network. The competition for cable networks has increased, and may result in higher acquisition costs and longer return on investment periods.

Competition posed by new entrants in Macedonia and Montenegro may result in a downward pressure on pricing, sales volume and profitability, which would have an adverse effect on our financial condition and results of operations.

**Our ability to meet our revenue targets will depend in part on our ability to offset the declining fixed line voice revenues with data, TV, Internet, SI/IT and retail energy revenues and our ability to acquire telecommunications companies.**

In fixed line operations, we expect continued decline in fixed line voice revenues due to continued line reduction and fixed line unit price erosion driven by mobile substitution and increased competition in the fixed line market, including competition from VoIP or VoCable providers. To mitigate this decrease in fixed line voice revenues, we are now moving from pure fixed line voice offers to integrated 2Play, 3Play, 4Play packages and energy (electricity, natural gas) services, which allow us to partially substitute declining voice traffic revenues with content, entertainment and bundled access revenues. In the mobile operations in Hungary, market penetration has now reached full saturation levels, and we expect declining voice revenues in 2012. We may not be able to sustain our revenue targets, if we are unsuccessful in offsetting the effect of our declining voice and messaging revenues with new services. In order to avoid concentration on the telecommunications market, the relevant authorities may prevent us from acquiring some of our competitors to increase our market share, or we may not be able to find resources for acquisitions.

**We may be unable to adapt to technological changes in the telecommunications market.**

The telecommunications industry is characterized by rapidly changing technology with related changes in customer demands for new products and services at competitive prices. Technological developments are also shortening product life cycles and facilitating convergence of various segments of the increasingly global industry. Our future success will largely depend on our ability to anticipate, invest in and implement new technologies with the levels of service and prices that customers demand. Technological advances may also affect our level of earnings and financial condition by shortening the useful life of some of our assets or potentially requiring their impairment. Further, the tough economic situation in Hungary in the past years has affected our ability to invest in and deploy new technology.

**The future of our current operational model is subject to currently unforeseeable changes in the future business environment.**

The telecommunications industry is undergoing a major change globally with an effect on the Hungarian market as well. We have considered these market trends including changes in technology, customer requirements, competition and regulation, and accordingly, we have planned our operational restructuring to be in line with these market trends. Our operational model effective from 2008 is based on customer segments and also provides a solid basis to capture long-term growth. We have designed our operational model according to our most current knowledge of market trends and our business needs; however, the future business environment might evolve into currently unforeseen directions that will require us to adjust our operational model.

**Developments in the technology and telecommunications sectors have resulted and may result in impairments in the carrying value of certain of our assets.**

Developments in the technology and telecommunications sectors, including significant declines in stock prices, market capitalization and credit ratings of market participants may result in impairments of our tangible, intangible and financial assets. Future changes in these areas could lead to further impairments at any time. Recognition of impairment of tangible, intangible and financial assets could adversely affect our financial condition and results of operations and might lead to a drop in the trading price of our shares. We review on a regular basis the value of each of our subsidiaries and their assets. The value of goodwill is reviewed annually. In addition to our regular impairment tests, whenever we identify any indication (including changes in the economic, regulatory, business or political environments) that goodwill, intangible assets or fixed assets may have been impaired, we consider the necessity of performing certain valuation tests which may result in an impairment charge.

**Our business may be adversely affected by actual or perceived health risks associated with mobile communications technologies.**

Hungary based its EMF (ElectroMagnetic Field) limits on ICNIRP (International Commission on Non-Ionizing Radiation Protection) following the approach of most European countries as well as the EU Commission Recommendation. Media reports have suggested that radio frequency emissions from mobile telephones are linked to medical conditions such as cancer. In addition, a number of consumer interest groups have requested investigations into claims that digital transmissions from handsets used in connection with digital mobile technologies pose health risks and cause interference with hearing aids and other medical devices. There can be no assurance that the findings of such studies will not have a material effect on our mobile business or will not lead to additional government regulations. Our ability to install new mobile telecommunications base stations and other infrastructure may also be adversely affected, and related cost may increase, due to regulations or consumer action in response to concerns over health risks and adverse effect on the value of properties adjacent to such facilities. The actual or perceived health risks of mobile communications devices could adversely affect mobile communications service providers, including us, through increased barriers to network development, reduced subscriber growth, reduced network usage per subscriber, threat of product liability lawsuits or reduced availability of external financing to the mobile communications industry.

**System failures could result in reduced user traffic and revenue and could harm our reputation.**

Our technology infrastructure (including our network infrastructure for fixed network services and mobile telecommunications services) is vulnerable to damage and interruption from information technology failures, power loss, floods, windstorms, fires, intentional wrongdoing and similar events. Unanticipated problems at our facilities, system failures, hardware or software failures or computer viruses could affect the quality of our services and cause service interruptions.

In addition, we face continuous pressure on the operating expenses of our network. Each year, we cut the resources spent on network maintenance. As a result, we also have to reduce the value of our support contracts, which is a significant part of our costs. The reduction of support fees, in most cases, can be realized by renegotiating our contracts by the reduction of services ordered from suppliers, and the reduction of the amount and quality of the support activities. Both of these actions cause significant risk related to the quality levels of operated equipment and the services provided by these equipment, as well. The amount of preventive maintenance has reduced significantly, causing the aging of our equipment. Due to the permanent decrease of vendor support and the aging technologies, we face increasing risk in the number of failures and the probability of longer fault repair time, which may result in revenue losses and increasing number of penalties.

Any of these occurrences could also result in reduced user traffic and revenue and could harm our reputation.

**Loss of key personnel could weaken our business.**

Our operations are managed by a small number of directors and key executive officers. The loss of directors or key executive officers could significantly impede our financial, marketing and other plans. We believe that the growth and future success of our business will depend in large part on our continuing ability to attract and retain highly skilled and qualified personnel at all levels; however, the competition for qualified personnel in the telecommunications industry is intense. We can give no assurances that we will be able to hire or retain necessary personnel.

**Ongoing government investigations into contracts and activities in Montenegro and Macedonia may result in fines or other sanctions.**

See Note 1.2 in the Consolidated Financial Statements.

**Our share price may be volatile, and your ability to sell our shares may be adversely affected due to the relatively illiquid market for our shares and ADSs.**

The Hungarian equity market is relatively small and illiquid compared to major global markets. As a result of the limitations of the Hungarian equity market and the volatility of the telecommunications sector in general, the price of our shares and ADSs may be relatively volatile and you may have difficulty selling your shares in the event of unfavorable market conditions. Further, effective as of November 12, 2010, the Company's ADSs were delisted from and are no longer traded on the New York Stock Exchange (NYSE), which may impact the liquidity of our ADSs.

**The value of our investments, results of operations and financial condition could be adversely affected by economic developments in Hungary and other countries.**

Our business depends on general economic conditions in Hungary and abroad. Each of our business segments is affected by its unique business environment, and we are subject to circumstances and events that are unforeseen or beyond our control. A cautious or negative business outlook may cause our customers to delay or cancel investment in information technology and telecommunications systems and services, which would adversely affect our revenues directly and, in turn, slow down the development of new services and applications that could become future revenue sources.

The European economy is slowing down and shows signs of recession risk in 2012. Major uncertainties surrounding the future of the euro and the debt crisis have escalated for several euro-zone members. The Hungarian economy is impacted heavily by the second wave of the financial crisis. GDP projections for 2012 have been reduced significantly, analyst and government forecasts indicate GDP growth of about half a percent in 2012. The unemployment rate remains very high, at above ten percent, and the volatility of the Hungarian currency is expected to continue. The Hungarian Government experienced difficulties in financing the budget deficit through the financial markets at the end of 2011. As a result, negotiations were reopened with international financial institutions, such as the International Monetary Fund ("IMF") and the European Central Bank ("ECB") to receive precautionary loan facilities.

In order to balance the government budget, the government implemented several measures to decrease the deficit to 2.5% of GDP in 2012. The most significant of these was the 2 ppt VAT increase, from 25% to 27%. The special telecommunications tax, which came into effect in 2010, is expected to have a negative impact of more than HUF 24 billion on our EBITDA in 2012. Our T-Systems Business Unit was also affected by heavy spending cuts by the government, our largest business customer. In addition, our businesses in Macedonia and Montenegro are also affected by similar factors.

A significant amount of cash of the Group's Macedonian and Montenegrin subsidiaries is held in local banks and in connection with these deposits the counterparty risk may be higher, due to the small number of internationally substantial financial institutions in these countries, however, all of our deposits are covered with bank guarantees issued by banks from the European Union. These amounts are deposited primarily on fixed interest rate terms in order to minimize exposure to market changes that would potentially adversely change the cash flows from these instruments.

We may also experience higher financing costs in the future as higher fluctuations of interest rates seem to be more likely due to the increased volatility in the international capital and money markets after the financial crisis. For additional information about our financial risk management, see Note 3 to the Consolidated Financial Statements.

**We are subject to unpredictable changes in Hungarian tax regulations.**

In October 2010, the Hungarian government imposed special "crisis" taxes on the telecommunications, energy and retail sectors. The taxes were introduced with a retroactive effect for the fiscal year 2010. The special telecommunications tax is a progressive tax to be calculated on the revenues from electronic telecommunication services. Tax rates are: 0% (on revenues below HUF 500 million), 4.5% (on revenues between HUF 500 million and HUF 5 billion) and 6.5% (on revenues exceeding HUF 5 billion). The total special telecommunications tax paid by the Company in 2011 amounted to HUF 27 billion and the impact on Earnings before Interest, Tax, Depreciation and Amortization ("EBITDA") was HUF 26 billion.

Pursuant to the relevant legislation, these special taxes will be in effect until the end of 2012; however, there were indications that these special taxes or other similar taxes affecting the telecommunications sector may be imposed beyond 2012.

On March 14, 2011, the European Commission announced that it had decided to send a request for information to Hungary, in the form of a 'letter of formal notice', thereby opening an infringement procedure against Hungary in relation to the special telecommunications tax. The Commission raised concerns that this tax is incompatible with EU telecommunications rules. On September 29, 2011 the European Commission requested Hungary to abolish the telecoms tax in the form of a 'reasoned opinion' under EU infringement procedures. The Hungarian Foreign Ministry sent a letter on November 29, 2011 to the European Commission, in which it insisted that the tax did not run counter to EU law. As a result of this, on March 22, 2012 the European Commission decided to refer Hungary to the EU's Court of Justice. The outcome of the infringement procedure, to which the Company and/or its affiliates are not party, is uncertain.

These uncertain and unforeseeable changes to tax legislation in Hungary has had, and in the future may continue to have, as a result of these or similar regulations introduced by the government, a material effect on our results of operations and financial condition.

**Fluctuations in the currency exchange rate could have an adverse effect on our results of operations.**

We are subject to currency translation risks, mainly relating to the results of our Macedonian and Montenegrin operations. Devaluation of the Macedonian denar or appreciation of the Hungarian forint may have a negative impact on Makedonski Telekom's results when converted into HUF. The conversion of Crnogorski Telekom's results into HUF depends on the value of the HUF against the EUR. This is mainly a reporting risk, but through the dividend payments it has direct financial (cash flow) effects on us as well. The recent financial crisis increased the volatility of exchange rate fluctuations, which affect our purchasing costs of goods and services. While the vast majority of our revenues are denominated in the functional currency of the pertinent Group company, part of our operating expenses and capital expenditures are denominated in EUR and USD.

**We are continuously involved in disputes and litigation with regulators, competitors and other parties.**

We are subject to numerous risks relating to legal and regulatory proceedings, in which we are currently a party, or which could develop in the future. Litigation and regulatory proceedings are inherently unpredictable. Legal or regulatory proceedings in which we are or could be involved (or settlements thereof), may have a material adverse effect on our results of operations or financial condition.

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## Share information

### Major shareholders

The share capital of Magyar Telekom Plc. is HUF 104,274,254,300, consisting of 1,042,742,543 Series "A" ordinary shares with a nominal value of HUF 100 each at December 31, 2011.

Information concerning our ownership structure as of December 31, 2011 is set out in the following table:

Shareholder	Number of shares	Percentage of share capital
MagyarCom <sup>(1)</sup>	617,436,759	59.21
Publicly traded	424,914,922	40.75
Treasury stock	390,862	0.04
	<b>1,042,742,543</b>	<b>100.00</b>

(1) MagyarCom is a wholly owned subsidiary of Deutsche Telekom.

MagyarCom does not have different voting rights than our other shareholders and, as with our other shareholders, MagyarCom is entitled to one vote per each ordinary share that it owns.

### Prospective share repurchase program

On February 23, 2012, the Board of Directors resolved to propose to the General Meeting to provide a new authorization for the repurchase of ordinary Magyar Telekom shares. The purpose of the authorization is to supplement Magyar Telekom's current shareholder remuneration policy in line with international practice. The purchased shares might also be used for management remuneration.

According to the Board of Directors' proposal, the General Meeting would authorize the Board of Directors to purchase a total of up to 104,274,254 ordinary shares (with a face value of HUF 100 each) of Magyar Telekom Plc. The authorization would be valid for 18 months starting on the approval date of the General Meeting. The shares to be purchased on the basis of this authorization may not at any time account for more than ten percent of the share capital of Magyar Telekom Plc. In addition, the shares would be purchased through the stock exchange. The authorization may be exercised in full or in part, and the purchase can be carried out in partial tranches spread over various purchase dates within the authorization period until the maximum purchase volume is reached.

### Dividend policy

The Board of Directors of the Company proposed a HUF 50 per ordinary share dividend distribution to be approved by the Annual General Meeting of the Company on April 16, 2012. Based on the Board of Directors proposal the record date for payment of the dividends is May 8, 2012.

Under Hungarian law, the Company is permitted to pay annual dividends out of profits and profit reserves, determined on the basis of the annual unconsolidated accounts prepared in accordance with Hungarian Accounting Rules, following a declaration by the AGM of shareholders. Prior to the approval of the annual unconsolidated accounts, the Company's shareholders at the General Meeting may also declare a dividend advance on the basis of an interim set of financial statements. The General Meeting of shareholders may decide to declare a higher or lower dividend than that recommended by the Board of Directors, provided that shareholders' equity under Hungarian Accounting Rules would still meet the statutory requirements following the dividend payment.

Our shareholders may also decide not to declare dividends, even if the Board of Directors recommends such a declaration. The Company distributes dividends to holders of shares duly registered in the shareholders' register as the legal owners of shares on the date determined by our shareholders at the AGM to be the dividend record date.

The determination of whether to pay dividends and the amount of dividends paid depends upon, among other things, the Company's earnings, financial condition and cash requirements, applicable restrictions on the payment of dividends under Hungarian law and any other factors the Board of Directors may consider relevant. As of December 31, 2011, the reserves available for distribution were HUF 232,569 million.

The Company will declare any cash dividends in Hungarian forints. In the case of shares represented by ADSs, cash dividends are paid to the depository and converted into and paid in U.S. dollars at the prevailing rate of exchange, net of conversion expenses of the depository and applicable Hungarian withholding tax.

Fluctuations in exchange rates will affect the amount of dividends that ADS holders receive. Dividends paid to non-Hungarian holders, including U.S. holders, of shares or ADSs may be converted into foreign currency and repatriated, subject to Hungarian withholding tax.

In the medium-term, our strategic priority remains finding further value-creating acquisitions, which require a flexible balance sheet to be maintained by keeping the net debt ratio (net debt to total capital) in the range of 30–40%. The dividend payments are not only dependent on the acquisition opportunities that might arise, but also on the future profitability and financial position of the Group.

# Consolidated financial statements

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# Independent Auditor's Report

## To the Shareholders of Magyar Telekom Nyrt.

### Report on the consolidated financial statements

We have audited the accompanying consolidated financial statements of Magyar Telekom Nyrt. ("the Company") which comprise the consolidated statement of financial position as of 31 December 2011 (in which the total of statement of financial position is HUF 1,098,028 million, the total comprehensive income for the year is HUF 25,974 million), the consolidated statement of comprehensive income and consolidated statement of changes in equity and consolidated statement of cash flows for the year then ended, and the notes to the consolidated financial statements including a summary of the significant accounting policies and other explanatory information.

#### Management's Responsibility for the Consolidated Financial Statements

Management is responsible for the preparation and fair presentation of the consolidated financial statements in accordance with International Financial Reporting Standards as adopted by the EU and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

#### Auditor's Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audit. We conducted our audit in accordance with Hungarian Standards on Auditing and with applicable laws and regulations in force in Hungary. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

#### Opinion

During our work we have audited the components and disclosures along with the underlying accounting records and supporting documentation in the consolidated financial statements of Magyar Telekom Nyrt. in accordance with Hungarian Standards on Auditing and, on the basis of our audit work, we have gained sufficient and appropriate evidence that the consolidated financial statements have been prepared in accordance with International Financial Reporting Standards as adopted by the EU. In our opinion, the accompanying consolidated financial statements give a true and fair view of the financial position of Magyar Telekom Nyrt. as of 31 December 2011, and of the results of its operation for the year then ended in accordance with International Financial Reporting Standards as adopted by the EU.

### Other reporting requirements regarding the business report

We have examined the accompanying consolidated business report of Magyar Telekom Nyrt. ("the Company") for the financial year of 2011.

Management is responsible for the preparation of the consolidated business report which is consistent with the consolidated financial statements prepared in accordance with International Financial Reporting Standards as adopted by the EU. Our responsibility is to assess whether or not the accounting information disclosed in the consolidated business report is consistent with that contained in the consolidated financial statements. Our work in respect of the consolidated business report was limited to checking it within the aforementioned scope and did not include a review of any information other than that drawn from the audited accounting records of the Company. In our opinion the 2011 consolidated business report is consistent with the disclosures in the consolidated financial statements as of 31 December 2011.

Budapest, March 5, 2012

#### **Manfred Krawietz**

Partner

PricewaterhouseCoopers Auditing Ltd.

1077 Budapest, Wesselényi u. 16.

License Number: 001464

#### **Hegedűsné Szűcs Márta**

Statutory auditor

Licence number: 006838

1077 Budapest, Wesselényi u. 16.

Note:

Our report has been prepared in Hungarian and in English. In all matters of interpretation of information, views or opinions, the English version of our report takes precedence over the Hungarian version.

## Consolidated statements of financial position as at December 31, 2010 and 2011

	Note	At December 31,	
		2010	2011
		(in HUF millions)	
<b>Assets</b>			
<b>Current assets</b>			
Cash and cash equivalents	6	15,841	14,451
Trade and other receivables	7	114,625	124,663
Other current financial assets	8.1	56,560	65,286
Current income tax receivable	9.1	1,804	927
Inventories	10	9,592	9,904
Non current assets held for sale	11	2,152	5,165
<b>Total current assets</b>		<b>200,574</b>	<b>220,396</b>
<b>Non current assets</b>			
Property, plant and equipment	12	549,752	536,224
Intangible assets	13	332,993	308,313
Investments in associates and joint ventures	14	77	-
Deferred tax assets	9.4	913	750
Other non current financial assets	8.2	24,033	31,590
Other non current assets	15	664	755
<b>Total non current assets</b>		<b>908,432</b>	<b>877,632</b>
<b>Total assets</b>		<b>1,109,006</b>	<b>1,098,028</b>
<b>Liabilities</b>			
<b>Current liabilities</b>			
Financial liabilities to related parties	16	72,208	49,865
Other financial liabilities	17	46,647	70,155
Trade payables	18	88,613	101,119
Current income tax payable	9.1	661	1,335
Provisions	19	7,722	3,703
Other current liabilities	20	30,966	29,213
<b>Total current liabilities</b>		<b>246,817</b>	<b>255,390</b>
<b>Non current liabilities</b>			
Financial liabilities to related parties	16	234,164	230,166
Other financial liabilities	17	8,828	17,928
Deferred tax liabilities	9.4	10,924	26,270
Provisions	19	12,298	11,236
Other non current liabilities	21	1,263	947
<b>Total non current liabilities</b>		<b>267,477</b>	<b>286,547</b>
<b>Total liabilities</b>		<b>514,294</b>	<b>541,937</b>

### Consolidated statements of financial position as at December 31, 2010 and 2011 (continued)

	Note	At December 31,	
		2010	2011
(in HUF millions)			
<b>Equity</b>			
Equity of the owners of the parent			
Common stock		104,275	104,275
Additional paid in capital		27,379	27,379
Treasury stock		(307)	(307)
Retained earnings		385,283	325,709
Accumulated other comprehensive income		14,882	30,959
<b>Total Equity of the owners of the parent</b>		<b>531,512</b>	<b>488,015</b>
Non-controlling interests		63,200	68,076
<b>Total equity</b>		<b>594,712</b>	<b>556,091</b>
<b>Total liabilities and equity</b>		<b>1,109,006</b>	<b>1,098,028</b>

These consolidated financial statements were authorized for issue by the Board of Directors on February 23, 2012 and signed on their behalf by:

**Christopher Mattheisen**  
Chairman and Chief Executive Officer

**Thilo Kusch**  
Chief Financial Officer

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

## Consolidated statements of comprehensive income for the years ended December 31, 2010 and 2011

	Note	For the year ended December 31,	
		2010	2011
		(in HUF millions, except per share amounts)	
Revenue	22	609,579	597,617
Expenses directly related to revenues	23	(157,427)	(161,047)
Employee related expenses	24	(93,884)	(91,823)
Depreciation and amortization		(100,872)	(132,915)
Other operating expenses	25	(148,750)	(155,057)
<b>Operating expenses</b>		<b>(500,933)</b>	<b>(540,842)</b>
Other operating income	26	3,448	6,392
<b>Operating profit</b>		<b>112,094</b>	<b>63,167</b>
Interest income	27	4,938	3,633
Interest expense	28	(23,784)	(23,184)
Other finance expense – net	29	(9,267)	(12,911)
<b>Net financial result</b>		<b>(28,113)</b>	<b>(32,462)</b>
Share of associates' and joint ventures' profits / (losses)	14	(27)	12
<b>Profit before income tax</b>		<b>83,954</b>	<b>30,717</b>
Income tax expense	9.2	(6,583)	(27,538)
<b>Profit for the year</b>		<b>77,371</b>	<b>3,179</b>
Exchange differences on translating foreign operations		6,617	22,816
Revaluation of available-for-sale financial assets – before tax		20	(21)
Revaluation of available-for-sale financial assets – tax effect		-	-
<b>Other comprehensive income for the year, net of tax</b>		<b>6,637</b>	<b>22,795</b>
<b>Total comprehensive income for the year</b>		<b>84,008</b>	<b>25,974</b>
<b>Profit attributable to:</b>			
Owners of the parent		64,378	(7,457)
Non-controlling interests		12,993	10,636
		<b>77,371</b>	<b>3,179</b>
<b>Total comprehensive income attributable to:</b>			
Owners of the parent		69,505	8,620
Non-controlling interests		14,503	17,354
		<b>84,008</b>	<b>25,974</b>
Earnings per share (EPS) information:			
Profit attributable to the owners of the Company		64,378	(7,457)
Weighted average number of common stock outstanding (thousands) used for basic and diluted EPS		1,041,290	1,042,352
Basic and diluted earnings per share (HUF)		61,83	(7,15)

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

## Consolidated statements of cash flows for the years ended December 31, 2010 and 2011

	Note	For the year ended December 31,	
		2010	2011
		(in HUF millions)	
<b>Cashflows from operating activities</b>			
Profit for the year		77,371	3,179
Depreciation and amortization		100,872	132,915
Income tax expense		6,583	27,538
Net financial result		28,113	32,462
Share of associates' and joint ventures' (profits) / losses		27	(12)
Change in assets carried as working capital		(8,364)	(9,068)
Change in provisions		(4,194)	(5,702)
Change in liabilities carried as working capital		(3,009)	23,277
Income tax paid		(11,419)	(10,999)
Dividend received		95	24
Interest and other financial charges paid		(27,426)	(24,153)
Interest received		4,919	3,650
Other cashflows from operations		1,102	(4,330)
<b>Net cash generated from operating activities</b>		<b>164,670</b>	<b>168,781</b>
<b>Cashflows from investing activities</b>			
Purchase of property plant and equipment (PPE) and intangible assets	30	(87,300)	(80,074)
Purchase of subsidiaries and business units	31	(1,534)	(2,675)
Cash acquired through business combinations		6	468
Proceeds from / (Payments for) other financial assets – net		34,327	(997)
Proceeds from disposal of subsidiaries and associates	26	780	-
Proceeds from disposal of PPE and intangible assets		873	5,526
<b>Net cash used in investing activities</b>		<b>(52,848)</b>	<b>(77,752)</b>
<b>Cashflows from financing activities</b>			
Dividends paid to shareholders and Non-controlling interest		(91,819)	(64,626)
Proceeds from loans and other borrowings		190,797	159,812
Repayment of loans and other borrowings		(229,545)	(188,414)
Change in Non-Controlling interests		(22)	-
<b>Net cash used in financing activities</b>		<b>(130,589)</b>	<b>(93,228)</b>
Exchange gains on cash and cash equivalents		338	809
Change in cash and cash equivalents		(18,429)	(1,390)
Cash and cash equivalents, beginning of year		34,270	15,841
<b>Cash and cash equivalents, end of year</b>	<b>6</b>	<b>15,841</b>	<b>14,451</b>

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

### Consolidated statements of changes in equity for the years ended December 31, 2010 and 2011

	Shares of common stock	Common stock	Additional paid in capital	Treasury stock	Retained earnings	Cumulative translation adjustment	Revaluation reserve for AFS financial assets – net of tax	Reserve for equity settled share based transactions	Equity of the owners of the parent	Non-controlling interests	Total Equity
	(a)	(a)	(b)	(c)	(d)	(e)	(f)	(g)		(h)	
<b>Balance at December 31, 2009</b>	<b>1,042,742,543</b>	<b>104,275</b>	<b>27,379</b>	<b>(1,179)</b>	<b>398,250</b>	<b>9,768</b>	<b>(62)</b>	<b>49</b>	<b>538,480</b>	<b>60,566,940</b>	<b>420</b>
Dividend (i)					(77,053)				(77,053)	-	(77,053)
Dividend declared to Non-controlling interests (j)									-	(18,243)	(18,243)
Share based compensation program (k)				872	(292)				580	-	580
Total comprehensive income for the year					64,378	5,165	11	(49)	69,505	14,503	84,008
<b>Balance at December 31, 2010</b>	<b>1,042,742,543</b>	<b>104,275</b>	<b>27,379</b>	<b>(307)</b>	<b>385,283</b>	<b>14,933</b>	<b>(51)</b>	<b>-</b>	<b>531,512</b>	<b>63,200</b>	<b>594,712</b>
Dividend (i)					(52,117)				(52,117)	-	(52,117)
Dividend declared to Non-controlling interests (j)									-	(12,478)	(12,478)
Total comprehensive income for the year					(7,457)	16,089	(12)		8,620	17,354	25,974
<b>Balance at December 31, 2011</b>	<b>1,042,742,543</b>	<b>104,275</b>	<b>27,379</b>	<b>(307)</b>	<b>325,709</b>	<b>31,022</b>	<b>(63)</b>	<b>-</b>	<b>488,015</b>	<b>68,076</b>	<b>556,091</b>
Of which treasury stock	(390,862)										
Shares of common stock outstanding at December 31, 2011	1,042,351,681										

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

### Notes to the Consolidated Statements of Changes in Equity

- (a) The total amount of issued shares of common stock of 1,042,742,543 (each with a nominal value of HUF 100) is fully paid as at December 31, 2011. The number of authorized ordinary shares on December 31, 2011 is 1,042,742,543.
- (b) Additional paid in capital represents the amount above the nominal value of the shares that was received by the Company during capital increases.
- (c) Treasury stock represents the cost of the Company's own shares repurchased.
- (d) Retained earnings include the accumulated and undistributed profit of the Group. The distributable reserves of the Company under Hungarian law at December 31, 2011 amounted to approximately HUF 232,569 million (HUF 253,793 million at December 31, 2010).
- (e) Cumulative translation adjustment represents the foreign exchange differences arising on the consolidation of foreign subsidiaries.
- (f) Revaluation reserve for available-for-sale (AFS) financial assets includes the unrealized gains and losses net of tax on available-for-sale financial assets.
- (g) Reserve for equity settled share based transactions includes the compensation expenses accrued in this reserve related to share settled compensation programs. The December 31, 2009 balance of this reserve of HUF 49 million represented the amount reserved for the 103,530 options granted in 2000 to Magyar Telekom's ex-CEO. Since these options lapsed unexercised in 2010, the balance of the reserve was released to Profit for the year in 2010 (Note 24.2).
- (h) Non-controlling interests represent the Non-controlling shareholders' share of the net assets of subsidiaries, in which the Group has less than 100% ownership.
- (i) In 2011 Magyar Telekom Plc. declared HUF 50 dividend per share (HUF 74 in 2010).
- (j) The amount of dividends declared to Non-controlling interests includes predominantly the dividends declared to the Non-controlling owners of Makedonski Telekom (MKT) and Crnogorski Telekom (CT), the Group's subsidiaries.
- (k) In 2010 Magyar Telekom launched a share allocation program under which Magyar Telekom shares were awarded to the Company's selected employees. In total, 1,112,679 treasury shares were granted to employees for free in December 2010 (Note 24.3). The fair value of the treasury shares at the grant date was HUF 580 million, which was recognized as employee expense in 2010. The loss on the re-issuance of the treasury shares (measured as the difference between the original cost of re-acquisition and the grant date stock exchange price of the treasury shares) was recognized in Retained earnings in an amount of HUF 292 million.

Together with the approval of these financial statements for issue, the Board of the Company proposes a HUF 50 per share dividend distribution (in total HUF 52,117 million) to be approved by the Annual General Meeting of the Company in April 2012.

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

# Notes to the Consolidated financial statements

## 1 General Information

### 1.1 About the Company

Magyar Telekom Telecommunications Public Limited Company (the Company or Magyar Telekom Plc.) with its subsidiaries form Magyar Telekom Group (Magyar Telekom or the Group). Magyar Telekom is the principal of telecommunications services in Hungary, Macedonia and Montenegro and alternative service provider in Bulgaria and Romania. These services are subject to various telecommunications regulations depending on the countries of operations (Note 1.3).

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 stock exchange and its shares are traded on the Budapest Stock Exchange. Magyar Telekom's American Depository Shares (ADSs) each representing five ordinary shares were also traded on the New York Stock Exchange until November 12, 2010, when the ADSs were delisted.

The immediate controlling shareholder of the Company is MagyarCom GmbH owning 59.21% of the issued shares, while the ultimate controlling parent of Magyar Telekom is Deutsche Telekom AG (DT or DTAG).

The consolidated financial statements are prepared and presented in millions of Hungarian Forints (HUF), unless stated otherwise.

These consolidated financial statements of the Company were approved for issue by the Company's Board of Directors (the Board), however, the Annual General Meeting (AGM) of the owners, authorized to accept these financials, has the right to require amendments before acceptance. As the controlling shareholders are represented in the Board of the Company that approved these financial statements for issuance, the probability of any potential change required by the AGM is extremely remote, and has never happened in the past.

### 1.2 Investigation into certain consultancy contracts

As previously disclosed, the Company's Audit Committee conducted an internal investigation regarding certain contracts relating to the activities of the Company and/or its affiliates in Montenegro and Macedonia that totaled more than EUR 31 million. In particular, the internal investigation examined whether the Company and/or its Montenegrin and Macedonian affiliates had made payments prohibited by U.S. laws or regulations, including the U.S. Foreign Corrupt Practices Act (the FCPA). The Company has previously disclosed the results of the internal investigation. The Company's Audit Committee informed the U.S. Department of Justice (the DOJ) and the U.S. Securities and Exchange Commission (the SEC) of the internal investigation. The DOJ and the SEC commenced investigations into the activities that were the subject of the internal investigation. For further information regarding the internal investigation, see the Company's annual report for the year ended December 31, 2010.

In 2011, the Company entered into final settlements with the DOJ and the SEC to resolve the DOJ's and the SEC's investigations relating to the Company. The settlements concluded the DOJ's and the SEC's investigations.

The Company has entered into a two-year deferred prosecution agreement (the DPA) with the DOJ, under which the Company was charged with a violation of the anti-bribery provisions of the FCPA and two violations of the books and records provisions of the FCPA. In accordance with the DPA, on December 29, 2011, the DOJ filed a criminal information (the Information) setting out these charges in the U.S. District Court for the Eastern District of Virginia. The Company has agreed to admit to the DOJ's allegations and to acknowledge responsibility for the acts as charged in the Information. The Company has agreed to pay a criminal penalty of USD 59.6 million to cooperate with the DOJ in future investigations, to refrain from any violations of U.S. federal criminal law, to continue to operate a compliance program and to report to the DOJ annually regarding the compliance program during the term of the DPA. The DOJ will seek to dismiss the charges upon conclusion of the two-year term, unless the Company violates the terms of the DPA.

On December 29, 2011, the SEC filed in the U.S. District Court for the Southern District of New York a Complaint (the Complaint) and a proposed Final Judgment against the Company (the Final Judgment). Without admitting or denying the allegations in the Complaint, the Company consented to the filing of

the Complaint and entry of the Final Judgment to resolve the SEC's investigation. The Complaint alleged civil violations of the FCPA's anti-bribery, books and records and internal control provisions. The Final Judgment, which was approved by the U.S. District Court for the Southern District of New York on January 3, 2012, permanently enjoined the Company from violating these provisions and required the Company to pay USD 25.2 million for disgorgement of profits and USD 6.0 million of prejudgment interest thereon.

The final settlements recognize the DOJ's and the SEC's consideration of the Company's self-reporting, thorough internal investigation, remediation and cooperation with the DOJ's and the SEC's investigations. The Company has undertaken several remedial measures to address the issues identified during the course of these investigations. These measures include steps designed to revise and enhance the Company's internal controls, as well as the establishment of the Corporate Compliance Program. The Corporate Compliance Program promotes awareness of the Company's compliance policies and procedures through training, the operation of a whistleblower hotline, and monitoring of, and communications with, employees and subsidiaries of the Company. The Company remains fully committed to responsible corporate behavior.

The aggregate amount of USD 90.8 million (HUF 21,857 million) payable by the Company in settlement of the DOJ's and SEC's investigations was fully provided for before the end of 2011. Of this amount HUF 16,191 million was recognized as Other operating expense, HUF 1,119 million was recognized as Interest expense and HUF 4,547 million was recognized as foreign exchange loss included in Other finance expense – net. The amounts provided for as at December 31, 2011 were reclassified to Other current financial liabilities.

On January 6, 2012 the Company paid a criminal penalty of USD 59.6 million (HUF 14,712 million) pursuant to the settlement with the DOJ and on January 23, 2012 the Company paid USD 25.2 million for disgorgement of profits and USD 6.0 million of prejudgment interest (HUF 7,366 million in total) pursuant to the settlement with the SEC, totaling USD 90.8 million (HUF 22,078 million) paid with respect to the settlements with the DOJ and the SEC.

In addition to the DOJ's and the SEC's investigations, the Ministry of Interior of the Republic of Macedonia, the Montenegrin Supreme State Prosecutor and the Hungarian Central Investigating Chief Prosecutor's Office commenced investigations into certain of the activities that were the subject of the internal investigation. These governmental investigations are continuing, and the Company and its relevant subsidiaries continue to cooperate with these investigations.

### 1.3 Public service concession and license arrangements

Magyar Telekom's primary activities are the fixed line and mobile operations in Hungary, Macedonia and Montenegro. These services are in most cases regulated by these countries' laws or other legislations. These services in most cases require the acquisition of a license or concession, which usually requires a one-off fee, which is capitalized and amortized over the original duration of license or concession, and also requires annual payments, which are recognized as Other operating expenses (included in Fees and levies) in the year the payment obligation refers to.

The most important features of the regulations of these services are described below.

#### 1.3.1 Hungarian Fixed line

Magyar Telekom Plc. is the market leading fixed line telecom service provider in Hungary. The Implementation of the EU New Regulatory Framework (NRF) Review package had been completed by the amendment of the Act C of 2003 on Electronic Communications (hereinafter: Communications Act). Amendments of the Communications Act came into effect on August 3, 2011. The National Media and Infocommunications Authority of Hungary (NMIAH) is the supreme supervisory body and is responsible for secondary legislation making and the preparation of relevant decrees. In Q4 2011, as the result of secondary legislation making process, the NMIAH published some important decrees, such as Decree on subscriber contracts issues, Decree on Service Quality issues and Decree on Numbering related issues.

Universal services are basic communications services (including access to communication services at a fixed location, public payphones, directory and directory enquiry services) that should be available to all customers at an affordable price. Magyar Telekom Plc. was a Universal Service Provider from 2002 to 2008, for which a universal service contract was valid until December 31, 2008. The necessary modifications of the telecommunications law and the concerning governmental and ministerial decrees entered into force in the first half of 2010. The new legislation provides favorable conditions -

in line with market changes – than the earlier regime. Magyar Telekom's universal service contract was signed on July 29, 2011, with a retrospective effect from January 1, 2011. The universal service contract expired on December 31, 2011, however consultations are ongoing with the Ministry about renewal of the contract. Even though there is no universal service contract in place, the Company continues to comply with the provisions of the expired contract.

In the electronic communications field Magyar Telekom was designated as an SMP operator (a service provider with significant market power) on the regulated markets. The current 7 relevant markets include retail and wholesale telephony and broadband services stipulated by the EU (according to the second recommendation on the relevant markets).

Magyar Telekom Plc's retail tariffs are regulated in two ways: 1) there is a price cap regulation based on SMP resolutions on retail residential and business fixed voice markets which limits price increases of monthly fees and 2) price squeeze is prohibited on the markets where Magyar Telekom is designated as SMP as well (i.e. retail prices should be set in accordance with wholesale tariffs providing an acceptable level of retail margins).

Magyar Telekom is Hungary's leading fixed line broadband service provider in the wholesale market and one of the leading ones in the retail market. In 2011, the NMIAH designated the Company again as an SMP operator on the wholesale broadband access market. In accordance with the effective resolution, all retail fix products shall be 'reproducible' by competitors based on the wholesale service. Consequently, the full retail portfolio shall have a wholesale equivalent compliant to the pricing regulations (retail minus methodology) set forth by the NMIAH. The Company has a non-discrimination obligation, which means that the same terms and conditions shall be granted in terms of wholesale services to competitors under identical circumstances.

According to the Act on Electronic Communications, designated SMP operators are obliged to prepare reference unbundling offers for access to (physical) passive network infrastructure (RUO) and to provide these services when there is a request for them by other telecommunications service providers. The reference offer of each SMP operator must be approved by the NMIAH. The price setting of these services has to be cost based and calculated by a Top-Down Long Run Incremental Costs (TD-LRIC).

SMPs are also obliged to prepare reference offers for interconnection (RIO), containing applicable fees, 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 NMIAH, and prices have to be based on LRIC. Fees in the currently effective reference offers are applicable from April 1, 2009. It is expected that the new RIO will be approved by NMIAH in Q1, 2012. However, due to the relevant SMP resolution Magyar Telekom has to apply its new fee retrospectively from December 22, 2011.

According to the Act on Electronic Communications, designated SMP operators are obliged to enable carrier selection to their subscribers. Consequently, voice telephony customers have the right to select different service providers for each call directions 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 RIO based 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 fixed telephone numbers within the same geographical area.

### 1.3.2. Macedonian Fixed line

The Group is also present in the Macedonian fixed line telecommunications market through its subsidiary, Makedonski Telekom AD Skopje (MKT). MKT is the largest fixed line service provider in Macedonia. The Macedonian telecommunications sector is regulated by the Electronic Communications Law (ECL), enacted in March 2005. In October 2011 changes of ECL are proposed, with main focus on imposition of mandatory obligation for calling line identification presentation (CLIP) and location for emergency call, harmonizing operators' annual fees which are paid to Agency for Electronic Communications (Agency). Tender for Universal Service (US) providers designation-prequalification phase was held in February 2011. On June 29, 2011 MKT and R3 info media DOO Skopje were designated US providers. MKT is designated for US provider for fixed telephone services, public payphones and equivalent access for disabled end users. R3 info media DOO Skopje is US provider for unique subscri-

riber directory and directory enquiry. Operators are obliged to start providing the universal services on January 1, 2012 for the following 5 years.

Based on the Agency analysis for the relevant markets 1–6 related to fixed voice retail services and the program of the Agency for Electronic Communications (Agency) for 2011, the Agency announced public meeting on October 26, 2011 for start of the process for development and implementation of the methodology for retail price regulation. These activities are expected to result in price decrease of some retail services (business monthly fee, fixed-to mobile, international outgoing calls). By the end of 2011 MKT submitted all data requested by the Agency for development of price squeeze model and methodology for retail price regulation. More intensive retail regulation is expected as of May 2012.

On the public meeting dated October 14, 2011 the Agency presented detailed plan for Bottom UP LRIC model development by consultants which is expected to result in changes of Bitstream Access (BSA) pricing models and will modify service description. The Agency announced that prices will be set on a level of an efficient operator and initial LRIC bottom up results are expected in Q1 2012. On December 29, 2011, the Agency published inception report for development of a Bottom-Up LRIC Model for Bitstream Services. By the end of January 2012 MKT submitted to the Agency all data requested in details for development of a Bottom-Up LRIC Model for Bitstream Services.

MKT has a cost based price obligation for the Regulated wholesale services, using Long Run Incremental Costs methodology (LRIC). During December 2010, the Agency published results from its own developed LRIC Bottom-up costing model. The results from the costing model are implemented as of April 1, 2011 which resulted in the reduction of the monthly fee for Unbundled Local Loop (ULL) and interconnection rates (for origination, termination and transit), as well as in the reduction of the monthly fees for interconnection links and collocation.

As of November 1, 2011 MKT stopped offering PSTN and ISDN services for its customers as well as for its Wholesale Partners and all the newly committed services are based on IP (Internet Protocol) technology. In line with the PSTN migration of MKT's network, the Agency approved proposed modifications of MKT's Wholesale Line Rental Reference Offer (WLR) and Bitstream Access Service and Bitstream service resale offer (BSA) applicable as of January 1, 2012. In parallel MKT is trying to harmonize the process of PSTN migration with Wholesale operators.

Initial FTTx regulation was introduced in Q2 2011 with the imposed obligation for Reference Access Offer for ducts and dark fiber imposed on MKT by the Agency. The approved reference offer was published on December 5, 2011. It is fully in line with the introduced Rulebook for specific network access and elements and is applicable from 2012.

### 1.3.3. Montenegrin Fixed line

The Group's Montenegrin subsidiary, Crnogorski Telekom (CT) is registered to provide fixed line telecommunications services in Montenegro as well as to provide domestic voice and data services as well as VoIP, leased line, IPTV, value added services, etc. The telecommunications sector in Montenegro is regulated by the Law on Electronic Communications (the Law) that came into force in August 2008. The Law is based on the 2002 regulatory framework of the EU. All regulations that are contrary to the Law became automatically invalid and new ones have been issued or will have to be issued.

As a result of the market analysis, completed in November 2010, CT was designated as an SMP operator at all seven markets. Local loop unbundling, Bitstream access, wholesale leased line and carrier pre-selection were introduced on the Montenegrin market in February 2011, when CT published updated RIOs and ROs. Carrier selection was already implemented by CT in 2008. Number portability was introduced by the end of October 2011. RIO rates have been determined by the Resolution of the Agency for Electronic Communications and Postal Services (NRA) based on international benchmarks.

At the end of May 2011, the NRA adopted Cost Accounting methodology which will be applied by CT. Accounting Separation and Cost Accounting will be introduced before May 2012.

During Q2 2011 the NRA adopted decision on five new relevant markets that were evaluated through the three criteria test. According to the NRA's decision, CT was designated as SMP on 3 markets: 1. Retail market for local and long-distance calls, for business and residential, provided on fixed location 2. Retail market for international calls, for business and residential, provided on fixed location 3. Wholesale market of trunk segments of leased lines. Standard EU remedies (also prescribed in the Montenegrin Law) are imposed to CT.

In December 2010 Montenegro obtained EU candidate status. In accordance with the previously signed Stabilization and Association Agreement with the EU, the harmonization of the telecommunications regulations with the regulatory framework of the EU should be completed within three years of the ratification of the Agreement that is by the end of 2013.

#### 1.3.4 Hungarian Mobile

The Company is also the market leader in the Hungarian mobile market through the brand T-Mobile.

The initial duration of the concession regarding the GSM 900 public mobile radio telephone service was a period of 15 years starting 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 the Company extending the Company's rights and obligations to also provide service in the 1800 MHz band in Hungary until October 7, 2014. The duration of the concession regarding the DCS 1800 public mobile radio telephone service is 15 years starting from the execution of the new concession agreement (October 7, 1999 to October 7, 2014). As stipulated in the concession contracts, the Minister is entitled to extend the concession period for both services upon their expiration for another 7.5 years without the invitation of a tender. On November 8, 2007, the Company signed the renewed Concession Contract along with the Cooperation Agreement with the Minister that is effective from November 2008. The new Concession Contract prolonged the duration of the 900 MHz frequency usage right until May 4, 2016.

On December 7, 2004, the Company obtained 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 December 7, 2019) with an option to extend it for another 7.5 years. On August 26, 2005 the Company started to provide 3G service and has been operating it in compliance with the license conditions.

The Company is subject to number portability regulation since 2004, applicable only in case of other mobile operators. In 2005 and 2006 the Company was designated as having significant market power in the mobile wholesale call termination market, and it is currently subject to regulatory obligations regarding the termination charge of calls into its network. In December 2008 the Company was designated as an SMP for the third time in a row and in its resolution reinforced the symmetric mobile termination fees applicable from January 1, 2009, and set out further reduction of tariffs until December 2010 based on a new 'glide path'. At the end of August 2011, NMHH made its three new market analysis decisions, which affect the SMP operators next half-year commitments. On the mobile voice market the three mobile operators have to cut their wholesale prices by 40% in three steps.

Since June 30, 2007, an EU regulation has been regulating international roaming tariffs for wholesale and retail customers on the basis of a price cap system. The Regulation prescribed a glide-path that mandates further annual reductions of wholesale and retail prices in the forthcoming years. As of July 2009 the EU introduced regulated tariffs for SMS and data roaming similarly to the regulation of voice roaming.

The Company won a tender for a spectrum usage right license for a 26 GHz block on April 30, 2009.

The Company filed an auction bid in December 2011 with the Hungarian National Media and Infocommunications Authority for unused spectrum in the 900 MHz frequency band, relating to the provision of radio communications services. The spectrum can be utilized in a technology-neutral manner, allowing for the installation and operation of GSM, UMTS, LTE and/or WiMAX mobile networks. On January 31, 2012, the Company received from the Authority the first instance, non-final decision closing the auction. Pursuant to the first instance decision, the Company won the right of use of two duplex frequency blocks of 1 MHz each (one EGSM-band duplex frequency block of 1 MHz plus one PGSM-band duplex frequency block of 1 MHz) for a period of 15 years. See also Note 33.5.

### 1.3.5 Macedonian Mobile

T-Mobile Macedonia (T-Mobile MK), Magyar Telekom's subsidiary, is the leading mobile service provider in Macedonia. With the changes of the Electronic Communications Law (ECL) published on August 4, 2008, the existing Concession Contract of T-Mobile MK ceased to be valid as of August 5, 2008. On September 5, 2008 the Agency for Electronic Communications, ex officio, issued a notification to T-Mobile MK for those public electronic communication networks and/or services which have been allocated thereto under the Concession Contracts. The license for radiofrequencies used by T-Mobile MK with a bandwidth of 25 MHz in the GSM 900 band, was also issued in a form regulated in the ECL with a validity period until September 5, 2018, which can be renewed up to an additional 20 years in accordance with the ECL.

After the analysis of the market 16 "Call termination services in public mobile communication networks" the Agency on November 26, 2007 brought a decision by which T-Mobile MK was designated with SMP status on Market 16. T-Mobile MK published a RIO with regulated termination rate effective from August 1, 2008.

Based on the second round analysis on Market 16 published by the Agency on May 14, 2010, on July 30, 2010 T-Mobile MK received a Decision for changing the RIO by which the mobile termination rate (MTR) has been defined with a glide path decrease in a four years' time frame (until 2013). At the same time the Agency regulated the MTR's for the competitors as well with a respective 4 year glide path but introducing asymmetry between all three mobile operators which will lead to equal termination rates in September 2013. In August 2010 T-Mobile MK initiated a procedure before the Administrative Court to dispute the decision of the Agency arguing against the lowering of the MTR as well as against unjustified asymmetry. The administrative procedure has not started yet.

On July 7, 2010 the Agency concluded market analysis on Market 15 (Service for access and call initiation in the public mobile communication networks) and on July 28, 2010 brought a decision by which T-Mobile MK was designated with SMP status on Market 15. As a result of the SMP designation, T-Mobile MK was obliged to prepare and publish Referent Access Offer (RAO). T-Mobile MK submitted the offer to the Agency on August 28, 2010 and it was approved on November 29, 2010. On August 30, 2010 T-Mobile MK initiated a procedure before the Administrative Court challenging this decision of the Agency for designating T-Mobile MK as SMP on Market 15. The administrative procedure has not started yet.

On September 2, 2008 a decision for granting three 3G licenses was published. T-Mobile MK started commercial operations of the 3G services on June 11, 2009. The validity of the license is 10 years i.e. December 17, 2018, with a possibility for extension for 20 years in accordance with the ECL.

Four bylaws, for General terms, RIO provisions, LRIC calculation for mobile operators and for specific network elements, were enacted in 2011, after the completion of the public debates. Since the beginning of 2011, a number of other bylaws and acts in the secondary legislation were put on public debate and enacted, among which are a bylaw on accounting separation and a decision for relevant electronic communication markets where the market for SMS termination was included as a new relevant market in addition to the existing 13 relevant markets.

In January 2011 the Agency officially published the draft market analysis for SMS termination. In March 2011 the Agency published the final market analysis for SMS termination, and in May 2011 all 3 mobile operators were designated with SMP status on the SMS termination market. In June 2011 all 3 mobile operators submitted draft RIOs with the SMS termination service included, and in July 2011 the RIOs were approved by the Agency.

In October 2011, a public call for submission of requests for acquiring a radiofrequency license for mobile services in 790–862 MHz was published by the Agency, for which T-Mobile MK applied. No results were published so far.

The Electronic Communications Law was amended in January 2012. The changes are: obligation for sending location data for the subscribers when dialing the emergency numbers, obligations for free of charge SMS for promotion of cultural heritage of Republic of Macedonia upon a written request from the relevant state institutions, Agency discretion for Accounting separation obligations imposition. The Agency will create electronic register for the telecommunication terminal equipment for mobile communication services by July 1, 2012 and it shall control and measure the quality parameters of the public communications services which should be in line with the recommendations and standards of the EU.

### 1.3.6 Montenegrin Mobile

Crnogorski Telekom, the Group's Montenegrin subsidiary is also providing mobile services under the T-Mobile brand (T-Mobile CG). CT is registered as one of three GSM/UMTS providers in Montenegro. T-Mobile CG, as the second mobile operator, was launched in 2000. The third mobile operator entered the market in 2007. T-Mobile CG started 3G operations in 2007.

As a result of the market analysis of the NRA T-Mobile CG is designated as an SMP in the market of termination of voice calls in its own network. Interconnect rates have been determined by the Regulator based on benchmarks. New updated RIO was published in February 2011. Number portability was introduced also in the mobile sector. In the new cycle of relevant market analysis completed at the end of 2011 CT is designated as SMP at one mobile market: Wholesale market on access and origination of calls in public mobile telephone networks. Among other standard EU remedies imposed to CT, the NRA also obliged CT to provide carrier selection on this market.

The NRA launched a tender for the 4th Mobile license in Montenegro at the end of 2011. Existing operators were also allowed to bid for certain radio frequency ranges. There was no interest from new operators but Telenor participated and won the tender. Telenor is obliged by the NRA Decision to offer the transfer of right of 1/3 of granted frequency resources to each of the other two competitors. Only CT expressed its interest for offered range. The NRA is supposed to issue the approval for transferring the resources to the interested operator in February 2012.

## 2 Summary of Significant Accounting Policies

### 2.1 Basis of preparation

The consolidated financial statements of Magyar Telekom have been prepared in accordance with International Financial Reporting Standards (IFRS) as endorsed by the European Union (EU). All standards and interpretations issued by the International Accounting Standards Board (IASB) effective at the time of preparing the consolidated financial statements and applicable to Magyar Telekom have been endorsed by the EU. Therefore the consolidated financial statements currently also comply with IFRS as issued by the IASB and also comply with the Hungarian Accounting Law on consolidated financial statements, which refers to the IFRS as endorsed by the EU.

The consolidated financial statements are presented in millions of HUF.

The preparation of financial statements in conformity with IFRS requires the use of certain critical accounting estimates. It also requires management to exercise its judgment in the process of applying the Group's accounting policies. The areas involving a higher degree of judgment or complexity, or areas where assumptions and estimates are significant to the consolidated financial statements, are disclosed in Note 4.

#### 2.1.1 Standards, amendments and interpretations effective and adopted by the Group in 2011

- IAS 24 (revised). In November 2009, the IASB issued a revised version of IAS 24 Related Party Disclosures. Until now, if a government controlled, or significantly influenced, an entity, the entity was required to disclose information about all transactions with other entities controlled, or significantly influenced by the same government. The revised standard still requires disclosures that are important to users of financial statements but eliminates requirements to disclose information that is costly to gather and of less value to users. It achieves this balance by requiring disclosure about these transactions only if they are individually or collectively significant. Furthermore the IASB has simplified the definition of related party and removed inconsistencies. The Group adopted the revised standard as of January 1, 2011. The revised standard did not have a significant impact on the disclosures in the Group's financial statements.

#### 2.1.2 Standards, amendments and interpretations effective in 2011 but not relevant for the Group

- IAS 32 (amended) – The IASB published an amendment to IAS 32 Financial Instruments: Presentation in October 2009. The amendment clarifies the classification of rights issues as equity or liabilities for rights issues that are denominated in a currency other than the functional currency of the issuer. These rights issues are recorded as derivative liabilities before the amendment. The amendment requires that such right issues offered pro rata to all of an entity's existing shareholders are classified as equity. The classification is independent of the currency in which the exercise price is denominated. The amendment did not have any impact on the Group's financial statements as Magyar Telekom has no such instruments.
- IFRS 1 The IASB amended IFRS 1 in January 2010 and in December 2010. As the Group has been reporting according to IFRS for many years, neither the original standard, nor any revision to that is relevant for the Group.
- IFRIC 14 (amended) IAS 19 – The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction. In November 2009, the IASB issued an amendment to IFRIC 14, which corrects an unintended consequence of IFRIC 14. Without the amendments, in some circumstances entities are not permitted to recognize some voluntary prepayments for minimum funding contributions as an asset. The amendment permits such an entity to treat the benefit of such an early payment as an asset. The amended interpretation is not applicable to Magyar Telekom as the Group has no funded defined post-retirement benefit schemes.

- IFRIC 19 Extinguishing Financial Liabilities with Equity Instruments. This interpretation issued in November 2009 clarifies the requirements of IFRSs when an entity renegotiates the terms of a financial liability with its creditor and the creditor agrees to accept the entity's shares or other equity instruments to settle the financial liability fully or partially. The interpretation did not have any impact on Magyar Telekom's financial statements as the Group does not extinguish any of its financial liabilities with equity instruments.

### 2.1.3 Standards, amendments and interpretations that are not yet effective and have not been early adopted by the Group

- IAS 1 (amended) – The IASB published amendments to IAS 1 Presentation of Financial Statements in June 2011. The amendments to IAS 1 retain the 'one or two statement' approach at the option of the entity and only revise the way other comprehensive income is presented: requiring separate subtotals for those elements which may be reclassified to the profit or loss section of the income statement (recycled) and those elements that will not. The application of the amendment is required for annual periods beginning on or after July 1, 2012. The European Union has not yet endorsed the amendments of the standard.
- IAS 19 (amended) – The IASB published amendments to IAS 19 – Employee Benefits in June 2011. The amendments focus on the following key areas:  
Recognition (only defined benefit plans) – elimination of the "corridor approach"  
Presentation (only defined benefit plans) – gains and losses that arises from remeasurements should be presented (only) in other comprehensive income (elimination of the remaining options)  
Disclosures – enhancing of disclosure requirements, e.g.
  - the characteristics of a company's defined benefit plans,
  - amounts recognized in the financial statements,
  - risks arising from defined benefit plans and
  - participation in multi-employer plans
 Improved / clarified guidance relating to several areas of the standard, e.g.
  - classification of benefits,
  - recognition of termination benefits and
  - interest rate relating to the expected return on the plan assets
 The application of the amendment is required for annual periods beginning on or after January 1, 2013. We do not expect that the adoption of the amended standard would result in significant changes in the financial statements of the Group. The European Union has not yet endorsed the amendments of the standard.
- IAS 32 (amended) – The IASB published amendments to IAS 32 – Financial Instruments: Presentation in December 2011. The amendments to IAS 32 clarify the IASB's requirements for offsetting financial instruments. The amendments address inconsistencies in current practice when applying the offsetting criteria in IAS 32. The pronouncement clarifies:
  - the meaning of "currently has a legally enforceable right of set off the recognized amounts"; and
  - that some gross settlement systems may be considered equivalent to net settlement.
 The application of the amendment is required for annual periods beginning on or after January 1, 2014. A reporting entity must apply the amended standard retrospectively. We do not expect that the adoption of the amended standard would result in significant changes in the financial statements of the Group. The European Union has not yet endorsed the amendment of the standard.
- IFRS 7 (amended) – The IASB published an amendment to IFRS 7 – Amendments to IFRS 7 Financial Instruments: Disclosures in October 2010. The amendment requires quantitative and qualitative disclosures regarding transfers of financial assets that do not result in entire derecognition, or that result in continuing involvement. This is intended to allow users of financial statements to improve their understanding of such transactions (for example, securitizations), including understanding the possible effects of any risks that may remain with the entity that transferred the assets. The amendments also require additional disclosures if a disproportionate amount of such transactions are undertaken around the end of a reporting period. The application of the amendment is required for annual periods beginning on or after July 1, 2011. An earlier application is permitted. We do not expect that the adoption of the amended standard would result in significant changes in the financial statements disclosures of the Group. The European Union has not yet endorsed the amended standard.

The IASB published amendments to IFRS 7 – Amendments to IFRS 7 Financial Instruments: Disclosures in December 2011. The IASB and the Financial Accounting Standards Board (FASB) issued common disclosure requirements that are intended to help to better assess the effect or potential effect of offsetting arrangements on a company's financial position. The common disclosure requirements also improve transparency in the reporting of how companies mitigate credit risk, including disclosure of collateral pledged or received. The application of the amendment is required for annual periods beginning on or after January 1, 2013. A reporting entity must apply the amended standard retrospectively. We do not expect that the adoption of the amended standard would result in significant changes in the financial statements disclosures of the Group. The European Union has not yet endorsed the amended standard.

- IFRS 9 Financial Instruments. The standard forms the first part of a three-phase project to replace IAS 39 (Financial Instruments: Recognition and Measurement) with a new standard, to be known as IFRS 9 – Financial Instruments. IFRS 9 prescribes the classification and measurement of financial assets and liabilities. The remaining phases of this project, dealing with the impairment of financial instruments and hedge accounting, as well as a further project regarding derecognition, are in progress.

Financial assets – At initial recognition, IFRS 9 requires financial assets to be measured at fair value. After initial recognition, financial assets continue to be measured in accordance with their classification under IFRS 9. Where a financial asset is classified and measured at amortized cost, it is required to be tested for impairment in accordance with the impairment requirements in IAS 39. IFRS 9 defines the below rules for classification.

- IFRS 9 requires that financial assets are classified as subsequently measured at either amortized cost or fair value. There are two conditions needed to be satisfied to classify financial assets at amortized cost: (1) The objective of an entity's business model for managing financial assets has to be to hold assets in order to collect contractual cash flows; and (2) The contractual terms of the financial asset give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding. Where either of these conditions is not satisfied, financial assets are classified at fair value.
- Fair Value Option: IFRS 9 permits an entity to designate an instrument, that would otherwise have been classified in the amortized cost category, to be at fair value through profit or loss if that designation eliminates or significantly reduces a measurement or recognition inconsistency ('accounting mismatch').
- Equity instruments: The default category for equity instruments is at fair value through profit or loss. However, the standard states that an entity can make an irrevocable election at initial recognition to present all fair value changes for equity investments not held for trading in other comprehensive income. These fair value gains or losses are not reported as part of a reporting entity's profit or loss, even when a gain or loss is realized. Only dividends received from these investments are reported in profit or loss.
- Embedded derivatives: The requirements in IAS 39 for embedded derivatives have been changed by no longer requiring that embedded derivatives be separated from financial asset host contracts.
- Reclassification: IFRS 9 requires reclassification between fair value and amortized cost when, and only when there is a change in the entity's business model. The 'tainting rules' in IAS 39 have been eliminated.

Financial liabilities – IFRS 9 "Financial Instruments" sets the requirements on the accounting for financial liabilities and replaces the respective rules in IAS 39 "Financial Instruments: Recognition and Measurement". The new pronouncement

- Carries forward the IAS 39 rules for the recognition and derecognition unchanged.
- Carries forward most of the requirements in IAS 39 for classification and measurement.
- Eliminates the exception from fair value measurement for derivative liabilities that are linked to and must be settled by delivery of an unquoted equity instrument.
- Changes the requirements related to the fair value option for financial liabilities to address own credit risk.

The IASB issued amendments to IFRS 9 in December 2011 and deferred the mandatory effective date of IFRS 9 from January 1, 2013 to January 1, 2015. The deferral will make it possible for all phases of the IFRS 9 project to have the same mandatory effective date. The amendments also provide relief from the requirement to restate comparative financial statements for the effect of applying IFRS 9. This relief was originally only available to companies that chose to apply IFRS 9 prior to 2012. Instead, additional transition disclosures will be required to help investors understand the effect that the initial application of IFRS 9 has on the classification and measurement of financial instruments. The adoption of the new standard will likely result in changes in the financial statements of the Group, the exact extent of which we are currently analyzing. The European Union has not yet endorsed either the standard or its amendment.

- IFRS 10, IFRS 11, IFRS 12, IAS 27 (amended) and IAS 28 (amended) – The IASB published IFRS 10 – Consolidated Financial Statements, IFRS 11 – Joint Arrangements, IFRS 12 – Disclosures of Interests in Other Entities and amendments to IAS 27 – Separate Financial Statements and IAS 28 – Investments in Associates and Joint Ventures in May 2011.

IFRS 10 replaces the consolidation guidance in IAS 27 Consolidated and Separate Financial Statements and SIC-12 Consolidation – Special Purpose Entities by introducing a single consolidation model for all entities based on control, irrespective of the nature of the investee (i.e., whether an entity is controlled through voting rights of investors or through other contractual arrangements as is common in special purpose entities). Under IFRS 10, control is based on whether an investor has

- power over the investee;
- exposure, or rights, to variable returns from its involvement with the investee; and
- the ability to use its power over the investee to affect the amount of the returns.

IFRS 11 introduces new accounting requirements for joint arrangements, replacing IAS 31 – Interests in Joint Ventures. The option to apply the proportional consolidation method when accounting for jointly controlled entities is removed. Additionally, IFRS 11 eliminates jointly controlled assets to now only differentiate between joint operations and joint ventures. A joint operation is a joint arrangement whereby the parties that have joint control have rights to the assets and obligations for the liabilities. A joint venture is a joint arrangement, whereby the parties that have joint control have rights to the net assets.

IFRS 12 will require enhanced disclosures about both consolidated entities and unconsolidated entities in which an entity has involvement. The objective of IFRS 12 is to require information so that financial statement users may evaluate the basis of control, any restrictions on consolidated assets and liabilities, risk exposures arising from involvements with unconsolidated structured entities and non-controlling interest holders' involvement in the activities of consolidated entities.

The requirements relating to separate financial statements are unchanged and are included in the amended IAS 27 – Separate Financial Statements. The other portions of IAS 27 are replaced by IFRS 10.

IAS 28 – Investments in Associates and Joint Ventures is amended for conforming changes based on the issuance of IFRS 10, IFRS 11 and IFRS 12.

An entity shall apply this package of five new and revised standards for annual periods beginning on or after January 1, 2013. We do not expect that their adoption would result in significant changes in the financial statements of the Group, the exact extent of which we are currently analyzing. The European Union has not yet endorsed the new standards and the amendments.

- IFRS 13 The IASB published IFRS 13 – Fair Value Measurement in May 2011 in order to replace the guidance on fair value measurement in existing IFRS accounting literature with a single standard. The IFRS is the result of joint efforts by the IASB and FASB to develop a converged fair value framework. IFRS 13 defines fair value, provides guidance on how to determine fair value and requires disclosures about fair value measurements. However, IFRS 13 does not change the requirements regarding which items should be measured or disclosed at fair value. IFRS 13 seeks to increase consistency and comparability in fair value measurements and related disclosures through a 'fair value hierarchy'. The hierarchy categorizes the inputs used in valuation techniques into three levels. The hierarchy gives the highest priority to (unadjusted) quoted prices in active markets for identical assets or liabilities and the lowest priority to unobservable inputs. If the inputs used to measure fair value are categorized into different levels of the fair value hierarchy, the fair value measurement is categorized in its entirety in the level of the lowest level input that is significant to the entire measurement (based on the application of judgment). The new standard should be applied for annual periods beginning on or after January 1, 2013. Earlier application is permitted. We do not expect that the adoption of the new standard would result in significant changes in the financial statements of the Group, the exact extent of which we are currently analyzing. The European Union has not yet endorsed the new standard.

#### **2.1.4 Standards, amendments and interpretations that are not yet effective and not relevant for the Group's operations**

- IAS 12 (amended). In December 2010, the IASB issued the pronouncement "Deferred Tax: Recovery of Underlying Assets – Amendments to IAS 12". The new pronouncement "Deferred Tax: Recovery of Underlying Assets – Amendments to IAS 12" sets presumptions for the recovery (e.g. use or sale) of certain assets. This is relevant in cases where the type of recovery has different tax consequences. The pronouncement sets the rebuttable presumption that the carrying amount of investment property that is measured using the fair value model in IAS 40 will be recovered through sale. Moreover, the carrying amount of a non-depreciable asset measured using the revaluation model in IAS 16 is always deemed to be recovered through sale. The amendment supersedes SIC 21 and shall be applied for annual periods beginning on or after 1 January 2012. Earlier application is permitted. As Magyar Telekom does not have investment properties or non-depreciable asset measured using the revaluation model in IAS 16, the amended standard will not have any impact on the Group's financial statements. The European Union has not yet endorsed the amended standard.
- IFRIC 20 In October 2011, the IASB published IFRIC 20 – Stripping Costs in the Production Phase of a Surface Mine. The interpretation shall be applied for annual periods beginning on or after 1 January 2013. Earlier application is permitted. As Magyar Telekom does not have mining activity, the interpretation will not have any impact on the Group's financial statements. The European Union has not yet endorsed the interpretation.

## 2.2 Consolidation

### 2.2.1 Subsidiaries

Subsidiaries 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 as to obtain benefit from its activities, 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 acquisition method of accounting is used to account for business combinations. 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 whereby costs directly attributable to the acquisition are expensed for transactions closed after January 1, 2010. 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. If the cost of acquisition is less than the fair value of the net assets of the subsidiary acquired, the difference is recognized directly in the Profit for the year (Other operating income).

If applicable, the Group recognizes at the acquisition date a liability for any contingent purchase consideration. If the amount of contingent consideration accounted for as a liability changes as a result of a post-acquisition event (such as meeting an earnings target), it is recognized in accordance with other applicable IFRSs, as appropriate rather than as an adjustment of goodwill for acquisitions concluded after January 1, 2010. For acquisitions concluded before, the difference between the contingent consideration recognized at the acquisition date and the actual contingent consideration paid is recognized as an adjustment to goodwill.

As for the measurement of non-controlling interest, from January 1, 2010, the Group may recognize 100% of the goodwill of the acquired entity, not only the Group's portion of the goodwill. This is elected on a transaction-by-transaction basis. Before that date, the Group could only recognize its own share of the goodwill. The Group attributes their share of losses to the non-controlling interests even if this results in the non-controlling interests having a deficit balance since January 1, 2010. Before that date, the balance of the Non controlling interests could not be a negative amount and thus these losses would be allocated to the Group.

In a step acquisition, the fair values of the acquired entity's assets and liabilities, including goodwill, are measured on the date when control is obtained. Accordingly, goodwill is measured as the difference at the acquisition date between the fair value of any investment the business held before the acquisition, the consideration transferred and the fair value of the net asset acquired and non-controlling interest is recorded at fair value when the Group elects the fair value option.

In case of acquisitions where the transaction takes place between companies under common control (i.e. with other Deutsche Telekom Group companies), the transaction is recorded at the carrying amounts as recorded in the selling owner's accounts, and any gains, losses or differences between the carrying amount and the sale-purchase price are recognized in Retained earnings.

A partial disposal of an investment in a subsidiary while control is retained is accounted for as an equity transaction with owners, therefore gain or loss is not recognized in profit or loss for disposals concluded since January 1, 2010. Before that date, the gain or loss was recognized as a current year income.

A partial disposal of an investment in a subsidiary that results in loss of control triggers re-measurement of the residual interest to fair value. Any difference between fair value and carrying amount is a gain or loss on the disposal, recognized in profit or loss since January 1, 2010. Before that date, no such re-measurement took place.

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

At December 31, 2011 and 2010 the principal operating subsidiaries of the Group were as follows:

Subsidiaries	Group interest in capital as at December 31, (%)		Activity
	2010	2011	
Incorporated in Hungary:			
Dataplex Kft., Budapest	100	100	IT hardware co-location service provider
Origo Zrt., Budapest	100	100	Internet and TV content provider
KFKI Zrt., Budapest	100	100	System integration and IT services
IQSYS Zrt., Budapest	100	100	System integration and IT services
Pro-M Zrt., Budapest	100	100	Professional Mobile Radio (PMR) network operator
ISH Kft., Budapest	100	100	Integrated healthcare IT services
Daten-Kontor Kft., Budapest	-	100	Software development
Telekom New Media Zrt., Budapest	100	100	Interactive service provider of telecommunications applications
Incorporated in Macedonia:			
Makedonski Telekomunikacii A. D., Skopje (MKT)	56,67	56,67	Fixed line telecom service provider
T-Mobile Macedonia A. D., Skopje (T-Mobile MK)	56,67	56,67	Cellular telecom service provider
Stonebridge A. D., Skopje	100	100	Holding company
Incorporated in Montenegro:			
Crnogorski Telekom a. d., Podgorica (CT)	76,53	76,53	Telecom service provider
Incorporated in Romania:			
Combridge S.R.L., Bukarest	100	100	Wholesale telecommunications service provider
Incorporated in Bulgaria:			
Novatel EOOD, Szófia	100	100	Wholesale telecommunications service provider
Incorporated in the Ukraine:			
Novatel Ukraine LLC., Kijev	100	100	Alternative telecommunications and internet service provider

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

### 2.2.2 Associates and joint ventures

Associates are all entities over which the Group has significant influence but not control, generally reflecting a voting right between 20% and 50%. Joint ventures are entities in which the Group has a voting right of 50% with an equivalent external partner holding the other 50% of the voting rights. Investments in associates and joint ventures are accounted for using the equity method of accounting and are initially recognized at cost. The Group's investment in associates and joint ventures includes goodwill arising on acquisitions, and net of any accumulated impairment loss.

The Group's share of its associates' and joint ventures' post-acquisition profits or losses is recognized in the Profit for the year (Share of associates' and joint ventures' profits). The cumulative post-acquisition movements are adjusted against the carrying amount of the investment. When the Group's share of losses in an associate or joint venture equals or exceeds its interest in the company, the Group does not recognize further losses, unless it has incurred legal or constructive obligations or made payments on behalf of the associate or joint venture.

Unrealized gains on transactions between the Group and its associates and joint ventures are eliminated to the extent of the Group's interest in the company. Accounting policies of associates and joint ventures have been adjusted where necessary to ensure consistency with the policies adopted by the Group.

At December 31, 2011 the Group had no associates or joint ventures, while at the end of 2010 the Group had one insignificant operational associate and one joint venture in liquidation, which was completed in 2011.

## 2.3 Foreign currency translation

### 2.3.1 Functional and presentation currency

Items included in the financial statements of each of the Group's entities are measured using the currency of the primary economic environment in which the entity operates ('the functional currency').

The consolidated financial statements are presented in millions of HUF, as the Group's presentation currency is the Hungarian Forint.

### 2.3.2 Transactions and balances

Foreign currency transactions are translated into the functional currency using the exchange rates prevailing at the dates of the transactions. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation at year-end exchange rates of monetary assets and liabilities denominated in foreign currencies are recognized in the Profit for the year (Other finance expense – net).

### 2.3.3 Group companies

The income and financial position of all of the Group's entities (none of which has the currency of a hyperinflationary economy) that have a functional currency different from the presentation currency are translated into the presentation currency as follows:

- 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 the date of acquisition. 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.
- Assets and liabilities for each Statement of financial position presented are translated at the closing rate at the date of that Statement of financial position.
- Statements of comprehensive income are translated at cumulated average exchange rates.

- All resulting exchange differences are recognized directly in the consolidated equity (Cumulative translation adjustment). When a foreign operation is fully or partially disposed of so that control is given up, exchange differences that were recorded in equity are recognized in the Profit for the year as part of the gain or loss on sale.

## 2.4 Financial instruments

A financial instrument is any contract that gives rise to a financial asset of one entity and a financial liability or equity instrument of another entity.

Financial assets of the Group include cash and cash equivalents, equity instruments of another entity (available-for-sale) and contractual rights to receive cash (trade and other receivables) or another financial asset from another entity or to exchange financial assets or financial liabilities with another entity under conditions that are potentially favorable to the entity (derivatives).

Financial liabilities of the Group include liabilities that originate from contractual obligations to deliver cash or another financial asset to another entity (non-derivatives); or to exchange financial assets or financial liabilities with another entity under conditions that are potentially unfavorable to the entity (derivatives).

Financial liabilities, in particular, include liabilities to banks and related parties, finance lease payables, trade payables and derivative financial liabilities.

Finance lease receivables and liabilities meet the criteria of a financial instrument, but these are recognized and measured according to IAS 17 – Leases. See Note 2.17.

The fair value of traded financial instruments is determined by reference to their market prices at the end of the reporting period. This typically applies to available-for-sale (AFS) financial instruments.

The fair value of financial instruments that are not traded in an active market (e.g. derivative financial instruments) is determined by using discounted cash flow valuation technique. The fair value of forward foreign exchange contracts is determined using quoted spot exchange rates and appropriate interest rates at the end of the reporting period.

The fair value of other financial instruments is also determined by using discounted cash flow valuation technique. The expected quarterly cash inflows or outflows are discounted by market based interest rates interpolated from the official Budapest and EUR Interest Rate Swap.

The fair value of long term fixed-rate financial liabilities (Financial liabilities to related parties, Bank loans and Nonconvertible bonds and debentures) is also determined by using discounted cash flow valuation technique. The cash flows of the liabilities are discounted by interest rates, which are reasonable to the Group for similar financial instruments. The carrying amount of floating-rate financial liabilities or those expiring within one year approximate the fair values at the end of the reporting period.

Assumptions applied in the fair value calculations are subject to uncertainties. Changes in the assumptions applied in the calculations would have an impact on the carrying amounts, the fair values and/ or the cash flows originating from the financial instruments. Sensitivity analyses related to the Group's financial instruments are provided in Note 3.

### 2.4.1 Financial assets

The Group classifies its financial assets in the following categories:

- at fair value through profit or loss
- loans and receivables
- available-for-sale (AFS)
- held-to-maturity

The classification depends on the purpose for which the financial asset was acquired. Management determines the classification of financial assets at their initial recognition.

Standard purchases and sales of financial assets are recognized on the 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 Profit for the year.

The Group assesses at each financial statement date whether there is objective evidence that a financial asset is impaired. There is objective evidence of impairment if as a result of loss events that occurred after the initial recognition of the asset have an impact on the estimated future cash flows of the financial asset or group of financial assets that can be reliably estimated.

Impairment losses of financial assets are recognized in the Profit for the year against allowance accounts to reduce the carrying amount until the derecognition of the financial asset, when the net carrying amount (including any allowance for impairment) is derecognized from the Statement of financial position. Any gains or losses on derecognition are calculated and recognized as the difference between the proceeds from disposal and the (net) carrying amount derecognized.

Financial assets 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.

#### 2.4.1.1 Financial assets at fair value through profit or loss

The “financial assets at fair value through profit or loss” measurement category includes the following financial assets:

- Financial assets that are designated as “at fair value through profit or loss” using the fair value option as per IAS 39
- Financial assets incurred for the purpose of selling immediately or in the near term and thus classified as “held for trading”
- Derivative financial assets are classified as “held for trading”

Assets in this category are normally classified as current assets (Other financial current assets). Derivatives aimed to hedge the cash flow risk of non current financial instruments are classified as non current assets (Other financial non current assets).

No reclassification between categories has been made in the past and no reclassifications are expected in the future.

Assets in this category are initially recognized and subsequently carried at fair value. Gains or losses arising from changes in the fair value and impairment losses or their reversals are recognized in the Profit for the year (Other finance expense – net) in the period in which they arise. The Group only classifies derivative financial instruments in this category.

Derivatives are initially recognized at fair value on the date a derivative contract is entered into and their fair values are re-measured at subsequent financial statement dates. Magyar Telekom does not apply hedge accounting for its financial instruments, therefore all gains and losses are recognized in the Profit for the year (Other finance expense – net).

#### 2.4.1.2 Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. Receivables are included in current assets, except those with maturities over 12 months after the financial statement date. These are classified as Other non-current financial assets.

The following items are assigned to the “loans and receivables” measurement category:

- cash and cash equivalents,
- trade receivables,
- other receivables,
- employee loans,
- loans granted to related parties and third parties.

Loans and receivables are initially recognized at fair value and subsequently carried at amortized cost using the effective interest method, less any impairment.

The carrying amount of loans and receivables, which would otherwise be past due, whose terms have been renegotiated is not impaired if the collectability of the renegotiated cash flows are considered ensured.

**(a) Cash and cash equivalents**

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

Should an impairment on cash and cash equivalents occur, it would be recognized in the Profit for the year (Other finance expense – net).

**(b) Trade and other receivables**

Trade and other receivables are recognized initially at fair value and subsequently measured at amortized cost using the effective interest method, less provision for impairment.

A provision for impairment of trade and other receivables is established when there is objective evidence that the Group will not be able to collect all amounts due according to the underlying arrangement. Significant financial difficulties of the debtor, probability that the debtor will enter bankruptcy or financial reorganization, and default or delinquency in payments as well as historical collections are considered indicators that the trade receivable is impaired.

If there is objective evidence that an impairment loss on loans and receivables carried at amortized cost has been incurred, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows (excluding future credit losses that have not been incurred) discounted at the financial asset's original effective interest rate (i.e. the effective interest rate computed at initial recognition). The carrying amount of the asset is reduced through the use of an allowance account, and the amount of the loss is recognized in the Profit for the year (Other operating expenses – Bad debt expense).

The Group first assesses whether objective evidence of impairment exists individually for financial assets that are individually significant, and collectively for financial assets that are not individually significant. If no objective evidence of impairment exists for an individually assessed financial asset, whether significant or not, Magyar Telekom includes the asset in a group of financial assets with similar credit risk characteristics and collectively assesses them for impairment. Assets that are individually assessed for impairment and for which an impairment loss is recognized are not included in a collective assessment of impairment.

The Group's benchmark policy for collective assessment of impairment is based on the aging of the receivables due to the large number of relatively similar type of customers.

Individual valuation is carried out for customers under litigation; bankruptcy proceedings and for the total receivables of customers with overdue receivables. Itemized valuation is also performed in special circumstances, if there is an overdue receivable from any designated customer with different credit risk attributes.

When a trade or an other receivable is established to be uncollectible, it is written off with a parallel release of cumulated impairment against Other operating expenses in the Profit for the year (Bad debt expense). Subsequent recoveries of amounts previously written off are credited against the same line of the Statement of comprehensive income.

If, in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognized (such as an improvement in the debtor's credit rating), the previously recognized impairment loss shall be reversed by adjusting the allowance account. The reversal shall not result in a carrying amount of the financial asset that exceeds what the amortized cost would have been had the impairment not been recognized at the date the impairment is reversed. The amount of the reversal shall be recognized in the Profit for the year as a reduction to Other operating expenses (Bad debt expense).

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 (such as interconnection receivables and payables).

**(c) Employee loans**

Employee loans are recognized initially at fair value and subsequently measured at amortized cost using the effective interest method, less any impairment loss.

The difference between the nominal value of the loan granted and the initial fair value of the employee loan is recognized as prepaid employee benefits. Interest income on the loan granted calculated by using the effective interest method is recognized as Interest income, while the prepaid employee benefits are amortized to Employee related expenses evenly over the term of the loan.

Impairment losses on Employee loans are recognized in the Profit for the year (Employee related expenses).

#### **(d) Loans granted to related parties and third parties**

Loans granted to related parties and third parties include short term loans and deposits made with DTAG or other trading partners.

Impairment losses on Loans granted to related parties and third parties are accounted for in the Profit for the year (Other finance expense – net).

#### **2.4.1.3 Available-for-sale (AFS) financial assets**

AFS financial assets are non-derivative financial assets that are either designated in this category or not classified in any of the other categories. They are included in Other non current financial assets unless management intends to dispose of the investment within 12 months of the financial statement date. In this latter case they are included in current assets (Other financial assets).

The “available-for-sale financial assets” measurement category includes:

- listed equity instruments that are neither consolidated nor included using the equity method in the consolidated financial statements
- unlisted equity instruments that are neither consolidated nor included using the equity method in the consolidated financial statements
- debt instruments

AFS financial assets are initially recognized and also subsequently carried at fair value. The unrealized changes in the fair value of available-for-sale financial assets are recognized in equity (Revaluation reserve for AFS financial assets).

Interest on available-for-sale debt securities calculated using the effective interest method is recognized in the Profit for the year (Interest income). Dividends on available-for-sale equity instruments are recognized in the Profit for the year (Other finance expense – net) when the Group’s right to receive payments is established.

The Group assesses at each financial statement date whether there is objective evidence that a financial asset is impaired. There is objective evidence of impairment if as a result of loss events that occurred after the initial recognition of the asset have an impact on the estimated future cash flows of the financial asset that can be reliably estimated. If any such evidence exists for AFS financial assets, the cumulative unrealized gain (if any) is reclassified from Other comprehensive income to Profit for the year, and any remaining difference is also recognized in the Profit for the year (Other finance expense – net). Impairment losses recognized on equity instruments are not reversed through the Profit for the year, while impairment losses recognized on debt instruments are reversed through the Profit for the year.

When AFS financial assets are sold or redeemed, therefore derecognized, the fair value adjustments accumulated in equity are reclassified from Other comprehensive income to Profit for the year (Other finance expense – net).

#### **2.4.1.4 Held-to-maturity investments**

This category includes non-derivative financial assets with fixed or determinable payments and fixed maturity that the Group has the positive intention and ability to hold to maturity. The Group does not classify any of its financial instruments in this category.

#### **2.4.2 Financial liabilities**

There are two measurement categories for financial liabilities used by the Group:

- Financial liabilities carried at amortized cost
- Financial liabilities at fair value through profit or loss

No reclassification between categories has been made in the past and no reclassifications are expected in the future. Both types of financial liabilities are initially recognized at fair value, while subsequent measurements are different (see below). We remove a financial liability (or a part of a financial liability) from the Statement of financial position when, and only when, it is extinguished – i.e. when the obligation specified in the contract is discharged, cancelled or expired.

#### **2.4.2.1 Financial liabilities carried at amortized cost**

The measurement category for “financial liabilities measured at amortized cost” includes all financial liabilities not classified as “at fair value through profit or loss”.

##### **(a) Loans and other borrowings**

Borrowings are recognized initially at fair value less transaction costs, and subsequently measured at amortized costs using the effective interest rate method. The effective interest is recognized in the Profit for the year (Interest expense) over the period of the borrowings.

##### **(b) Trade and other payables**

Trade and other payables (including accruals) are recognized initially at fair value and subsequently measured at amortized cost using the effective interest method. The carrying values of trade and other payables approximate their fair values due to their short maturity.

#### **2.4.2.2 Financial liabilities at fair value through profit or loss**

Since the Group currently has no intention of measuring non-derivative financial liabilities at fair value, generally only derivative financial instruments are assigned to this category.

The Group does not designate any derivatives as hedging instruments, therefore, all derivatives are classified as “held for trading”.

Derivatives are initially recognized at fair value on the date a derivative contract is entered into and their fair values are re-measured at subsequent financial statement dates. Magyar Telekom does not apply hedge accounting for its financial instruments, therefore all gains and losses are recognized in the Profit for the year (Other finance expense – net).

The Group considers only those contracts as a separable host contract and an embedded derivative which are denominated neither in the functional currency of either of the contracting parties nor in a currency that is commonly used in contracts to purchase or sell non-financial items in the economic environment in which the transaction takes place (e.g. a relatively stable and liquid currency that is commonly used in local business transactions or external trade). The Group has identified EUR and USD (except Montenegro) as currencies commonly used in the Group's operating area.

### **2.5 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 basis. The cost of inventories comprises all costs of purchase, cost of construction and other costs incurred in bringing the inventories to their present location and condition. Net realizable value is the estimated selling price in the ordinary course of business less the estimated costs of completion and the estimated costs necessary to make the sale.

Phone sets are often sold for less than cost in connection with promotions to obtain new subscribers with minimum commitment periods (Note 4.6). Such loss on the sale of equipment is only recorded when the sale occurs if the normal resale value is higher than the cost of the phone set. If the normal resale value is lower than costs, the difference is recognized as impairment immediately.

Impairment losses on Inventories are recognized in Other operating expenses (Materials, maintenance and service fees).

## 2.6 Non current assets held for sale

An asset is classified as held for sale if it is no longer needed for the future operations of the Group, and has been identified for sale, which is highly probable and 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. Depreciation is discontinued from the date of designation to the held for sale status. When an asset is designated for sale, and the fair value is determined to be lower than the carrying amount, the difference is recognized in the Profit for the year (Depreciation and amortization) as an impairment loss.

## 2.7 Property, plant and equipment (PPE)

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

The cost of an item of PPE 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 PPE are deducted from the original cost of the items and are recognized in the Profit for the year through the reduced amount of depreciation of the related assets over their useful lives. Investment tax credits relating to qualifying investment projects (Note 9.5) are also recognized in this manner.

Cost in the case of telecommunications equipment comprises of all expenditures including the cabling within customers' premises and borrowing costs of related loans.

Subsequent expenditure on an asset that meets the recognition criteria to be recognized as an asset or an addition to an asset is capitalized, while maintenance and repairs are charged to expense when incurred.

When assets are scrapped, the cost and accumulated depreciation are removed from the accounts and the loss is recognized in the Profit for the year (Depreciation and amortization).

When assets are sold, the cost and accumulated depreciation are removed from the accounts and any related gain or loss is recognized in the Profit for the year (Other operating income).

Depreciation is calculated on a straight-line basis from the time the assets are deployed and charged over their economic useful lives. On an annual basis, Magyar Telekom reviews the useful lives and residual values for consistency with current development plans and advances in technology. For further details on the groups of assets impacted by the most recent useful life revisions refer to Note 12. The annual revisions are conducted in the second quarter of the year and the resulting changes are applied from the third quarter of the year. In addition to the regular revisions, any investment decisions made throughout the year may also result in a change of useful life of a group of assets in any period of the year.

## 2.8 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. These costs are amortized over the estimated useful life of the software. Costs associated with developing or maintaining computer software programs are generally recognized as an expense as incurred. Costs 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 related costs and an appropriate portion of relevant overhead. Computer software development costs recognized as assets are amortized over their estimated useful lives. As these assets represent an immaterial portion of all software, these are not disclosed separately.

Costs associated with the acquisition of long term frequency 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 availability of the frequency for commercial use until the end of the initial concession or license term. No renewal periods are considered in the determination of useful life.

Amortization is calculated on a straight-line basis from the time the assets are deployed and charged over their economic useful lives. On an annual basis, Magyar Telekom reviews the useful lives for consistency with current development and replacement plans and advances in technology. For further details on the groups of assets impacted by the most recent useful life revisions refer to Note 13. The annual revisions are conducted in the second quarter of the year and the resulting changes are applied from the third quarter of the year. In addition to the regular revisions, any investment decisions made throughout the year may also result in a change of useful life of a group of assets in any period of the year.

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 or business at the date of acquisition. Goodwill is carried at cost less accumulated impairment losses. Impairment testing is carried out on an annual basis for all goodwill in the last quarter of the year based on the carrying values as at September 30 of the year. Impairment losses on goodwill are not reversed. Gains and losses on the disposal of an entity or business include the carrying amount of goodwill relating to the entity or business sold.

In determining whether an asset that incorporates both intangible and tangible elements should be treated under IAS 16 – Property, Plant and Equipment or as an intangible asset under IAS 38 – Intangible Assets, management uses judgment to assess which element is more significant and recognizes the assets accordingly.

## 2.9 Impairment of PPE and intangible assets

Assets that are subject to amortization or depreciation 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 the assets' fair value less costs to sell and its 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 – CGUs).

The fair values of the individual tangible and intangible assets of the Group in most cases cannot be determined as individual assets do not generate cash flows. Instead, the Group determines CGUs to which the individual assets are allocated and the fair values can only be determined at CGU level, primarily by using discounted cash flow analyses. See also Note 4.3. Corporate assets which have the distinctive characteristics of not generating cash inflows independently of other assets or groups of assets are allocated to CGUs when conducting impairment tests.

Goodwill is tested for impairment annually or more frequently if circumstances indicate that impairment may have occurred. When conducting the impairment tests, Magyar Telekom allocated goodwill to its cash generating units or groups of cash generating units, which, in 2010 in the vast majority of the cases, were determined at the operating segment level. In 2011, the goodwill was allocated and tested at operating segment level. See also Note 4.2. Operating segments may include one clearly identifiable company or a group of companies, or components of one company and other companies as well.

For the subsidiaries included in the operating segments the Group establishes the subsidiaries' recoverable amounts by determining their fair value less cost to sell 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 analyses and option pricing models, making maximum use of market inputs and relying as little as possible on entity-specific inputs. The fair values determined as described above are used as a basis when establishing the need for an impairment of any goodwill allocated to the CGUs or the operating segments. See also Note 4.2. If the calculated fair value less cost to sell is lower than the carrying amount of the operating segment, goodwill is impaired.

The impairment losses of PPE and intangible assets are accounted for in the Depreciation and amortization line of the Statement of comprehensive income.

## 2.10. Provisions and contingent liabilities

Provisions 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.

Provisions are measured and recorded as the best estimate of the economic outflow required to settle the present obligation at the financial statement date. The estimate can be calculated as the weighted average of estimated potential outcomes or can also be the single most likely outcome. Expenses for provisions are recognized in the statement of comprehensive income line where the actual expense is expected to be incurred. When a provision is released unused, it is released to the same statement of comprehensive income line where it was originally provided for. Provisions made for liabilities expected to be incurred in foreign currency are recognized in the functional currency at the spot FX rate, and any change in the provision in the functional currency as a result of a subsequent change in the FX rate is recognized in Other finance expense – net.

Provisions for obligations expected to fall due after 12 months are generally recognized at their present value and are accreted (against Interest expense) until utilization or reversal.

No provision is recognized for contingent liabilities. A contingent liability is a possible obligation that arises from past events and whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the entity; or a present obligation that arises from past events but is not recognized because it is not probable that an outflow of resources embodying economic benefits will be required to settle the obligation or the amount of the obligation cannot be measured with sufficient reliability.

## 2.11 Treasury stock

When the Company or its subsidiaries purchase the Company's equity shares, the consideration transferred including any attributable incremental external costs are deducted from the Equity of the owners of the parent as Treasury stock until they are re-sold or cancelled. When such shares are subsequently sold, the treasury share balance decreases by the original cost of the shares, thereby increasing equity, while any gains or losses are also recognized in equity (Retained earnings). Treasury stock transactions are recorded on the transaction date.

## 2.12 Revenues

Revenues for all services and equipment sales (Note 22) are shown net of VAT, discounts and excluding sales within the Group. Revenue is recognized when the amount of the revenue can be reliably measured, and when it is probable that future economic benefits will flow to the Group and all other specific recognition criteria of IAS 18 or IAS 11 on the sale of goods and rendering of services are met for the provision of each of the Group's services and sale of goods.

Customers of the Group are granted loyalty awards (credit points) based on their usage of the Group's services including timely payment of their invoices. Loyalty awards can be accumulated and redeemed to obtain future benefits (e.g. call credits, handset discounts, etc.) from the operators of the Group. When customers earn their credit points, the fair value of the credit points earned are deducted from the revenue invoiced to the customer, and recognized as Other liabilities (deferred revenue). On redemption (or expiry) of the points, the deferred revenue is released to revenue as the customer collected (or waived) the undelivered element of the deemed bundle.

Revenues from operating leases are recognized on a straight line basis over the period the services are provided. Operating lease revenues are primarily included in the System integration and IT revenues.

### 2.12.1. Fixed line and mobile telecommunications 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.

Customer subscriber arrangements typically include an equipment sale, subscription fee and charge for the actual voice, internet, data or multimedia services used. The Group considers the various elements of these arrangements to be separate earnings processes and classifies the revenue for each of the deliverables into the categories as disclosed in Note 22 using the residual method for each of the elements. These units are identified and separated, since they have value on a standalone basis and are sold not only in a bundle, but separately as well. Therefore the Group recognizes revenues for all of these elements using the residual method which is the amount of consideration allocated to the delivered elements of the arrangements equals the total consideration less the fair value of the undelivered elements.

The Group provides customers with narrow and broadband access to its fixed, mobile and TV distribution networks. Service revenues are recognized when the services are provided in accordance with contractual terms and conditions. Airtime revenue is recognized based upon minutes of use and contracted fees less credits and adjustments for discounts, while subscription and flat rate revenues are recognized in the period they relate to.

Revenues and expenses associated with the sale of telecommunications equipment and accessories are recognized when the products are delivered, provided that there are no unfulfilled obligations that affect the customer's final acceptance of the arrangement.

Advertising revenues are recognized in the period that the advertisements are exhibited.

Revenues from premium rate services (Voice and Non-voice) are recognized on a gross basis when the delivery of the service over Magyar Telekom's network is the responsibility of the Group, the Group establishes the prices of these services and bears substantial risks of these services; otherwise these revenues are presented on a net basis.

Customers may also purchase prepaid mobile, public phone and internet credits ("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. Revenues from the sale of cards are recognized when used by the customers or when the credits expire with unused traffic.

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. These wholesale (incoming) traffic revenues included in Voice and Non-voice (Data and Internet) revenues are 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 applicable. The revenues and costs of these transit calls are stated gross in the Financial statements as the Group is the principal supplier of these services using its own network freely defining the pricing of the services, and recognized in the period of related usage.

### 2.12.2 System integration and IT revenues

Contracts for network services, which consist of the installation and operation of communication networks for customers, have an average duration of 2-3 years. Revenues for voice and data services are recognized under such contracts when used by the customer.

Revenue from outsourcing contracts reflects the extent of actual services delivered in the period in accordance with the terms of the contract. The contracts are analyzed based on the requirements of IFRIC 4 – Determining whether an Arrangement contains a Lease, and if they include embedded lease elements, the revenues attributable to these are recognized according to IAS 17 – Leases as described in Note 2.17.

Revenue from system integration contracts requiring the delivery of customized products and/or services is generally covered by one of the following types of contracts: fixed-price or time and material-based. For fixed-price contracts, revenue is generally recognized based on percentage of completion taking into account the proportion that contract costs incurred for work performed to date bear to the estimated total contract costs. In the case of contracts billed on the basis of time and material, revenue is recognized as the services are rendered.

Revenue from maintenance services (generally fixed fee per month) is recognized over the contractual period or as the services are provided. Revenue from repairs, which are not part of the maintenance contract, billed on the basis of time and material used is recognized as the services are provided.

Revenue from hardware and software sales or sales-type leases is recognized when the risk of ownership is substantially transferred to the customer, provided there are no unfulfilled obligations that affect the customer's final acceptance of the arrangement. Any costs of these obligations are recognized when the corresponding revenue is recognized.

Revenues from construction contracts are accounted for using the percentage-of-completion method. The stage of completion is determined on the basis of the costs incurred to date as a proportion of the estimated total costs. Receivables from construction contracts are classified in the Statement of financial position as Trade receivables. If the total actual and estimated expenses exceed revenues for a particular contract, the loss is recognized immediately (in Expenses directly related to revenues) against a provision.

## **2.13 Employee benefits**

### **2.13.1 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.

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.

### **2.13.2 Share based compensation**

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 its equity reserves (Reserve for equity settled share based transactions) if the services are received in an equity-settled share based payment transaction. When the share based compensation program is completed, i.e. the shares are transferred to the employees' ownership or the share options have forfeited, the respective reserve is transferred to Retained earnings. If the services are received in a cash-settled share based payment transaction, the Group recognizes the expense against a liability, re-measured at each financial statement date.

Fair values are determined using option pricing models (such as Black-Scholes and Monte Carlo simulation) and other relevant techniques. As Magyar Telekom Plc. is listed and actively traded on the Budapest Stock Exchange, 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 Profit for the year at their time-proportioned fair value (Note 24.1) against an accumulating balance in Provisions.

### **2.13.3 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 the possibility of withdrawal or to provide termination benefits as a result of an offer made to encourage voluntary redundancy.

### **2.13.4 Post-employment defined benefits**

Magyar Telekom does not have significant post-employment defined benefit schemes.

## **2.14 Research and Marketing expenses**

Research as well as marketing costs are expensed as incurred. Research costs are not material, while marketing expenses are disclosed in Note 25.

## 2.15 Borrowing costs

Borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset form part of the cost of that asset. Other borrowing costs are recognized as an expense. Borrowing costs include interest and other costs that the Group incurs in connection with the borrowing of funds. The borrowing costs eligible for capitalization are capitalized applying the weighted average of the borrowing costs applicable to the general borrowings of the Group that are outstanding during the period. A qualifying asset is an asset that necessarily takes a substantial period of time, in general over 12 months, to get ready for its intended use.

## 2.16 Income taxes

### 2.16.1 Corporate income taxes

Corporate income taxes are payable to the central tax authorities of the countries in which the Group's consolidated entities operate. The basis of the tax is the taxable entities' accounting profit adjusted for non-deductible and non-taxable items. The nominal tax rates and the determination of the tax bases vary among the countries in which the Group operates.

### 2.16.2 Other income taxes

Other income taxes include certain local and central taxes levied in Hungary on the companies' net margins, determined at a substantially higher level than the corporate tax base, but applying a significantly lower tax rate.

### 2.16.3 Deferred taxes

Deferred tax is recognized applying the liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the Consolidated financial statements. However, deferred tax is not accounted for if it arises from initial recognition of an asset or liability in a transaction other than a business combination that at the time of the transaction affects neither accounting nor taxable profit. Deferred tax is determined using income tax rates that have been enacted or substantially enacted by the financial statement date and are expected to apply when the related deferred tax asset is realized or the deferred tax liability is settled.

Deferred tax assets are recognized to the extent that it is probable that future taxable profit (or reversing deferred tax liabilities) will be available against which the temporary differences can be utilized.

Deferred tax is also provided on taxable temporary differences arising on investments in subsidiaries and associates and joint ventures, except where the timing of the reversal of the temporary difference is controlled by the Group and it is probable that the temporary difference will not reverse in the foreseeable future.

## 2.17 Leases

### 2.17.1 Operating lease – Group as lessor

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

### 2.17.2 Finance lease – Group as lessor

Leases of assets where Magyar Telekom transfers substantially all the benefits and risks of ownership are recognized and disclosed as revenue against a finance lease receivable. The revenue equals the estimated present value of the future minimum lease payments receivable and any unguaranteed residual value (net investment in the lease). The cost of the asset sold in a finance lease transaction is recognized at the inception of the lease. Each lease receipt is then allocated between the receivable and interest income so as to achieve a constant rate of return on the finance receivable balance outstanding. The interest element of the lease receipt is recognized in Interest income.

### 2.17.3 Operating lease – Group as lessee

Costs in respect of operating leases are charged to the Profit for the year (Operating expenses) on a straight-line basis over the lease term.

### 2.17.4 Finance lease – Group as 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 against a finance lease payable. Each lease payment is allocated between the finance liability and interest expense so as to achieve a constant rate of interest on the outstanding finance balance payable. The finance lease obligations, net of finance charges, are included in the Statement of financial position (Other financial liabilities). The interest element of the lease payments is charged to the Profit for the year (Interest expense) 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.

### 2.17.5 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 Profit for the year over the lease term through lower depreciation expense. If the leaseback qualifies as an operating lease, any gains or losses on the sale are recognized in the Profit for the year (Other operating income) at the time of the sale as the sales price reflects the fair value of the asset, while the lease payments are recognized in the Profit for the year (Operating expenses) on a straight line basis over the period of the lease.

### 2.18 Earnings per share

Basic earnings per share is calculated by dividing profit attributable to the owners of the Company for the period by the weighted average number of common stocks outstanding. Diluted earnings per share is calculated considering the weighted average number of diluting share options (if any) in addition to the number of common stocks outstanding.

### 2.19 Dividends

Dividends payable to the Company's shareholders and to Non-controlling shareholders of the Group's subsidiaries are recorded as a liability and debited against equity (Retained earnings or Non-controlling interests) in the Group's financial statements in the period in which the dividends are approved by the shareholders.

### 2.20 Segments

In the Financial statements, the Group's segments are reported in a manner consistent with the internal reporting provided to the chief operating decision makers, the members of the Management Committee (MC) of Magyar Telekom Plc. The MC is responsible for allocating resources to, and assessing the performance of, the operating segments on a monthly basis. The accounting policies and measurement principles of the operating segments are very similar to those applied for the Group described in the previous sub-notes of the Summary of significant accounting policies. The differences primarily originate from the fact that the operating segments' annual results are determined and closed at an earlier stage, around January 10–12 each year, than these Financial statements. Any items discovered and requiring adjustment between the closing date of the segment results and the approval date of the Financial statements are reflected in the next year's segment results.

The operating segments' revenues include revenues from external customers as well as the internal revenues generated from other segments for telecommunications and, to a lesser extent, from inter-segment support services. In order to concentrate on real performance achieved on third party transactions, the number of inter-segment cross-charges applied within the organizations of Magyar Telekom Plc. operating in different segments is fairly limited. These cross-charges are not meant to allocate all the actual costs to the operating segment which are in fact incurred for the operation of the particular segment. Consequently, regardless of the costs incurred for the operation of another segment, the supporting organizations of the operating segments do not charge revenues for the services delivered within Magyar Telekom Plc., the largest legal entity of the Group.

The operating segments' results are monitored by the MC down to EBITDA (Earnings before interest, tax, depreciation and amortization) level, which is defined by the Group as Operating profit without Depreciation and amortization expense.

The MC does not monitor the assets and liabilities at the segment level.

Another important KPI monitored at segment level is capital expenditure (Capex), which is determined as the gross additions to PPE and Intangible assets, excluding those due to business combinations.

## 2.21 Comparative information

In order to maintain consistency with the current year presentation in the Financial statements and the Notes thereto, certain items may have been reclassified for comparative purposes. Material changes in disclosures, if any, are described in detail in the relevant Notes. In 2011 there were no material reclassifications.

## 3 Financial Risk Management

### 3.1 Financial risk factors

Magyar Telekom is primarily exposed to credit risks related to its financial assets. In addition, the Group is also exposed to risks from movements in exchange rates, interest rates that affect the fair value and/or the cash flows arising from financial assets and liabilities.

Financial risk management aims to limit these risks through ongoing operational and finance activities. Selected derivative and non-derivative hedging instruments are also used for this purpose, depending on the risk assessment. Magyar Telekom only hedges the risks that affect the Group's cash flows, no hedges are concluded to hedge fair values. Derivatives are exclusively used as hedging instruments, i.e., not for trading or other speculative purposes. To reduce the counterparty risk, hedging transactions are generally only concluded with Deutsche Telekom or leading Hungarian financial institutions. Nevertheless, hedge accounting is not applied to such transactions, considering that not all the criteria in IAS 39 are met.

The detailed descriptions of risks, the management thereof as well as sensitivity analyses are provided below. These sensitivity analyses calculate with reasonably possible changes in the relevant risk variables and their impact on profit before tax. The impacts disclosed below are subject to an average effective income tax rate of approximately 25% (2010: approximately 10%) in the Group, i.e. the impact on Profit for the year would be approximately 75% of the pre tax amount in a year that is free from significant one-off non-deductible pre-tax impacts and significant changes in the tax legislation. The potential impacts disclosed (less tax) would be the same on the Group's Equity.

There were no major changes in these risks compared to the previous reporting period.

#### 3.1.1 Market risk

Market risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market prices. Market risk comprises three types of risk: currency risk, interest rate risk and other price risk.

The fundamentals of Magyar Telekom's financing strategy are established each year by the Board of Directors. The Group's policy is to borrow centrally using a balanced combination of medium term and short term loans, and fixed and floating interest rates on those loans. The Board of Directors has approved two debt protection ratio limits, and monitors their fulfillment annually. At the end of 2010 and 2011 Magyar Telekom fulfilled both criteria; Total Debt to EBITDA ratio of 1.88 in 2011 (2010: 1.70), the allowed maximum of which would be 2.5 and EBITDA to Interest Expense ratio of 6.04 in 2011, (2010: 7.58), the allowed minimum of which would be 3.0. The Group's Treasury department is responsible for implementing the finance policy and for ongoing risk management. The details of foreign exchange, liquidity and counterparty risk management guidelines are determined and monitored by the Group Treasurer continuously.

Magyar Telekom is exposed to interest and foreign exchange (FX) rate risk associated with its interest bearing assets and liabilities 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. Consequently, Magyar Telekom's objective is to minimize the level of its financial risk in HUF terms.

For the presentation of market risks, we also provided sensitivity analyses that show the effects of hypothetical changes of relevant risk variables on Profit before tax. These hypothetical changes were modeled to present a reasonably possible change in the relevant risk variables. The periodic effects are determined by relating the hypothetical changes in the risk variables to the balance of financial instruments at the end of the latest reporting period (2011) and the preceding reporting period (2010). The balances at the end of the reporting period are usually representative for the year as a whole, therefore the impacts are calculated using the year end balances as though the balances had been constant throughout the reporting period. The methods and assumptions used in the sensitivity calculations did not change significantly. As a result of the still rather volatile international capital and securities markets, higher fluctuations of the FX and interest rates are also possible.

### 3.1.1.1 Foreign currency risk

Foreign currency risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in FX rates. Currency risks primarily arise on financial instruments being denominated in a currency that is not the functional currency of the given operating segment of the Group. Differences resulting from the translation of the foreign subsidiaries financial statements into the Group's presentation currency are not taken into consideration. Relevant risk variables are generally all non-functional currencies in which Magyar Telekom has financial instruments.

Due to the free-float of the HUF introduced in 2008, the Group is exposed to FX risk in case of FX denominated financial instruments of the Hungarian entities to a higher degree than before. In order to mitigate this risk, Magyar Telekom minimized its foreign currency borrowings in the past years, or covered them with derivative instruments to substantially reduce FX risk.

#### (a) FX risks arising on loans from DTIF and related swaps with DT AG

From 2002 to 2009 all new related party loans taken from DT were denominated in HUF. In agreement with Deutsche Telekom, the new related party loans taken to finance general corporate needs from the financing vehicle of Deutsche Telekom, Deutsche Telekom International Finance B.V. (DTIF) from June 2009 are denominated in EUR, while, at the same time, cross-currency interest rate swaps are concluded with Deutsche Telekom AG to fix the actual cash flows of Magyar Telekom in HUF for the whole nominal amount and interest payments of these loans. Even though the Group does not apply hedge accounting, the change in the HUF/EUR exchange rate has limited (net) impact on Profit before tax related to the hedged loans and the swaps together. A 20% weaker HUF would cause an FX loss of approximately HUF 20 billion on the EUR denominated loans, while the swap agreements would have a compensating impact of a gain of approximately HUF 22 billion. A 20% stronger HUF would cause an FX gain of approximately HUF 20 billion on the EUR denominated loans, while the swap agreements would have a compensating impact of a loss of approximately HUF 22 billion.

#### (b) FX risks arising on third party loans and related swaps

Magyar Telekom also has third party loans denominated in EUR, for the majority of which we also concluded cross-currency interest rate swap agreements with one of the substantial Hungarian banks to eliminate FX risk in connection with these loans and hedge the whole foreign currency denominated cash flows of these loans. Even though the Group does not apply hedge accounting, the change in the HUF/EUR exchange rate has no significant (net) impact on Profit before tax related to the hedged loans and the swaps together.

#### (c) Other FX exposure

The remaining FX exposure of Magyar Telekom is mostly related to (i) holding foreign currency cash balances in its subsidiaries in the Southern and Eastern Europe region, and (ii) operating activities through revenues from, and payments to, international telecommunications carriers as well as capital expenditure contracted with vendors in foreign currency. In line with currency hedging policy, the Company holds sufficient amounts of foreign currencies on its bank accounts, the amounts of which are determined considering the balance of FX denominated trade and leases payables and trade receivables in order to hedge the currency risk arising in connection with those assets and liabilities. The Group's foreign currency denominated assets (primarily held by the Group's foreign subsidiaries),

however, exceed the Group's foreign currency denominated liabilities (other than the above described loans), therefore changes of the functional currencies' exchange rates would have significant impact on the profit of the Group. Compared to the spot FX rates as of December 31, 2011, a 20% weaker functional currency HUF against the EUR and a 35% weaker functional currency HUF against the USD would have caused an unrealized loss of less than HUF 2.4 billion on this net balance (2010: HUF 0.1 billion loss). The same amount of gain would have been caused by a 20% and 35% stronger functional currency HUF against the EUR and USD, respectively. Compared to the spot FX rates as of December 31, 2011, a 15% weaker functional currency MKD against the EUR and USD would have caused HUF 3.5 billion unrealized gain on this net balance (2010: HUF 3.9 billion gain). The same amount of loss would have been caused by a 15% stronger functional currency MKD against the EUR and USD.

In order to reduce the above exposure, Magyar Telekom occasionally enters into derivative contracts. The fair value of the open short term forward positions was HUF 3.5 billion (asset) as of December 31, 2011 (2010: HUF -666 million (liability)). These positions were opened to hedge the FX risks of future FX payments exceeding FX income. Compared to the spot FX rates as of December 31, 2011, a 20% weaker functional currency HUF against the EUR and a 35% weaker functional currency HUF against the USD would have caused HUF 18.4 billion unrealized gain on this net balance while a 20% and 35% stronger HUF against the EUR and USD, respectively would have caused HUF 11.3 billion unrealized loss.

As a result of the volatile international capital and securities markets, even a more than 20% fluctuation of the functional currency HUF against EUR and a more than 35% fluctuation of the functional currency HUF against USD and a more than 15% fluctuation of the functional currency MKD against the EUR and USD is possible as extraordinary market conditions may cause extreme volatility on FX markets.

### 3.1.1.2. Interest rate risk

Magyar Telekom is also exposed to interest rate fluctuations. This is due to the fact that changing interest rates affect the fair value of the fixed rate instruments and also affect the cash flows through the floating rate instruments.

Changes in the market interest rates of non-derivative financial instruments with fixed interest rates only affect income if these are measured at their fair value. On the other hand, all financial instruments with fixed interest rates (which are carried at amortized cost) are not subject to cash flow interest rate risk.

Changes in the market interest rate of interest rate derivatives (interest rate swaps, cross-currency swaps) that are not part of a hedging relationship as set out in IAS 39 affect financial income or expense (net gain/ loss from re-measurement of the financial assets to fair value).

Changes in market interest rates affect the interest income or expense of non-derivative floating-interest financial instruments for which no cash flow hedges are in place.

#### (a) Financial assets

Excess cash of the Group's Hungarian operations is primarily used to repay loans, however, significant amount of cash of the Group's Macedonian and Montenegrin subsidiaries are held in local banks. These amounts are deposited primarily on fixed interest rate terms in order to minimize exposure to market changes that would potentially adversely change the cash flows from these instruments.

The Group had no significant HUF denominated bank deposits at the end of 2011 and 2010.

The Group's MKD denominated bank deposits amounted to HUF 19.3 billion at the end of 2011 (2010: HUF 15.7 billion). A 1 percentage point higher interest rate throughout 2011 (assuming the year-end 2011 balance throughout 2011) would have resulted in HUF 0.2 billion higher interest income in 2011 (2010: HUF 0.2 billion). The interest income would be lower by the same amount in case of 1 percentage point lower interest rate.

The Group's EUR denominated bank deposits amounted to HUF 40.5 billion at the end of 2011 (2010: HUF 38.0 billion). A 1 percentage point higher interest rate throughout 2011 (assuming the year-end 2011 balance throughout 2011) would have resulted in HUF 0.4 billion higher interest income in 2011 (2010: HUF 0.4 billion). The interest income would be lower by the same amount in case of 1 percentage point lower interest rate.

As a result of the volatile international capital and securities markets, a higher fluctuation of the interest rates is also possible, the exposure to which is mitigated by the balanced portfolio of fixed and floating interest rate deposits (see above). Sensitivities have been disclosed for a movement of 1 percentage point for EUR, but extraordinary market conditions may cause extreme volatility on money markets, which can result in even higher percentage point change in interest rates.

### **(b) Financial liabilities**

Financial liabilities exposed to interest rate risk are primarily the related party (DTIF) and third party loans and the related swap agreements in place. These loans are almost exclusively taken by the Company as the financing of the Group is managed centrally. The analysis below describes the Group's net exposure to the net interest rate risks related to the loans and the related swap agreements.

As the vast majority of debt portfolio is denominated in HUF, or swap agreements are in place so that the loans payable are exposed to changes in HUF interest rates, the Group is mostly exposed to the HUF interest rate fluctuations for its financial liabilities. To control this interest rate risk, a combination of fixed and floating rate debt is used. Fixed interest-bearing debts (including loans swapped to fixed interest and excluding loans swapped to floating interest) made up 58% of the Group's total debt as of December 31, 2011 (2010: 63%).

In addition, some of the Group's loan agreements with Deutsche Telekom include a fixed interest rate that in fact may change in case of downgrading the credit rating of Deutsche Telekom by specific international rating agencies below the level of credit rating BBB+. Such rating downgrades from the current grade would have caused additional annual interest payments of approximately HUF 0.2 billion (assuming the year-end 2011 balance and rating throughout 2011) on top of the pre-fixed amount of interest (2010: HUF 0.2 billion). On the other hand, such rating upgrades would have caused no change in interest expense for 2011 as loans affected by DT credit rating upgrade matured in 2011 (2010: HUF 0.2 billion lower interest expense in case of rating upgrades above the level of the credit rating A assuming the year-end 2010 balance and rating throughout 2010).

Floating interest-bearing debts (including loans swapped to floating interest and excluding loans swapped to fixed interest) made up 42% of the Group's total debt as of December 31, 2011 (2010: 37%). A 2 percentage point higher interest rate throughout 2011 (assuming the year-end 2011 balance throughout 2011) would have resulted in HUF 2.9 billion higher interest expense in 2011, while the same decrease of interest rates would cause the same decrease in interest payments (2010: HUF 2.7 billion).

The fair value of the swap agreements contracted with DT are also exposed to changes in the HUF and EUR interest rates. Assuming an unchanged HUF interest but an increase of 1% in the EUR interest rates, the fair value of the swap agreements would also change causing a loss of HUF 3.7 billion, while a 1% decrease in the EUR rates would result in an income of HUF 3.8 billion. Similarly, assuming an unchanged EUR interest but an increase of 2% in the HUF interest rates, the fair value of the swap agreements would also change resulting in an income of HUF 4.4 billion, while a 2% decrease in the HUF rates would cause a loss of HUF 4.6 billion.

#### **3.1.1.3. Other price risk**

As of the end of the reporting periods, Magyar Telekom did not hold any material investments, which could be affected by risk variables such as stock exchange prices or other indices, therefore, the Group's exposure to such price changes is very limited. See also Note 8.2.

#### **3.1.2 Credit risk**

Credit risk is the risk that one party to a financial instrument will cause a financial loss for the other party by failing to discharge an obligation.

The maximum exposure to credit risk as at the financial statement dates are represented by the carrying amounts of the financial assets in the Statement of financial position. Guarantee agreements reducing the maximum exposure to credit risk as at the end of the reporting period are described later in this section.

The following table represents Magyar Telekom's maximum exposure to credit risk as at December 31, 2010 and 2011.

	At December 31,	
	2010	2011
	(in HUF millions)	
Cash and cash equivalents	15,841	14,451
Bank deposits with original maturities over 3 months	47,798	54,926
Trade receivables	106,732	113,350
Finance lease receivables	20,385	16,783
Employee loans	4,704	5,392
Derivative financial instruments	1,305	14,325
Trade receivables over one year	1,524	1,696
Loans to third parties	947	1,164
Financial assets available for sale	296	278
RDC receivables	715	620
Other current	2,400	1,422
Other non-current	519	270
	<b>203,166</b>	<b>224,677</b>

The vast majority of credit risks may arise in respect of Cash and cash equivalents, Bank deposits with original maturities over 3 months and Trade receivables, and to a lesser extent, of Finance lease receivables. Cash and cash equivalents, Bank deposits with original maturities over 3 months and Trade receivables have short term maturities, which represent the vast majority of the Group's financial assets.

According to the Group's risk management policy Magyar Telekom Group companies deposit the excess cash only in banks rated at least BBB+ (or equivalent), or make efforts to get guarantees for the deposits from banks rated at least BBB+. Moreover, Magyar Telekom prefers to deposit in banks which grants loans for Magyar Telekom to make possible the compensation of debts and loans in case of the default of the bank.

In case of Cash and cash equivalents and Bank deposits with maturities over 3 months held in Hungary concentrations of credit risk are limited as Magyar Telekom places its cash in Hungary with substantial credit institutions. Further, excess HUF cash is also used for repayment of the HUF denominated loans and borrowings, or is deposited at partner banks which grant loans for Magyar Telekom, therefore, the credit risk related to cash held in HUF is very limited.

Cash and cash equivalents and Bank deposits with maturities over 3 months held in Macedonia are primarily denominated in MKD and EUR, while the Cash and cash equivalents and Bank deposits with maturities over 3 months held in Montenegro are primarily denominated in EUR. Cash and cash equivalents and Bank deposits with maturities over 3 months deposited in these countries run higher counterparty risk, due to the small amount of internationally substantial financial institutions in those countries. The bank deposits in Montenegro of HUF 14.1 billion as at December 31, 2011 (2010: HUF 10.1 billion) and those in Macedonia of HUF 45.7 billion as at December 31, 2011 (2010: HUF 43.7 billion) are fully covered with bank guarantees issued by international financial institutions rated at BBB or above, or Magyar Telekom has the right to net the deposits with loans taken from the guarantor, in case of default of the bank. Credit risk related to bank deposits is further limited by the diversification of the deposits among several independent credit institutions determinant on the local market.

Finance lease receivables, in most cases, are legally embedded in service contracts also requiring to provide assets related to the services, which are legally in the Group's ownership. Should the customers fail to pay their bills, we are entitled to discontinue the services and take the assets back to the Group's locations. As these assets are rarely customer specific, we can utilize these assets in other ways as well, therefore, the credit risk related to finance leases is in fact rather limited.

Concentrations of credit risk relating to trade receivables are limited due to the large number of customers comprising the Group's customer base and their dispersion across many different geographic areas and industries.

No financial assets other than trade and other receivables had to be impaired in the reported years, as they are neither past due nor are there any signs of impairment.

The following table contains the carrying amount of trade receivables broken down by country of operation.

	At December 31,	
	2010	2011
	(in HUF millions)	
Hungary	88,099	92,902
Macedonia	12,852	13,998
Montenegro	4,792	5,205
Other	989	1,245
	<b>106,732</b>	<b>113,350</b>

The amounts in the table above are shown net of provisions for impairment losses of HUF 34.6 billion as at December 31, 2011 (2010: HUF 34.5 billion). The annual bad debt expense of the Group in 2011 was 1.0% (2010: 1.6%) of the consolidated revenues. Adverse changes in customer payment behavior in the future, however, may result in higher impairment losses. Each additional 1 percentage point of uncollectible revenue would result in additional impairment charges of HUF 6.0 billion in 2011 (2010: HUF 6.1 billion).

### Hungary

There are varying credit checking practices applied across the members of the Group. The majority of customers are located in Hungary. For these customers the Company follows the practice described below.

Credit checking at the time of the service request is carried out automatically by the credit checking application of the Sales Department. A variety of checks including checking the bankruptcy list, the internal database of risky installation locations, the collection history of the past 6 months, the outstanding debt and the joint database of debtors of the Hungarian mobile operators are performed depending on the service to be used. The Fraud Detecting System monitors extreme usage and fraudulent behavior of customers for mobile, fixed-line and Internet services. In case of business customers, account managers check if the customer has outstanding debts.

Dunning procedures are run automatically by the billing systems and include various reminder tools like SMS, telephone calls, reminder letters, restricted service, termination letters and disconnections. Over a minimum overdue amount we apply varying and customized reminder procedures with specific deadlines to the different customer groups. After the termination of the contract and depending on the expected success of the process, we combine the different collection steps of involving external partners, selling the outstanding debt or initiating legal proceedings. All parts of the process are regulated by internal directives.

### Macedonia

The process of managing the credit risk from operating activities includes preventive measures such as credibility checking and prevention barring, corrective measures during legal relationship (reminding and disconnection activities), collaboration with collection agencies and collection after legal relationship as litigation process, court proceedings and involvement of the executive unit. The overdue payments are monitored through a debt escalation procedure based on customer type, credit class and amount of debt. The credit risk is controlled through credibility checking – which determines that the customer is not indebted and the customers credit worthiness and through preventive barring – which determines the credit limit based on the usual level of the customer's consumption. There is no concentration of risk in Macedonia either with any single customer or group of customers with similar characteristics. The procedures in Macedonia ensure on a permanent basis that sales are made to customers with an appropriate credit history and that an acceptable level of credit exposure is not exceeded.

### Montenegro

In Montenegro, receivables management and credit risk control were focus points of the efficiency program in the finance area in 2010 and 2011. In 2010, through organizational change, Customer Finance department has been formed, with the goal of reducing bad debt expenses, when most of the processes have been changed: reminder processes were changed and harmonized to different residential customer segments; strong focus has been given to earlier collection of business revenues; the credit checking processes for new and existing customers have been redesigned. Further improvement in collection processes was continued in 2011. All of these activities resulted in sharp decline of bad debt expenses. Still, as the economic situation in Montenegro has not improved and liquidity of the economy is very low, the collection process is closely monitored and activities are tuned in accordance with it.

### 3.1.3 Liquidity risk

Liquidity risk is the risk that an entity may encounter difficulty in meeting obligations associated with financial liabilities.

Prudent liquidity risk management implies maintaining sufficient Cash and cash equivalents and Bank deposits as well as available funding through adequate amount of committed credit lines. The Group Treasury's management aims at maintaining flexibility in funding by keeping committed credit lines available. The undrawn credit lines amounted to HUF 51.4 billion as at December 31, 2011 (2010: HUF 54.6 billion), and the Company also had uncommitted credit lines from several Hungarian Banks as at December 31, 2011 and 2010. In addition to the above, Deutsche Telekom confirmed its readiness to finance Magyar Telekom Group's budgeted financing needs until the end of June 2013.

The following two tables summarize the maturity structure of Magyar Telekom's financial liabilities including the interest payable on those liabilities as of December 31, 2011 and 2010. As the majority of the financial liabilities are paid from the cash generated from the ongoing operations, the maturity analysis of the financial assets as at the end of the reporting periods (in comparison with the financial liabilities) would not be useful, therefore, is not included in the tables below.

December 31, 2011 (in HUF millions)	Total	within 1 year	1 to 5 years	after 5 years
Trade payables	101,119	101,119	-	-
Dividend payable	392	392	-	-
Financial liabilities to related parties	334,153	64,835	243,751	25,567
Bank loans	65,250	48,759	16,491	-
Finance lease liabilities	8,877	1,537	4,484	2,856
Nonconvertible bonds and debentures	190	70	120	-
Other financial liabilities	23,491	22,995	492	4
<b>Total other financial liabilities</b>	<b>97,808</b>	<b>73,361</b>	<b>21,587</b>	<b>2,860</b>
Total cash flows	533,472	239,707	265,338	28,427
<b>Open swap positions' cash flows</b>				
Gross cash inflow in EUR million	383	23	281	79
Gross cash inflow in HUF million (at spot rate)	119,286	7,290	87,527	24,469
Gross cash outflow in HUF million	(119,033)	(10,244)	(87,429)	(21,360)
Net cash inflow / (outflow) in HUF million	253	(2,954)	98	3,109
<b>Open forward positions' cash flows</b>				
Gross cash inflow in EUR million	100	100	-	-
Gross cash inflow in USD million	103	103	-	-
Total gross cash inflow in HUF million (at spot rate)	55,831	55,831	-	-
Gross cash outflow in HUF million	(52,803)	(52,803)	-	-
Net cash inflow in HUF million	3,028	3,028	-	-

December 31, 2010 (in HUF millions)	Total	within 1 year	1 to 5 years	after 5 years
Trade payables	88,613	88,613	-	-
Dividend payable	319	319	-	-
Financial liabilities to related parties	363,184	87,788	245,188	30,208
Bank loans	52,813	46,348	6,465	-
Finance lease liabilities	4,462	1,080	2,664	718
Nonconvertible bonds and debentures	191	70	121	-
Other financial liabilities	1 243	1 119	123	1
Total other financial liabilities	58,709	48,617	9,373	719
Total cash flows	510,825	225,337	254,561	30,927
<b>Open swap positions' cash flows</b>				
Gross cash inflow in EUR million	312	25	287	-
Gross cash inflow in HUF million (at spot rate)	87,089	6,861	80,228	-
Gross cash outflow in HUF million	(100,849)	(10,037)	(90,812)	-
Net cash outflow in HUF million	(13,760)	(3,176)	(10,584)	-
<b>Open forward positions' cash flows</b>				
Gross cash inflow in EUR million	123	123	-	-
Gross cash inflow in USD million	5	5	-	-
Total gross cash inflow in HUF million (at spot rate)	35,253	35,253	-	-
Gross cash outflow in HUF million	(36,395)	(36,395)	-	-
Net cash outflow in HUF million	(1,142)	(1,142)	-	-

The average maturity of Magyar Telekom's debt portfolio was 2.6 years as at December 31, 2011 (2010: 2.5 years), both of which are in line with the predefined liquidity management limit range of keeping the average maturity of the debt portfolio between 2 and 3 years.

The floating interest payments arising from the financial instruments were calculated using the last interest rates fixed before December 31, 2011 and 2010.

### 3.2 Capital risk management

The Group's objectives when managing capital are to safeguard the Group's ability to continue as a going concern in order to provide returns for shareholders and benefits for other stakeholders and to maintain an optimal capital structure to reduce the cost of capital.

The Company's management proposes to the owners (through the Board) of the Company to approve dividend payments or adopt other changes in the Company's equity capital in order to optimize the capital structure of the Group. This can be achieved primarily by adjusting the amount of dividends paid to shareholders, or alternatively, by returning capital to shareholders by capital reductions, selling or buying own shares. Consistent with others in the industry, the Group monitors capital on the basis of the gearing ratio. This ratio is calculated as Net debt divided by Equity (including Non-controlling interest) and Net debt.

Net debt is calculated as follows:

- Current and non current financial liabilities to related parties – Note 16
- plus Other current and non current financial liabilities – Note 17
- less Cash and cash equivalents – Note 6
- less Other current financial assets – Note 8.1

During 2010 and 2011, the Group's strategy as approved by the Board was to maintain a gearing ratio within 30% to 40%. The gearing ratio at December 31, 2011 was 34.1% (2010: 32.7%).

In addition to the above, according to the Hungarian Companies Act, Magyar Telekom Plc. has to ensure that the Company's Equity does not fall below its Common stock, i.e. the total of the reserves should not be negative. The Company is in compliance with this regulation, and no such statutory regulation exists for consolidated equity.

The equity capital, which the Group manages, amounted to HUF 556 billion on December 31, 2011 (2010: HUF 595 billion)

## 4 Critical Accounting Estimates and Judgments

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 Group makes estimates and assumptions concerning the future. The resulting accounting estimates will, by definition, rarely equal the related actual results. The estimates and assumptions that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities are outlined below.

### 4.1 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 this is a critical accounting estimate since it involves assumptions about technological development in an innovative industry and heavily dependent on the investment plans of the Group. Further, due to the significant weight of depreciable assets in our total assets, the impact of any changes in these assumptions can be material to our financial position, and results of operations. As an example, if Magyar Telekom was to shorten the average useful life of its assets by 10%, this would result in additional annual depreciation and amortization expense of approximately HUF 10 billion (2010: HUF 10 billion). See Notes 12 and 13 for the changes made to useful lives in 2011.

The Group constantly introduces a number of new services or platforms including, but not limited to, the UMTS and 4G based broadband services in the mobile communications and the fiber-to-the-home rollout in the fixed line operations. In case of the introduction of such new services, the Group conducts a revision of useful lives of the already existing platforms, but in the vast majority of the cases these new services or assets are designed to co-exist with the existing platforms, resulting in no change-over to the new technology. Consequently, the useful lives of the existing platforms usually do not require shortening.

### 4.2 Estimated impairment of goodwill

Goodwill is not amortized, but tested for impairment annually or more frequently. The recoverable amounts of the operating segments (or CGUs) are calculated based on fair value less cost to sell determined by the discounted projected cash flows of the operating segments over the next ten years with a terminal value. This is highly judgmental, which carries the inherent risk of arriving at materially different recoverable amounts if estimates used in the calculations would prove to be inappropriate. The Group has an implemented policy to make the impairment test based on a 10-year cash flow projection on reasonable and supportable assumptions that present the management's best estimate on market participants' assumptions and expectations. We use 10 year cash flow projections as the payback period of our investments in the telecommunications operations often exceeds 5 years.

In order to determine the recoverable amounts of the operating segments, the Group calculates the operating segments' fair values less cost to sell. In the calculations, Magyar Telekom uses a range of weighted average cost of capital (WACC) and estimated perpetual growth rate (PGR) depending on the country of operations and the characteristics of the markets the Group's segments operate in. The WACCs are determined based on CAPM (capital asset pricing model) using the average betas of the peer group, 10 year zero coupon yields and a debt ratio in line with the usual indebtedness of listed peer telecommunications companies, while the PGRs used are in line with the long-term average growth rate for the particular segment.

Costs of certain central functions that are not cross charged are also considered in the fair value calculations, when conducting the goodwill impairment tests. The costs of these central functions are allocated to the operating segments based on the segments' revenue share of the Group's total revenue.

Goodwill is allocated to the following operating segments of the Group: Hungary, T-Systems, Macedonia and Montenegro.

As a result of the impairment testing carried out in 2011, using the above described valuation techniques, we identified and recognized an impairment loss on the goodwill of the Macedonia segment. The main reason for the impairment is that the revenue plans of the Macedonia segment prepared in 2011 had to be reduced by 7–19% compared to the plans prepared a year before due to the unfavorable economic environment and fiercer than expected mobile competition resulting in significant pricing pressure and increasing level of handset subsidies. Even though management will try to compensate the loss in cash inflows with stricter control on cash outflows, this foreseen decrease in revenues will not be possible to be fully compensated by the planned reduction of operating expenses and the planned reduction of capital expenditures. In addition to the decrease in expected cash flows, the increase of the applied WACC from 10.96% to 12.11% also resulted in additional reduction of the enterprise value of the Macedonia segment. Further, due to the above described reasons, the PGR used in the 2010 calculations had to be decreased from 1.7% to 0.5% in the 2011 calculations.

Due to the above described changes in the economic circumstances an impairment loss of HUF 31,390 million was recognized for the Macedonia segment based on the fair value less cost to sell (FVLCS) calculations. Magyar Telekom's management believes that preparing the value in use (VIU) calculation is unnecessary, since it would result in a lower enterprise value than the FVLCS. The VIU method is assuming a model without future investments, meaning that additional Capex and related revenues and gains to be recognized in the future cannot be considered in the calculations. Assuring the revenues on long term in a telecom business very much depends on future investments. In Magyar Telekom on average only approximately 20% of the Capex spent in a year is related to maintenance. Others are new investments, also related to providing new connections to the network. It is obvious, that without this the revenue generation would start to sharply decline on a long term. Consequently, we have not prepared the value in use calculations for the Macedonia or any other segments.

In 2011 no goodwill allocated to the other segments had to be impaired and no goodwill in 2010 had to be impaired.

The tables below show the WACCs and PGRs used in the fair value calculations of the Group's operating segments (and the MBU CGU in 2010) for the goodwill impairment test conducted in 2011 and 2010. The tables below also include sensitivity analyses that show how much impairment (or additional impairment in case of Macedonia) would have been recognized as at December 31, 2011 or 2010 for the goodwill allocated to the operating segments (or the MBU CGU in 2010) if we changed the sensitive parameters in the calculations.

In case of the WACCs we disclose what impact a 2 percentage point increase of the WACC would have on the goodwill. In case of the PGRs we disclose what impact a 5 percentage point decrease of the PGR would have on the goodwill. In case of the cash flow projections we disclose what impact a 10% or a 20% lower than projected cash flow stream would have on the goodwill.

2011	Hungary	T-Systems	Macedonia (after impairment)	Montenegro
<b>WACC</b>				
Used in the calculation (%)	12.99	13.27	12.11	10.54
If changed to (%)	14.99	15.27	14.11	12.54
Potential impairment (HUF million)	33,969	-	9,170	-
<b>PGR</b>				
Used in the calculation (%)	1.0	1.5	0.5	0.0
If changed to (%)	-4.0	-3.5	-4.5	-5.0
Potential impairment (HUF million)	15,771	-	7,240	-
<b>Cash-flows</b>				
If changed by (%)	-10	-10	-10	-10
Potential impairment (HUF million)	8,595	-	6,777	-
If changed by (%)	-20	-20	-20	-20
Potential impairment (HUF million)	74,621	-	13,576	-

There were certain changes in the operating segment structure of the Group from January 2011, whereby the Group's new operating segment Hungary includes the former Consumer Services Business Unit (CBU), the small and medium size business (SMB) customers of the Business Services Business Unit (BBU) and the former Headquarters and Technology Units. The T-Systems segment includes the former BBU, without the SMB customers. The Macedonia and Montenegro segments have not changed. The table below shows the impairment sensitivity analysis using the same potential change in the parameters as for the 2011 impairment calculations, however in the old segment structure. There was no need for an impairment due to the re-segmentation of the Group as at December 31, 2010, and as it can be seen from the table below, there was no risk of material impairment even when changing the parameters used in the 2010 calculations to reasonably possible levels.

2010	CBU	BBU	MBU	Macedonia	Montenegro
<b>WACC</b>					
Used in the calculation (%)	12.36	12.28	12.56	10.96	10.68
If changed to (%)	14.36	14.28	14.56	12.96	12.68
Potential impairment (HUF million)	-	-	-	-	-
<b>PGR</b>					
Used in the calculation (%)	1.5	2.0	2.0	1.7	1.2
If changed to (%)	-3.5	-3	-3	-3.3	-3.8
Potential impairment (HUF million)	-	-	-	-	-
<b>Cash-flows</b>					
If changed by (%)	-10	-10	-10	-10	-10
Potential impairment (HUF million)	-	-	-	-	-
If changed by (%)	-20	-20	-20	-20	-20
Potential impairment (HUF million)	-	-	-	1,841	-

### 4.3 Estimated 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 of value is anticipated. The calculations of recoverable amounts are primarily 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 impairment. If impairment is identified using the value in use calculations, we also determine the fair value less cost to sell (if determinable), to calculate the exact amount of impairment to be charged. As this exercise is highly judgmental, the amount of a potential impairment may be significantly different from that of the result of these calculations.

### 4.4 Estimated impairment of trade and other receivables

We calculate impairment for doubtful accounts receivable based on estimated losses resulting from the inability of our customers to make required payments. For the largest customers and other telecommunications service providers, impairment is calculated on an individual basis, while for other customers it is estimated on a portfolio basis, for which we base our estimate on the aging of our accounts receivable balance and our historical write-off experience, customer credit-worthiness and recent and expected changes in our customer payment terms. These factors are reviewed periodically, and changes are made to the calculations when necessary. In addition, we consider also the nature of the business (residential, business, fixed line, mobile, internet, cable TV, etc.) and the environment in which the Group's entities operate in the various markets. The estimates also 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. See also Note 3.1.2.

### 4.5 Provisions

Provisions in general are highly judgmental, especially in case of legal disputes. The Group assesses the probability of an adverse event as a result of a past event and if the probability of an outflow of economic benefits is evaluated to be more than fifty percent, the Group fully provides for the total amount of the estimated liability (see also Note 2.10). The assessment of the probability is highly judgmental, as – for example – in Hungary there are very few cases where the appealed NMIAH decisions have been finally concluded by the Supreme Court. Further, in Macedonia, there is also a lack of sufficient history for Competition Office or Agency decisions appealed against at the Administrative Court. In order to determine the probabilities of an adverse outcome, the Group uses internal and external legal counsel.

### 4.6 Subscriber acquisition and retention costs

Subscriber acquisition and retention 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 or retain the existing subscribers. The Group's agents also spend a portion of their agent fees for marketing the Group's products, while a certain part of the Group's marketing costs could also be considered as part of the subscriber acquisition and retention costs. The up-front fees collected from customers for activation or connection are marginal compared to the incremental acquisition and retention costs. These revenues and costs are recognized when the customer is connected to the Group's fixed or mobile networks. No such costs or revenues are capitalized or deferred. These acquisition and retention costs (losses) are recognized immediately as they are not accurately separable from other marketing costs. Among these, net losses on equipment sales of the Group amounted to HUF 14.7 billion in 2011 (2010: HUF 13.9 billion), while agent fees amounted to HUF 10.1 billion in 2011 (2010: HUF 9.2 billion). The Group's marketing costs amounted to HUF 12.9 billion in 2011 (2010: HUF 13.4 billion).

## 5 Business Combinations

### 5.1 Acquisitions in 2011

#### 5.1.1 Daten-Kontor

Magyar Telekom signed a share purchase agreement to acquire 100% of Daten-Kontor Kft. on July 20, 2010. The closing of the transaction was subject to the approval of the Competition Office. The maximum purchase price of HUF 1.4 billion is dependent on the 2011 and 2012 financial performance and was adjusted with the value of the net debt at the closing of the transaction on February 28, 2011, when the Group obtained control over Daten-Kontor. Daten-Kontor develops, installs and operates IT applications in Hungary. In 2010 the revenue of Daten-Kontor Kft. was HUF 2.7 billion and its EBITDA was HUF 340 million. Daten-Kontor has been a consolidated subsidiary of the Group since February 28, 2011, included in the T-Systems operating segment.

The carrying values and the fair values of assets and liabilities acquired as well as the considerations transferred are disclosed in the table below.

	Fair values	Carrying values
	(in HUF millions)	
Initial purchase price	900	
Additional estimated contingent purchase price	498	
Consideration transferred	1,398	
Net assets acquired	1,332	
Goodwill	66	
<b>Net assets acquired:</b>		
Cash and cash equivalents	455	455
Trade and other receivables	701	701
Income tax payable	(2)	(2)
Inventories	5	5
Property, plant and equipment	93	93
Intangible assets	619	79
Trade and other payables	(312)	(312)
Provision	(173)	(173)
Net deferred tax liability	(54)	-
	<b>1,332</b>	<b>846</b>

The initial purchase price in a total amount of HUF 900 million and HUF 173 million of the estimated additional purchase price were paid in cash in 2011 while the remaining amount is expected to be payable in 2012 and 2013.

The goodwill arising on this acquisition (fully allocated to the T-Systems segment) mostly represent the assembled workforce that cannot be recognized as a separable asset.

In Hungarian GAAP, there is also no goodwill amortization, but in case of impairment, the total amount of goodwill (HUF 429 million) recognized is tax deductible according to the corporate tax law prevailing in 2011.

### 5.1.2 Globe

In May 2011, Magyar Telekom signed a sale purchase agreement to acquire the ownership rights of the Globe Banking Software (Globe) in a value of HUF 1 billion, and entered into a 7-year IT outsourcing service contract with the clients applying Globe. Globe is a software system applied as central administration system of finance institutions in Hungary. Globe was used by 14 Hungary-based finance institutions and their branches as central administration system of financial service activity at the date of acquisition. As the scope of activities acquired includes inputs, processes and immediate outputs as defined by IFRS 3, the transaction qualifies as an acquisition of a business.

Globe is a market-leader system in its customer segment and the revenue generated from the services provided to the Savings banks amounts to approximately HUF 320 million per annum. The Globe software system and the related revenues and expenses have been consolidated from June 2011, included in the T-Systems operating segment of the Group.

The fair values of assets acquired as well as the consideration transferred are disclosed in the table below.

	<b>Fair values</b>
	(in HUF millions)
Software	300
Customers	563
Goodwill	137
<b>Assets acquired / Total consideration transferred</b>	<b>1,000</b>

The purchase price of HUF 1,000 million was paid in cash in 2011.

The customer value recognized as an intangible asset represents the customer base and services rendered to them existing on the acquisition date, while goodwill (fully allocated to the T-Systems segment) represents the value of, and the future expected revenues from, customers to be acquired from the acquisition date and the planned extension of services.

In Hungarian GAAP no goodwill was recognized.

### 5.1.3 Budakalász

Magyar Telekom acquired the remaining 75% of Budakalász Kábel TV Kft. on November 30, 2011. Budakalász is a cable TV service provider in Hungary, which had approximately 1.7 thousand subscribers at the acquisition date. The purchase price was HUF 239 million. Budakalász has been a consolidated subsidiary of the Group since that day included in the Hungary operating segment. Budakalász was an associate of Magyar Telekom before the acquisition, the disposal of which resulted in a net profit of HUF 58 million.

The carrying values and the estimated fair values of assets and liabilities acquired as well as the considerations transferred are disclosed in the table below.

	Fair values	Carrying values
	(in HUF millions)	
Purchase price of the remaining 75%	239	
Fair value of the 25% ownership	80	
Consideration transferred	319	
Net assets acquired	199	
Goodwill	120	
<b>Net assets acquired:</b>		
Cash and cash equivalents	13	13
Trade and other receivables	7	7
Income tax receivable	7	7
Inventories	1	1
Property, plant and equipment	72	72
Intangible assets	112	1
Trade and other payables	(2)	(2)
Net deferred tax liability	(11)	-
	<b>199</b>	<b>99</b>

The purchase price of HUF 239 million was paid in cash in 2011.

The customer value recognized as an intangible asset represents the customer base and services rendered to them existing on the acquisition date, while goodwill (fully allocated to the Hungary segment) represents the value of, and the future expected revenues from, customers to be acquired from the acquisition date and the planned extension of services.

In Hungarian GAAP, there is also no goodwill amortization, but in case of impairment, the total amount of goodwill (HUF 185 million) recognized is tax deductible according to the corporate tax law prevailing in 2011.

## 5.2 Acquisitions in 2010

### 5.2.1 Modultechnika

Magyar Telekom signed a share purchase agreement to acquire 100% of Modultechnika Kft. in July 2010. The purchase price paid in cash in 2010 was HUF 1,421 million. A maximum additional HUF 143 million is payable in the period until 2015, depending on potential third party and certain authority claims. The fair value of this amount was recognized as a liability. Modultechnika is a cable TV service provider in Hungary with approximately 13,000 customers and annual revenues of HUF 500 million. The transaction was closed on July 22, 2010, since when Modultechnika has been a consolidated subsidiary of the Group, included in the Hungary operating segment.

The purchase price allocation was not completed by the issuance of the 2010 financial statements, but was completed later in 2011. The table below includes the provisional and the final fair values of assets and liabilities acquired at the time acquisition.

	Provisional fair values	Final fair values
	(in HUF millions)	
Purchase price of ownership acquired	1,421	1,421
Additional estimated purchase price	143	143
Consideration transferred	1,564	1,564
Net assets acquired	861	897
Goodwill	703	667
<b>Net assets acquired:</b>		
Cash and cash equivalents	6	6
Trade receivables	26	26
Inventories	9	9
Other receivables	6	6
Income tax receivable	2	2
Property, plant and equipment	197	272
Intangible assets	799	764
Trade and other payables	(102)	(102)
Net deferred tax liability	(82)	(86)
	<b>861</b>	<b>897</b>

The initial purchase price was paid in cash in 2010, while the additional purchase price is expected to be paid in the period until 2015, of which HUF 41 million was paid in 2011.

The customer contract value recognized as an intangible asset only represents the customers and services rendered to them existing on the acquisition date, while the majority of the goodwill represents the value of, and the future expected revenues from, customers to be acquired from the acquisition date and the planned extension of services.

In Hungarian GAAP, there is also no goodwill amortization, but in case of impairment, the total amount of goodwill (HUF 1,477 million) recognized is tax deductible according to the corporate tax law prevailing in 2010.

### 5.3 Pro forma information on business combinations

The following pro forma information shows the most important financial data of the Group, including the subsidiaries and businesses acquired as if they had been consolidated from the beginning of 2011, and also how much the business combinations contributed to the reported figures since the acquisition date in the year of acquisition.

	2010	2011
	(in HUF millions)	
<b>Revenues</b>		
Reported	609,579	597,617
Pro forma – if consolidated from beginning of year	609,825	598,030
Current year contribution since date of business combination in the year of acquisition	192	2,818
<b>Profit for the year</b>		
Reported	77,371	779
Pro forma – if consolidated from beginning of year	77,363	861
Current year contribution since date of business combination in the year of acquisition	(42)	319

## 6 Cash and cash equivalents

Cash and cash equivalents include cash on hand and in banks, and all highly liquid deposits and securities with original maturities of three months or less, and exclude all overdrafts. These financial assets are exposed to credit risks, for which see more details in Note 3.1.2. No impairment had to be recognized for any of these balances in the reported years.

	At December 31,	
	2010	2011
	(in HUF millions)	
Cash on hand	157	196
Cash in bank (demand deposits)	9,490	9,145
Bank deposits with original maturities less than 3 months	6,194	5,110
	<b>15,841</b>	<b>14,451</b>

Cash and cash equivalents by country of location	At December 31,	
	2010	2011
	(in HUF millions)	
Hungary	7,945	7,625
Macedonia	6,598	5,691
Montenegro	893	651
Other countries	405	484
	<b>15,841</b>	<b>14,451</b>

## 7 Trade and other receivables

### 7.1 Trade and other receivables – carrying amounts

	At December 31,	
	2010	2011
	(in HUF millions)	
Trade receivables from third parties	99,741	105,017
Trade receivables from Deutsche Telekom Group companies	6,991	8,333
Trade receivables from associates and joint ventures	-	-
<b>Total trade receivables<sup>(a)</sup></b>	<b>106,732</b>	<b>113,350</b>
Prepayments and advance payments	4,748	8,275
Other taxes receivable	2,056	2,650
Other	1,089	388
<b>Total other receivables</b>	<b>7,893</b>	<b>11,313</b>
	<b>114,625</b>	<b>124,663</b>

#### (a) Age profile of Trade receivables

The following tables show the age profile of the Group's trade receivables by country of operation by days outstanding (past due). The carrying amounts of past due receivables are shown net of impairment losses charged as of the financial statement dates.

	Carrying amount as of Dec 31, 2011	of which not past due	of which past due by					
			less than 30 days	30–60 days	61–90 days	91–180 days	181–360 days	over 360 days
			(in HUF millions)					
Hungary	92,902	77,627	9,234	1,714	587	1,071	1,029	1,640
Macedonia	13,998	9,700	2,192	724	288	458	220	416
Montenegro	5,205	3,316	811	284	127	296	69	302
Other countries	1,245	1,027	42	35	13	17	22	89
<b>Total</b>	<b>113,350</b>	<b>91,670</b>	<b>12,279</b>	<b>2,757</b>	<b>1,015</b>	<b>1,842</b>	<b>1,340</b>	<b>2,447</b>

	Carrying amount as of Dec 31, 2010	of which not past due	of which past due by					
			less than 30 days	30–60 days	61–90 days	91–180 days	181–360 days	over 360 days
			(in HUF millions)					
Hungary	88,099	69,033	9,529	3,091	1,284	2,612	1,167	1,383
Macedonia	12,852	8,823	2,017	872	380	357	244	159
Montenegro	4,792	2,967	905	320	127	205	201	67
Other countries	989	613	95	54	40	26	101	60
<b>Total</b>	<b>106,732</b>	<b>81,436</b>	<b>12,546</b>	<b>4,337</b>	<b>1,831</b>	<b>3,200</b>	<b>1,713</b>	<b>1,669</b>

The vast majority of trade receivables is impaired on a portfolio basis. The vast majority of past due trade receivables are partly or fully impaired depending on the period of delay of payments. Only insignificant amounts of past due trade receivables are not impaired based on past experience of payment behavior of certain business and governmental customers. As these amounts are not significant, these are not disclosed separately.

Non past due receivables are not assessed collectively for impairment, but in case of bankruptcy of the customer non past due receivables may have to be partly or fully impaired, the amount of which is not significant, therefore, not disclosed separately. The non past due trade receivables represent approximately 1.8 months of revenue (2010: 1.6 months of revenue). As disclosed in Note 3.1.2, the annual bad debt expense of the Group is approximately 1.0 percent of the annual consolidated revenue, therefore, we can estimate that approximately this percentage of the non past due portion of trade receivables will not be collected, i.e. will have to be impaired in future periods, but are not impaired at the end of the reporting period.

The Group has no collaterals related to its trade receivables.

## 7.2 Impairment losses of trade and other receivables

The table below shows the impairment loss and changes therein for 2010 and 2011.

	At December 31,	
	2010	2011
	(in HUF millions)	
Impairment loss, beginning of period	29,665	34,486
Charged to expense – net (included in Other operating expenses)	9,991	6,255
Translation difference	326	1,433
Utilized	(5,496)	(7,606)
<b>Impairment loss, end of period</b>	<b>34,486</b>	<b>34,568</b>

The carrying amount of financial assets that would otherwise be past due or impaired whose terms have been renegotiated is not material therefore no separate disclosure is provided on those.

The amount of receivables that are individually determined to be impaired is not material, therefore, these are not disclosed separately.

The table below includes the impairment losses and the changes therein in 2010 and 2011 for the countries of operation of the Group.

	At December 31, 2009	Charged to expense	Translation difference	Utilized	At December 31, 2010
	(in HUF millions)				
Hungary	16,329	8,733	-	(3,776)	21,286
Macedonia	9,315	663	205	(1,614)	8,569
Montenegro	3,966	518	119	(29)	4,574
Other countries	55	77	2	(77)	57
<b>Group</b>	<b>29,665</b>	<b>9,991</b>	<b>326</b>	<b>(5,496)</b>	<b>34,486</b>

	At December 31, 2010	Charged to expense	Translation difference	Utilized	At December 31, 2011
	(in HUF millions)				
Hungary	21,286	5,829	-	(6,246)	20,869
Macedonia	8,569	1	942	(530)	8,982
Montenegro	4,574	411	484	(830)	4,639
Other countries	57	14	7	-	78
<b>Group</b>	<b>34,486</b>	<b>6,255</b>	<b>1,433</b>	<b>(7,606)</b>	<b>34,568</b>

## 8 Other financial assets

Other financial assets include receivables due within 12 months from the financial statement date (current) and due after 12 months from the financial statement date (non current). These financial assets are exposed to credit risks, for which see more details in Note 3.1.2. The impairment loss accounted for other current and non current financial assets is not material therefore its reversal is also insignificant.

### 8.1 Other current financial assets

	At December 31,	
	2010	2011
	(in HUF millions)	
Bank deposits with original maturities over 3 months <sup>(a)</sup>	47,798	54,926
Finance lease receivable <sup>(b)</sup>	4,298	4,267
Loans and receivables from employees <sup>(c)</sup>	542	727
RDC receivable <sup>(d)</sup>	199	222
Derivative financial instruments contracted with related parties <sup>(e)</sup>	1,004	193
Derivative financial instruments contracted with third parties <sup>(f)</sup>	301	3,500
Other	2,418	1,451
	<b>56,560</b>	<b>65,286</b>

(a) The table below shows the Bank deposits with original maturities over 3 months by country of location.

(b) See Note 33.3 for more information on Finance lease receivable.

(c) Loans and receivables from employees primarily represent the housing loans provided to the employees of the Group. There are no past due employee receivables, and the loans are pledged with mortgage.

(d) RDC receivable represents Crnogorski Telekom's receivable from the Government of Montenegro originating from the Share Transfer Agreement on the sale of ownership in the Radio Difuzni Centar (RDC) entered into in 2004.

(e) Derivative financial instruments contracted with related parties include the fair value of open currency forwards and cross-currency interest rate swaps (see more details in Note 3.1.1.1).

(f) Derivative financial instruments contracted with third parties include the fair value of open currency forwards and cross-currency interest rate swaps (see more details in Note 3.1.1.1).

	At December 31,	
	2010	2011
	(in HUF millions)	
Macedonia	37,686	40,785
Montenegro	10,091	14,121
Hungary	21	20
	<b>47,798</b>	<b>54,926</b>

## 8.2. Other non current financial assets

	At December 31,	
	2010	2011
	(in HUF millions)	
Finance lease receivable <sup>(b)</sup>	16,087	12,516
Loans and receivables from employees <sup>(c)</sup>	4,219	4,714
RDC receivable <sup>(d)</sup>	516	398
Trade receivables over one year <sup>(g)</sup>	1,524	1,696
Derivative financial instruments contracted with related parties <sup>(e)</sup>	-	10,291
Derivative financial instruments contracted with third parties <sup>(f)</sup>	-	341
Financial assets available for sale <sup>(h)</sup>	296	278
Other	1,391	1,356
	<b>24,033</b>	<b>31,590</b>

(b) See Note 33.3 for more information on Finance lease receivable.

(c) Loans and receivables from employees primarily represent the housing loans provided to the employees of the Group. There are no past due employee receivables, and the loans are pledged with mortgage.

(d) RDC receivable represents Crnogorski Telekom's receivable from the Government of Montenegro originating from the Share Transfer Agreement on the sale of ownership in the Radio Difuzni Centar (RDC) entered into in 2004.

(e) Derivative financial instruments contracted with related parties include the fair value of open currency forwards and cross-currency interest rate swaps (see more details in Note 3.1.1.1).

(f) Derivative financial instruments contracted with third parties include the fair value of open currency forwards and cross-currency interest rate swaps (see more details in Note 3.1.1.1).

(g) Trade receivables over one year includes receivables from customers paying over 1-2 years in installments for telecommunications equipment sold, as well as installment payments on software and hardware implementation services.

(h) Financial assets available for sale include insignificant investments in equity securities.

## 9 Income tax

### 9.1 Current income tax receivable and payable

Current income tax receivable and payable in the Statement of financial position represent the amount of corporate and other income taxes receivable from, and payable to, the tax authorities of the countries in which the Group operates.

### 9.2 Income tax expense

The table below shows the tax expenses charged in the Profit for the year.

	For the year ended December 31,	
	2010	2011
	(in HUF millions)	
Corporate income tax	5,158	4,336
Other income taxes	8,237	7,853
Deferred income taxes	(6,812)	15,349
<b>Total income tax expense</b>	<b>6,583</b>	<b>27,538</b>

### 9.3 Tax rate reconciliation

The reconciliation between the reported income tax expense and the theoretical amount arising by applying the statutory income tax rates is as follows:

	For the year ended December 31,	
	2010	2011
	(in HUF millions)	
<b>IFRS profit before income tax</b>	<b>83,954</b>	<b>30,717</b>
Tax at 19%	(15,951)	(5,836)
Impact of different tax rates	(a) 6,074	4,901
Tax on items not subject to income tax	(b) 1,254	973
Tax on non deductible items	(c) (745)	(4,035)
Other income taxes	(d) (8,237)	(7,853)
Impact of tax deductibility of other income taxes	(e) 1,565	1,492
Withholding tax on dividends	(f) (2,370)	(3,011)
(De)/recognized deferred tax on tax losses	(g) -	(527)
Broadband tax credit accretion	(h) 1,473	1,365
Changes in the Macedonian tax regime	(i) (4,172)	-
Change in the Hungarian corporate tax rate	(j) 14,526	(15,007)
<b>Income tax expense</b>	<b>(6,583)</b>	<b>(27,538)</b>
<b>Effective tax rate</b>	<b>7.8%</b>	<b>89.7%</b>

(a) Impact of different tax rates

The corporate tax rate in Hungary was 19% in 2011 and in 2010. In 2010, an amendment was made to the corporate tax law, introducing a lower rate of corporate tax (10%) as of July 1, 2010 for the first HUF 500 million tax base (on an annual basis) of the legal entities, above which the regular rate of 19% applies. The impact of the lower tax rate applicable to the Hungarian legal entities of the Group is included in this line of the reconciliation.

This line of the reconciliation also includes the tax impacts of the different tax rates of the foreign countries where the Group is also present through its subsidiaries. The tax rate in Macedonia is 0% for undistributed profits. The corporate tax rate is 9% in Montenegro, 16% in Romania, and 10% in Bulgaria in the reported years. The corporate tax rate was 25% until March 31, 2011 in the Ukraine, when it was decreased to 23%. This line of the reconciliation includes the tax impacts of the above differences compared to the 19% theoretical tax rate applied to the profit before tax.

(b) Tax on items not subject to income tax

Items not subject to income tax consist primarily of donation for non-profit organizations and R&D cost deductible from corporate income tax base. This line of the reconciliation includes the positive tax impact of the above items.

(c) Tax on non deductible items

This line of the reconciliation shows the negative tax impact of the non deductible expenses, including primarily the premature receivable write-downs, certain impairment losses and entertainment expenses as well as non deductible penalties. Non deductible penalties in 2011 included the amount of the criminal penalty payable to the DOJ, which was qualified as a non deductible expense in 2011 in an amount of HUF 14,345 million, the negative tax impact of which at 19% is HUF 2,726 million in this line of the reconciliation in 2011.

(d) Other income taxes

Other income taxes include certain local and central taxes levied in Hungary on the companies' net margins, determined at a substantially higher level than the corporate tax base, but with substantially lower tax rates. As the first line of the reconciliation calculates theoretical tax expense calculated using the corporate tax rate, the Hungarian local business tax, energy supplier tax and the innovation fee impose additional income tax expenses for the Hungarian entities of the Group, included in this line of the reconciliation.

## (e) Deductibility of other income taxes from the corporate tax base

The above described Hungarian other income taxes are deductible expenses for corporate tax purposes, the positive impact of which is included in this line of the reconciliation.

## (f) Withholding tax

Macedonia and Montenegro levy a 5% withholding tax on dividend distribution to Hungary. In addition, according to the Macedonian tax law changes in 2010, Macedonian companies have to pay "corporate income tax" on their annual profits if they distribute those profits as dividends to foreign companies (or Macedonian individuals) at 10%. We assess that the Macedonian corporate tax in 2010 and 2011 is in fact a withholding tax that is levied at the dividend distributions from Macedonia to Hungary, which imposes additional tax expenses for the Group related to the 2010 and 2011 profits of the Macedonian subsidiaries.

The reconciliation includes the amount of withholding tax accruing on the current year's profits to be distributed from the foreign subsidiaries to the Company. Dividends received by the Hungarian parent companies (from Macedonia and Montenegro as well) are eliminated on consolidation, therefore, the Group's profit before tax excludes these dividends. As these dividends are not subject to corporate tax in Hungary, the reconciliation includes the withholding tax burden on such dividends as a separate line.

## (g) (De)/recognized deferred tax on tax losses

Deferred tax asset is recognized on tax losses only to the extent that the realization of the related tax benefit is probable. Deferred tax assets on tax losses that will probably not be recovered are un-recognized in the period of the loss or de-recognized in subsequent periods. On the other hand, when the recoverability of the previously un/derecognized tax losses becomes probable, these deferred tax assets are recognized.

## (h) Broadband investment tax credit accretion

Broadband investment tax credit accretion shows the increase of the net present value of the investment tax credit deriving from the utilization of the tax credits in year(s) subsequent to the year of recognition.

## (i) Changes in the Macedonian tax regime

The change in the Macedonian tax law in 2010 resulted in the transformation of the Macedonian corporate tax (10%) to an additional withholding tax. In 2010, we recognized an additional deferred tax liability on the accumulated undistributed profits of our Macedonian subsidiaries expected to be distributed as dividends to Hungary. In the 2010 number of the reconciliation we included the impact of the change of the corporate tax to withholding tax. As the undistributed corporate tax rate in 2009 was 0%, no deferred tax was recognized for the accumulated profit of 2009, while the change in 2010 resulted in a withholding tax to be recognized at 10% (+5%) for 2009. See also subnotes (a) and (f) of this Note.

## (j) Change in the Hungarian tax rate

In 2010, an amendment was made to the Hungarian corporate tax law, introducing a lower rate of corporate tax (10%) as of July 1, 2010 for the first HUF 500 million tax base of the legal entities (HUF 250 million in 2010), above which the regular rate of 19% applies. A further amendment was made to the Hungarian tax law in 2010, which stated that the corporate tax rate from January 1, 2013 will be 10%. Deferred tax balances were recalculated accordingly, the impact of which is included in this line of the reconciliation for 2010.

In 2011, the amendment made to the corporate tax law to lower the corporate tax rate from January 1, 2013 uniformly to 10% has been eliminated. As a result after January 1 2013 the 19% of corporate tax rate has to be applied to the part of the tax base which exceeds HUF 500 million. Deferred tax balances were recalculated accordingly in 2011.

#### 9.4 Deferred taxes

Magyar Telekom's deferred tax balances are as follows:

	Balance at Dec. 31, 2009	Effect on profit	Other movements	Balance at Dec. 31, 2010	Effect on profit	Other movements	Balance at Dec. 31, 2011
(in HUF millions)							
<b>Deferred tax assets and (liabilities)</b>							
Investment tax credits	16,786	(751)	(3)	16,032	(526)	-	15,506
Net operating loss carry-forward	1,789	(794)	-	995	(39)	-	956
Investments in subsidiaries	(1,326)	392	-	(934)	5,968	-	5,034
Withholding tax	(3,099)	(3,206)	-	(6,305)	(1,919)	-	(8,224)
Other financial assets	348	(30)	-	318	(3,009)	-	(2,691)
Impairment of receivables and inventory	2,063	780	-	2,843	484	-	3,327
Property, plant and equipment and intangible assets	(27,694)	8,137	(116)	(19,673)	(8,772)	(160)	(28,605)
Goodwill	(9,852)	3,626	-	(6,226)	(6,992)	-	(13,218)
Trade and other payables	120	(62)	-	58	9	-	67
Loans and other borrowings	357	(236)	-	121	192	-	313
Deferred revenue	(130)	(220)	-	(350)	26	-	(324)
Provisions for liabilities and charges	3,934	(824)	-	3,110	(771)	-	2,339
<b>Total net deferred tax asset / (liability)</b>	<b>(16,704)</b>	<b>6,812</b>	<b>(119)</b>	<b>(10,011)</b>	<b>(15,349)</b>	<b>(160)</b>	<b>(25,520)</b>
Of which deferred tax liability after netting	(18,594)			(10,924)			(26,270)
Of which deferred tax asset after netting	1,890			913			750

Items included in other movements	Other movements 2010	Other movements 2011
	(in HUF millions)	
Investment tax credit recognized / (derecognized) against cost of PPE	(3)	-
Currency translation adjustment arising on consolidation	(68)	(95)
Arising on business combinations	(48)	(65)
	<b>(119)</b>	<b>(160)</b>

The Group consists of a number of legal entities, most of which have deferred tax assets and liabilities. The assets and liabilities are netted by legal entity so that one legal entity has either a deferred tax asset or a liability and the consolidated Statement of financial position includes these items accordingly.

The Group's net deferred tax liability balance is HUF 25,520 million which includes a high amount of individual deferred tax asset and liability items (see in the above table). Of these items, approximately HUF 2,701 million net deferred tax asset is expected to reverse in 2012 (deferred tax asset of HUF 5,723 million and deferred tax liability of HUF 3,022 million). The above items exclude deferred tax items expected to arise in 2012.

The Group's net deferred tax liability balance was HUF 10,011 million at December 31, 2010 which included a high amount of individual deferred tax asset and liability items (see in the above table). Of these items, approximately HUF 5,984 million net deferred tax asset was expected to reverse in 2011 (deferred tax asset of HUF 6,360 million and deferred tax liability of HUF 376 million). The above items excluded deferred tax items expected to arise in 2011.

Deferred tax arising on investment tax credits are recognized against the cost of the related investment.

Temporary differences associated with investments in subsidiaries for which deferred tax liabilities or assets have not been recognized amounted to a net liability of HUF 5,376 million at December 31, 2011 (2010: net liability of HUF 10,484 million).

If the Group's Macedonian and Montenegrin subsidiaries distribute their distributable reserves in the form of a dividend, the amounts paid to Hungary are subject to withholding tax. We recognize a deferred tax liability for the total amount of reserves distributable to the Company, considering our share of ownership.

Deferred tax assets are recognized for tax loss carry forwards only to the extent that realization of the related tax benefit is probable. There is no tax loss expiring in 2012 for which a deferred tax asset has been recognized. As of December 31, 2011, the balance of recognized tax losses is HUF 10,434 million of which HUF 117 million is subject to statutory limitations (2010: HUF 9,944 million of which no tax loss was subject to statutory limitations). The Group recognized deferred tax asset on tax losses for HUF 5,167 million as at December 31, 2011, while in 2010 deferred tax asset was recognized for the total amount of tax losses.

### 9.5 Investment tax credits

In order to increase broadband internet penetration in Hungary, companies investing over HUF 100 million in a year in broadband assets (e.g. DSL lines, UMTS assets) from 2003 can apply for a corporate tax reduction. The potential reduction of the corporate tax charge was defined as a percentage of the companies' capital investment in broadband assets. As these investment tax credits are of a government grant nature, Magyar Telekom recognized the deferred tax asset against the cost of the related investment. 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 outstanding amounts can be accreted. This accretion is recognized as an increase in the investment tax credit against a reduction in the deferred tax expense.

The following table shows the details of the tax credits in HUF millions:

Earned in year	Amount of qualifying broadband investment	Amount of tax credit earned	Accretion recognized in tax expense to date	Tax credit utilized	Tax credit carried forward at December 31, 2011	
2003	6,194	2,592	1,132	(3,724)	-	
2004	6,876	2,985	1,878	(4,863)	-	
2005	13,925	5,598	2,254	(2,836)	5,016	
2006	14,993	4,372	2,015	(473)	5,914	
2007	11,078	2,958	1,120	(87)	3,991	
2008	2,204	459	126	-	585	
<b>Total</b>	<b>55,270</b>	<b>18,964</b>	<b>8,525</b>	<b>(11,983)</b>	<b>15,506</b>	
Expires in year						
2015						5,016
2016						5,914
2017						3,991
2018						585
						<b>15,506</b>

In order to utilize the tax credits and certain tax deductibility opportunities earned by the Group's entities, they have to comply with strict requirements as set out in the relevant tax regulations. The most important requirement is that the relevant assets have to be operated for at least 5 years. Management believes that the Group has complied and will be able to comply with the requirements to recognize these as deferred tax assets.

### 9.6 Tax reviews

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.

### 9.7 Dividends paid by Magyar Telekom Plc.

The dividends paid and payable by Magyar Telekom Plc. to its owners may be subject to withholding or income taxes of the owners, which do not have an impact on the amount of the dividend declared or on the Company's tax expense as these taxes – if any – are levied on the owners.

## 10 Inventories

	At December 31,	
	2010	2011
	(in HUF millions)	
Inventory for resale	6,901	7,574
Other inventory and advances	2,880	2,657
<b>Subtotal</b>	<b>9,781</b>	<b>10,231</b>
Less allowances for obsolete inventory	(189)	(327)
	<b>9,592</b>	<b>9,904</b>

The impairment loss accounted for inventories is not material therefore any reversal is also insignificant.

The Group has no inventory pledged as security as at December 31, 2011 or December 31, 2010.

## 11 Non current assets held for sale

Non current assets held for sale include primarily land and buildings identified for sale or exchange, allocated mainly to the Macedonia and Hungary segments, which is expected within 12 months, as a result of the continuing improvement of utilization of properties and headcount reductions.

## 12 Property, plant and equipment

	Land and related rights	Buildings	Telecom. equipment	Other equipment	Total
	(in HUF millions)				
<b>At January 1, 2010</b>					
Cost	7,333	135,732	1,171,086	102,550	1,416,701
Accumulated depreciation	(1,766)	(36,102)	(745,471)	(79,827)	(863,166)
Carrying amount	5,567	99,630	425,615	22,723	553,535
Of which held for sale					(2,790)
					<b>550,745</b>
Carrying amount – January 1, 2010	5,567	99,630	425,615	22,723	553,535
Exchange differences	35	445	1 727	184	2,391
Additions due to business combinations	-	11	188	9	208
Additions due to and revisions of asset retirement obligations	-	616	(4)	-	612
Investments	1	2,117	62,674	7,697	72,489
Disposals	(21)	(77)	(168)	(246)	(512)
Decrease due to sale of subsidiary	-	-	(487)	(59)	(546)
Depreciation charge	(115)	(4,080)	(64,344)	(7,734)	(76,273)
Reclassifications	643	(643)	-	-	-
Carrying amount – December 31, 2010	6,110	98,019	425,201	22,574	551,904
<b>At December 31, 2010</b>					
Cost	7,979	137,403	1,204,746	102,834	1,452,962
Accumulated depreciation	(1,869)	(39,384)	(779,545)	(80,260)	(901,058)
Carrying amount	6,110	98,019	425,201	22,574	551,904
Of which held for sale					(2,152)
					<b>549,752</b>
Carrying amount – January 1, 2011	6,110	98,019	425,201	22,574	551,904
Exchange differences	142	2,123	7,493	1,192	10,950
Additions due to business combinations	-	-	221	36	257
Additions due to and revisions of asset retirement obligations	-	234	44	-	278
Investments	4	2,904	53,521	6,180	62,609
Disposals	(101)	(1,961)	(160)	(245)	(2,467)
Depreciation charge	(114)	(3,787)	(69,681)	(7,079)	(80,661)
Reclassifications	118	(118)	(1,481)	-	(1,481)
Carrying amount – December 31, 2011	6,159	97,414	415,158	22,658	541,389
<b>At December 31, 2011</b>					
Cost	8,140	139,553	1,236,234	101,473	1,485,400
Accumulated depreciation	(1,981)	(42,139)	(821,076)	(78,815)	(944,011)
Carrying amount	6,159	97,414	415,158	22,658	541,389
Of which held for sale					(5,165)
					<b>536,224</b>

The closing balance of Property, plant and equipment (PPE) includes assets in the course of construction in an amount of HUF 44,252 million as at December 31, 2011 (2010: HUF 42,670 million). In the table above the assets in course of construction are shown in the categories where the asset is expected to be placed into service.

Additions due to business combinations include the fair value of the assets acquired by Magyar Telekom through business combinations in the reported years. Differences between the preliminary and the final purchase price allocation are also included in this line.

Additions due to and revisions of asset retirement obligations represent the amounts recognized as part of the carrying amounts of the constructed assets against a provision for asset retirement obligation in the reported year (see also Note 19.5).

Investments represent the regular investing activity in PPE assets. These additions are shown net of the investment tax credit related to broadband investments. For more details, see Note 9.4.

No impairment was identified in 2011 and 2010.

The reclassifications between asset categories or their impact on depreciation expense was not material.

Included in buildings are assets sold and leased back under finance lease conditions. At December 31, 2011 the gross book value of the leased back assets is HUF 2,595 million (2010: HUF 1,706 million) and the net book value is HUF 1,590 million (2010: HUF 668 million).

Included mainly in buildings and telecom equipment are assets leased under finance lease conditions (other than sale and lease back). At December 31, 2011 the gross book value of the finance leased assets is HUF 1,360 million (2010: HUF 1,642) and the net book value is HUF 590 million (2010: HUF 780 million).

Included in telecommunications equipment at December 31, 2011 are assets leased under operating lease contracts to customers with a gross book value of HUF 943 million (2010: HUF 1,120 million) and net book value of HUF 35 million (2010: HUF 78 million). The future minimum lease payments receivable under these contracts are disclosed in Note 33.4.

HUF 2,180 million of PPE has restricted titles as at December 31, 2011 (2010: HUF 1,448 million), which are included in our assets as finance leases. The Group has no PPE pledged as security as at December 31, 2011 or December 31, 2010.

The reviews of the useful lives (and residual values) of property, plant and equipment during 2011 affected the lives of a large number of assets including primarily radio equipment, cable TV network, and antennas. In case of radio equipment, the revision resulted in a faster depreciation in 2011 and 2012 as a result of a group wide modernization of the radio access network to enable 4G services. The rest of the revisions on the other hand primarily resulted in the extension of the useful lives of the assets as a result of later expected replacement of the affected assets than originally estimated. The revision results in the following change in the original trend of depreciation in the current and future years.

	2011	2012	2013	2014	After 2014
	(in HUF millions)				
(Decrease) / increase in depreciation expense	1,219	(7)	1,460	(392)	(2,435)

The useful lives assigned to different types of property, plant and equipment are as follows:

	Years
Buildings	5–50
Duct, cable and other outside plant	3–38
Other telecommunications equipment	2–25
Other equipment	2–12

### 13 Intangible assets

	Goodwill	Software	Concessions and licenses	Other	Total
(in HUF millions)					
<b>At January 1, 2010</b>					
Cost	247,109	164,668	52,134	25,906	489,817
Accumulated amortization	-	(118,058)	(18,289)	(16,407)	(152,754)
Accumulated goodwill impairment	(969)	-	-	-	(969)
<b>Carrying amount</b>	<b>246,140</b>	<b>46,610</b>	<b>33,845</b>	<b>9,499</b>	<b>336,094</b>
Carrying amount – January 1, 2010	246,140	46,610	33,845	9,499	336,094
Exchange differences	200	214	154	107	675
Additions due to business combinations	1,227	-	-	763	1,990
Investments	-	18,760	117	396	19,273
Disposals	-	(23)	-	(10)	(33)
Decrease due to sale of subsidiary	(74)	-	(333)	-	(407)
Amortization charge	-	(18,064)	(4,301)	(2,234)	(24,599)
Reclassifications	-	-	(838)	838	-
<b>Carrying amount – December 31, 2010</b>	<b>247,493</b>	<b>47,497</b>	<b>28,644</b>	<b>9,359</b>	<b>332,993</b>
<b>At December 31, 2010</b>					
Cost	247,493	182,250	50,357	27,520	507,620
Accumulated amortization	-	(134,753)	(21,713)	(18,161)	(174,627)
Accumulated goodwill impairment	-	-	-	-	-
<b>Carrying amount</b>	<b>247,493</b>	<b>47,497</b>	<b>28,644</b>	<b>9,359</b>	<b>332,993</b>
Of which held for sale					-
					<b>332,993</b>
Carrying amount – January 1, 2011	247,493	47,497	28,644	9,359	332,993
Exchange differences	833	1,068	605	369	2,875
Additions due to business combinations	323	462	-	1,251	2,036
Investments	-	20,908	139	140	21,187
Disposals	-	-	-	(5)	(5)
Impairment	(31,390)	-	-	-	(31,390)
Amortization charge	-	(13,748)	(4,403)	(2,713)	(20,864)
Reclassifications	-	1,481	-	-	1,481
<b>Carrying amount – December 31, 2011</b>	<b>217,259</b>	<b>57,668</b>	<b>24,985</b>	<b>8,401</b>	<b>308,313</b>
<b>At December 31, 2011</b>					
Cost	248,649	206,520	51,469	20,292	526,930
Accumulated amortization	-	(148,852)	(26,484)	(11,891)	(187,227)
Accumulated goodwill impairment	(31,390)	-	-	-	(31,390)
<b>Carrying amount</b>	<b>217,259</b>	<b>57,668</b>	<b>24,985</b>	<b>8,401</b>	<b>308,313</b>
Of which held for sale					-
					<b>308,313</b>

Additions due to business combinations include the fair value of assets acquired by Magyar Telekom through business combinations in the reported years and the goodwill arising on these business combinations. Differences between the preliminary and the final purchase price allocation are also included in this line.

Investments represent the regular investing activity in intangible assets.

The amortization expense as well as the impairment losses of intangible assets including also goodwill is accounted for in the depreciation and amortization line of the Statement of comprehensive income.

Other than goodwill, the Group has no intangible assets with indefinite useful life. Intangible assets other than goodwill are amortized over their respective economic useful lives, as indicated below.

	Years
Software	2–8
Concessions and licenses	3–25
Other intangible assets	3–10

The reviews of the useful lives of intangible assets during 2011 affected the lives of a large number of assets including primarily acquired and internally developed software and server user rights. The revisions primarily resulted in the extension of the useful lives as a result of later expected replacement of the affected assets than originally estimated. The revision results in the following change in the original trend of depreciation in the current and future years .

	2011	2012	2013	2014	After 2014
	(in HUF millions)				
(Decrease) / increase in depreciation expense	(2,618)	(216)	1,014	619	1,201

The most significant intangible assets of the Group are the goodwill arising on business combinations. For the goodwill impairment tests, the total amount of goodwill was allocated to the operating segments of the Group as follows.

	At December 31,	
	2010	2011
	(in HUF millions)	
Hungary	162,589	162,661
T-Systems	27,749	27,952
Macedonia	51,379	20,199
Montenegro	5,776	6,447
Total goodwill	247,493	217,259

The Group regularly carries out an impairment test on goodwill in the last quarter of the financial years. During the annual impairment test conducted in the last quarter of 2010 no goodwill impairment was established for any goodwill of the Group. As a result of the impairment testing carried out in 2011 we identified and recognized an impairment loss of HUF 31,390 million on the goodwill of the Macedonia segment. No goodwill allocated to the other segments had to be impaired in 2011. For more details, see Note 4.2.

Besides goodwill, the most significant individual intangible assets are the concessions and licenses, which are listed in the table below.

	As at December 31,	
	2010	2011
	(in HUF millions)	
Hungarian GSM license	10,747	8,466
Hungarian UMTS license	10,699	9,508
Macedonian UMTS license	2,342	2,289
Other	4,856	4,722
<b>Total concessions and licenses</b>	<b>28,644</b>	<b>24,985</b>

The Group has no intangible assets with restricted title or pledged as security as at December 31, 2011 or December 31, 2010.

#### 14 Investments in associates and joint ventures

	For the year ended December 31,	
	2010	2011
	(in HUF millions)	
Opening balance	186	77
Dividends	(81)	(9)
Share of associates' and joint ventures' profits / (losses)	(27)	12
Budakalász fully acquired in 2011	-	(22)
Liquidation of Netrekész	(1)	-
Liquidation of Hunsat	-	(58)
<b>Closing balance</b>	<b>77</b>	<b>0</b>

Hunsat discontinued its commercial operations in 2010 and was liquidated in 2011. Netrekész was liquidated in 2010.

The remaining 75% shares of Budakalász were acquired in November 2011 (see also Note 5.1.3), as a result of which the Group has no associates or joint ventures as of December 31, 2011.

## 15 Other non current assets

Other non current assets mainly include long-term prepaid employee benefits.

## 16 Financial liabilities to related parties

Financial liabilities to related parties include HUF and EUR denominated loans taken from DT Group. In addition, for the whole nominal amount and interest payment of loans denominated in EUR granted by DTIF we have cross-currency interest rate swap agreements in place so that Magyar Telekom's exposure in fact remains in HUF. The loans and the related swap agreements are accounted for and disclosed on a gross basis. These loans were primarily taken for significant acquisitions and dividend payments. Some of these loans, when expiring, are also refinanced by DTIF, depending on the actual cash position of the Group.

The tables below show the details of the financial liabilities towards Deutsche Telekom Group members as at December 31, 2011 and 2010.

December 31, 2011	Carrying amount in HUF millions	Currency	Interest rate (%)	Fixed / floating	Repayable
	9,594	HUF	6.53	floating	Jan 2012
	40,271	HUF	7.75	floating	May 2012
Due within 1 year	49,865				
Derivatives	-				
<b>Total current</b>	<b>49,865</b>				
	9,594	HUF	6.54	floating	Jan 2013
	25,326	HUF	7.25	fixed	Oct 2013
	24,298	EUR	3.76	fixed	Jun 2014
	51,553	EUR	4.46	fixed	Jan 2015
	53,038	HUF	8.30	fixed	May 2015
	28,487	HUF	6.23	fixed	Dec 2016
	14,059	HUF	6.30	fixed	Dec 2016
	7,842	EUR	3.71	fixed	May 2017
	15,969	EUR	4.08	fixed	Nov 2018
<b>Total non current</b>	<b>230,166</b>				

December 31, 2010	Carrying amount in HUF millions	Currency	Interest rate (%)	Fixed / floating	Repayable
	9,579	HUF	5.72	floating	Jan 2011
	25,323	HUF	6.02	floating	Apr 2011
	35,324	HUF	7.21	fixed	Jul 2011
Due within 1 year	70,226				
Derivatives	1,982				
<b>Total current</b>	<b>72,208</b>				
	9,579	HUF	5.72	floating	Jan 2012
	40,225	HUF	6.39	floating	Jan 2012
	9,579	HUF	5.72	floating	Jan 2013
	25,327	HUF	7.26	fixed	Oct 2013
	21,896	EUR	3.76	fixed	Jun 2014
	46,046	EUR	4.46	fixed	Jan 2015
	53,034	HUF	8.30	fixed	May 2015
	28,478	HUF	6.23	fixed	Dec 2016
<b>Total non current</b>	<b>234,164</b>				

The table below shows the carrying amounts and fair values of the related party loans.

	At December 31,			
	2010		2011	
	Book value	Fair value	Book value	Fair value
	(in HUF millions)			
<b>HUF denominated loans</b>				
At fixed rate	142,163	143,880	120,910	118,758
At floating rate	94,285	94,285	59,459	59,459
	<b>236,448</b>	<b>238,165</b>	<b>180,369</b>	<b>178,217</b>
<b>EUR denominated loans</b>				
At fixed rate	67,942	72,928	99,662	108,254
At floating rate	-	-	-	-
	<b>67,942</b>	<b>72,928</b>	<b>99,662</b>	<b>108,254</b>
Swaps	1,982	1,982	-	-
<b>Total related party financial liabilities</b>	<b>306,372</b>	<b>313,075</b>	<b>280,031</b>	<b>286,471</b>

The weighted average interest rate on related party loans was 6.23% in 2011 (6.30% in 2010). The fixed interest rate loans are exposed to fair value risk as it can be seen in the table above. Any decrease of market interest rates will result in an increase of the fair value of the fixed interest rate liabilities.

Derivatives contracted with related parties include cross-currency interest rate swaps and FX forwards concluded with DT AG to change the Group's exposure to HUF in case of the EUR denominated loans and to cover FX needs of expected future foreign currency outflows.

There were no defaults and breaches in connection with the financial liabilities to related parties.

## 17 Other financial liabilities

		At December 31,	
		2010	2011
		(in HUF millions)	
Bank loans	(a)	43,924	46,082
Finance lease payable	(Note 33.1)	605	580
Accrued interest		60	428
Third party derivatives	(b)	869	-
Payable to the SEC and the DOJ	(c)	-	21,857
Other		1,189	1,208
<b>Total other financial liabilities – current</b>		<b>46,647</b>	<b>70,155</b>
Bank loans	(a)	6,199	14,579
Finance lease payable	(Note 33.1)	2,254	2,733
Other		375	616
<b>Total other financial liabilities – non current</b>		<b>8,828</b>	<b>17,928</b>

### (a) Bank loans

	As at December 31,	
	2010	2011
	(in HUF millions)	
Due within 1 year	43,924	46,082
Due in 1–2 years	2,788	3,576
Due in 2–3 years	3,411	11,003
Due after 3 years	-	-
<b>Total bank loans</b>	<b>50,123</b>	<b>60,661</b>

Loans totaling HUF 37,970 million at December 31, 2011 are revolving loans (2010: HUF 15,761 million) which can be prepaid at any time and may be drawn down in one to six month rolling periods.

The weighted average interest rate on bank loans was 6.98% in 2011 (5.74% in 2010).

The following table compares the carrying values and the fair values of the Group's bank loans.

	At December 31,			
	2010		2011	
	Book value	Fair value	Book value	Fair value
	(in HUF millions)			
<b>HUF denominated bank loans</b>				
At fixed rate	11,850	12,150	-	-
At floating rate	27,135	27,135	53,286	53,286
	<b>38,985</b>	<b>39,285</b>	<b>53,286</b>	<b>53,286</b>
<b>EUR denominated bank loans</b>				
At fixed rate	8,128	8,198	4,667	4,699
At floating rate	3,010	3,010	2,708	2,708
	<b>11,138</b>	<b>11,208</b>	<b>7,375</b>	<b>7,407</b>
<b>Total bank loans</b>	<b>50,123</b>	<b>50,493</b>	<b>60,661</b>	<b>60,693</b>

Floating interest rate loans are subject to interests calculated based on mostly BUBOR (Budapest Inter-Bank Offered Rate) and EURIBOR (Euro Inter-Bank Offered Rate) plus a margin interest formula.

The majority of the Group's third party loans and borrowings are subject to floating interest rates, which are exposed to cash flow risks. If interest rates are rising, it results in higher cash outflows through interest payments.

There were no defaults and breaches in connection with other financial liabilities.

#### (b) Third party derivatives

Third party derivatives included FX forward and cross currency interest rate swaps.

#### (c) Payable to the SEC and the DOJ

During 2011 the Company made provisions related to the expected penalty to be paid to the DOJ and the disgorgement of profits and the related prejudgment interest expected to be paid to the SEC (see also Note 19). As the agreements signed in December 2011 were approved by the relevant courts in early January 2012, the amounts provided for were reclassified as Other current financial liabilities. These amounts were paid to the DOJ and the SEC on January 6, 2012 and January 23, 2012 respectively. See Note 1.2 for more details.

#### (d) Credit facilities

At December 31, 2011, Magyar Telekom had un-drawn committed credit facilities of HUF 51,444 million (2010: HUF 54,603 million). These credit facilities, should they be drawn down, are subject to an interest rate of EURIBOR, BUBOR and commercial floating bank prime rates plus a margin depending on the currency and institution providing the facilities.

**18 Trade payables**

	At December 31,	
	2010	2011
	(in HUF millions)	
Payable to DT Group companies	7,103	7,972
Payable to associates and joint ventures	7	-
Other trade payables	81,503	93,147
	<b>88,613</b>	<b>101,119</b>

**19 Provisions**

	Severance	MTIP	Employee-related Subtotal	DOJ/ SEC	Other legal cases	ARO	Other	Total
	(in HUF millions)							
January 1, 2010	8,747	356	9,103	-	5,650	5,010	2,650	<b>22,413</b>
Amounts reversed	(1,005)	-	(1,005)	-	(1,574)	(8)	(347)	<b>(2,934)</b>
Additions	3,892	127	4,019	-	2,196	620	703	<b>7,538</b>
Accretion	-	-	-	-	477	174	53	<b>704</b>
Exchange rate difference	3	1	4	-	103	-	5	<b>112</b>
Amounts utilized	(5,427)	(5)	(5,432)	-	(551)	(110)	(1,314)	<b>(7,407)</b>
Reclassified to liabilities	-	(406)	(406)	-	-	-	-	<b>(406)</b>
<b>December 31, 2010</b>	<b>6,210</b>	<b>73</b>	<b>6,283</b>	<b>-</b>	<b>6,301</b>	<b>5,686</b>	<b>1,750</b>	<b>20,020</b>
Of which current	4,982	-	4,982	-	2,136	136	468	<b>7,722</b>
Of which non current	1,228	73	1,301	-	4,165	5,550	1,282	<b>12,298</b>
January 1, 2011	6,210	73	6,283	-	6,301	5,686	1,750	<b>20,020</b>
Amounts reversed	(577)	-	(577)	-	(1,153)	-	(574)	<b>(2,304)</b>
Acquired through business combinations	-	-	-	-	-	-	173	<b>173</b>
Additions	4,269	661	4,930	16,191	485	278	1,605	<b>23,489</b>
Accretion / interest	-	-	-	1,119	303	151	5	<b>1,578</b>
Exchange rate difference	12	-	12	4,547	287	-	63	<b>4,909</b>
Amounts utilized	(7,332)	-	(7,332)	-	(1,440)	(26)	(1,735)	<b>(10,533)</b>
Reclassified to liabilities	-	(536)	(536)	(21,857)	-	-	-	<b>(22,393)</b>
<b>December 31, 2011</b>	<b>2,582</b>	<b>198</b>	<b>2,780</b>	<b>-</b>	<b>4,783</b>	<b>6,089</b>	<b>1,287</b>	<b>14,939</b>
Of which current	1,563	-	1,563	-	1,492	56	592	<b>3,703</b>
Of which non current	1,019	198	1,217	-	3,291	6,033	695	<b>11,236</b>

Magyar Telekom does not expect any reimbursement with regards to the provisions recognized, therefore, no related assets have been recognized in the financial statements.

### 19.1 Severance

The majority of the provision for severance as at December 31, 2011 relates to the stand-by-pool and the employee terminations in 2012 in relation to the further efficiency improvement in Magyar Telekom Plc. The stand-by-pool of employees include people whose legal status is an employee, however, these people do not provide services to the Company any more, but the Company provides a reduced amount of compensation and pays social security expenses for them for maximum 4 years. This is a way of severance that is not paid in one lump sum but in maximum 48 installments following the discontinuation of services. The majority of the provision for severance as at December 31, 2010 related to the stand-by-pool and the employee terminations in 2011 in relation to the further efficiency improvement in Magyar Telekom Plc.

588 employees were dismissed in 2011 (2010: 552) at Group level, related to which severance payments were made. The balance of provision as at December 31, 2011 relates to 347 employees and former employees in the stand-by-pool (2010: 669).

The total payments made in relation to employee termination in 2011 amounted to HUF 9,627 million (2010: HUF 8,505 million).

### 19.2 MTIP

For more details on the Mid-term Incentive Plan see Note 24.1.

### 19.3 DOJ/SEC

During 2011 the Company made provisions related to the expected penalty to be paid to the DOJ and the disgorgement of profits and the related prejudgment interest expected to be paid to the SEC. When the expected payments became probable and estimable, the Company recognized the provisions in USD as the payments were expected to be agreed in USD terms. From the initial recognition of the provisions, the provided amounts were exposed to FX fluctuation, which is reflected in the exchange rate difference line of the table. As the agreements signed in December were approved by the relevant courts in early January 2012, the amounts provided for were reclassified as Other current financial liabilities as at December 31, 2011. See Note 1.2 for more details.

### 19.4 Other legal cases

Provisions for other legal cases mainly include amounts expected to be paid to regulatory and competition authorities as well as to ex-employees and trading partners as a result of legal disputes. There are numerous legal cases for which provisions were recognized, none of which are individually material, therefore not disclosed.

### 19.5 Asset retirement obligations (ARO)

Asset retirement obligations primarily exist in case of the telecommunications structures constructed on third parties' properties. The Group carries out a revision of the necessary provisions every year. The revisions did not result in material changes in 2011 or 2010.

### 19.6 Other provisions

Other provisions include guarantee obligations, onerous contracts and further other individually small items.

## 20 Other current liabilities

	At December 31,	
	2010	2011
	(in HUF millions)	
Deferred revenue and advances received	11,273	10,739
Other taxes and social security	10,833	9,069
Salaries and wages	6,458	6,884
Dividend payable to Non-controlling interests	319	392
Other liabilities	2,083	2,129
	<b>30,966</b>	<b>29,213</b>

## 21 Other non current liabilities

Other non current liabilities primarily include deferred revenues related to long term projects and customer loyalty programs.

## 22 Revenue

	For the year ended December 31,	
	2010	2011
	(in HUF millions)	
<b>Fixed line revenues</b>		
Voice retail	106,623	91,798
Voice wholesale	21,317	21,790
Internet	53,755	52,560
Data	27,710	27,050
TV	28,549	31,787
Equipment	4,091	3,852
Other fixed line revenues	7,588	11,715
<b>Total Fixed line revenue</b>	<b>249,633</b>	<b>240,552</b>
<b>Mobile revenues</b>		
Voice retail	185,967	177,226
Voice wholesale	36,815	31,728
Voice visitor	4,217	3,590
Non voice	57,789	62,146
Equipment	22,691	25,999
Other mobile revenues	7,694	7,829
Total Mobile revenue	315,173	308,518
<b>System integration and IT revenue</b>	<b>44,773</b>	<b>48,547</b>
<b>Total revenue</b>	<b>609,579</b>	<b>597,617</b>

None of the Group's customers represent a significant source of revenue. Revenues from transactions with a single external customer (or group of entities that – knowingly to us – are under common control of a third party or government) do not exceed 10 per cent of the Group's revenues.

## 23 Expenses directly related to revenues

	For the year ended December 31,	
	2010	2011
	(in HUF millions)	
Voice, data and internet related payments	65,247	60,598
Material cost of equipment sold	41,037	44,595
Payments to agents and other subcontractors	51,143	55,854
	<b>157,427</b>	<b>161,047</b>

## 24 Employee related expenses

	For the year ended December 31,	
	2010	2011
	(in HUF millions)	
Short term benefits	93,992	92,203
Share based payments – MTIP (Note 24.1)	127	661
Share based payments – ex-CEO (Note 24.2)	(49)	-
Share based payments – Share bonus to employees (Note 24.3)	580	-
Termination benefits (Note 19.1)	5,965	5,987
Total before capitalization	100,615	98,851
Expenses capitalized	(6,731)	(7,028)
	<b>93,884</b>	<b>91,823</b>
Total costs expensed in relation to defined contribution plans (including social security)	20,361	19,978
Average number of employees (full time equivalent)	10,351	10,127
Closing number of employees (full time equivalent)	10,258	10,111

### 24.1 Mid-term incentive plan (MTIP)

In 2004 Magyar Telekom launched a Mid Term Incentive Plan (MTIP) for its top and senior 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 was planned to cover five years, with a new package being launched in each year, and with each tranche lasting for three years. In 2009, 2010 and 2011, Magyar Telekom decided to prolong the original program by one additional year respectively, with the same concept. At the beginning of the plan each participant has an offered bonus. This bonus 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. Depending on the achievement of the targets, 0%, 50% or 100% of the bonus is paid if neither, one or both of the targets are met, respectively.

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 un-weighted average Magyar Telekom share price plus dividend payments. 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 un-weighted 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 are included in the table below. When determining the Group's liability, these target figures are weighted with the fair value factors of achieving these targets. The fair value factors are calculated using the Monte Carlo technique. The target figures are multiplied by the relevant fair value factors and these amounts are then accrued for the given tranche period. This technique aims to determine the fair values of the share options granted and present it in accordance with the accruals concept.

Tranche	Vesting period	MT Share price at the beginning of the vesting period (HUF)	Fulfillment
2008	January 1, 2008 – December 31, 2010	912	Only relative target met
2009	January 1, 2009 – December 31, 2011	561	Only relative target met
2010	January 1, 2010 – December 31, 2012	725	-
2011	January 1, 2011 – December 31, 2013	524	-

The provision for the payments in relation to the MTIP program and the movements thereof are disclosed in Note 19.

#### 24.2 The former CEO's share option plan

The former CEO of Magyar Telekom was granted share options in the past, out of which the options granted in 2000 remained unexercised until 2010, when they lapsed. The lapse of these share options resulted in the release of the total balance of the Reserve for equity settled share based transactions.

#### 24.3 Shares allocated to employees

The Board of Directors of Magyar Telekom approved a share allocation program under which Magyar Telekom shares were awarded to the Company's best performing employees in December 2010. In total, 1,112,679 treasury shares were granted to employees for free. The amount recognized as an expense includes the grant date fair value of the shares. The program awarded the participants based on their past performance without any further service commitments made by either the employees or the employer. Consequently, the total cost of the share based compensation program was recognized in 2010.

#### 24.4 Matching Share Plan of Magyar Telekom

In December 2011 the Board of Directors approved the implementation of the revolving Matching Share Plan of Magyar Telekom. The program is implemented for the CEO of Magyar Telekom starting in 2012. In order to ensure the long-term incentive effect and orientation toward the sustained development of the Company, an amount of minimum 10% of the gross annual variable bonus is to be invested in shares of Magyar Telekom. The investment must be made from the net payout. The CEO has the option of voluntary increase to a maximum of 33.3% of his bonus. These shares are to be held for a period of at least 4 years (lock-up period). After the lock-up period of 4 years has passed, one additional share („matching share“) will be granted for every share acquired as part of the aforementioned personal investment. The program is planned to be revolving in 5 consecutive years starting in 2012. As the vesting period of the program starts with the first purchase of shares by the CEO in 2012, no expenses have been recognized for the program in 2011.

## 25 Other operating expenses

		For the year ended December 31,	
		2010	2011
		(in HUF millions)	
Materials, maintenance and service fees		63,373	61,602
Hungarian telecommunications and other crisis taxes	(a)	26,970	25,350
DOJ criminal penalty and SEC disgorgement of profits	(b)	-	16,191
Marketing		13,437	12,895
Rental and operating lease		12,981	13,794
Fees and levies		12,276	12,298
Bad debt expense		9,991	6,255
Consulting, audit and other expert fees	(c)	7,825	5,406
Other expenses		1,897	1,266
		<b>148,750</b>	<b>155,057</b>

### (a) Hungarian telecommunications and other crisis taxes

On October 18, 2010 the Hungarian Parliament passed an act imposing special "crisis" taxes on telecommunications services, retail sales and energy sales as of January 1, 2010. These taxes were enacted for a defined period of 2010-2012.

Although Magyar Telekom is also engaged in energy and retail sales, the tax burden on those are either not applicable to the Group (energy) or not material (retail). The vast majority of the amount included in the table above relates to the revenues earned from electronic telecommunications services provided by the Hungarian members of the Group in the years presented. The tax is defined as a certain percentage of the revenue generated from the services defined as electronic telecommunications. The tax is progressive, i.e. the more revenue is generated a higher tax rate is applicable. Due to the high amount of revenues generated by the Group, the vast majority of the Group's Hungarian revenues are in the highest tax band subject to a tax rate of 6.5%.

The classification of these taxes requires judgment. Management believes that these taxes are not taxes on consumption of services by end customers but rather taxes on entities operating in selected industries. These taxes were levied retrospectively in 2010, the taxes are calculated on the combined revenues of groups using graduated tax rates and the calculation ignores whether the revenues are collected from end customers or not. Therefore management believes that there are strong indicators that these taxes are not sales taxes collected on behalf of the government, but rather taxes on the operations of the companies, and consequently these taxes are classified as operating expense in the consolidated financial statements.

### (b) DOJ criminal penalty and SEC disgorgement of profits

During 2011 the Company made provisions related to the expected penalty to be paid to the DOJ and the disgorgement of profits expected to be paid to the SEC. The amount in the table above includes these items recognized as operating expenses during the year. See Note 1.2 for more details.

### (c) Audit costs included in Consulting, audit and other expert fees

Consulting, audit and other expert fees among others include expenses incurred in relation to the audit of the standalone and consolidated financial statements of the Company by PricewaterhouseCoopers (PwC) as follows.

	For the year ended December 31,	
	2010	2011
	(in HUF millions)	
Audit of the financial statements	527	375
Other audit related fees	40	84
Other non audit related fees	4	25
<b>Total expenses payable to PwC</b>	<b>571</b>	<b>484</b>

Audit of the financial statements in the above table are the aggregate fees of PwC in connection with the audit of our annual financial statements, reviews of quarterly reports and services performed in relation to legal obligations and submissions required by regulatory provisions.

Other audit-related fees in the above table are the aggregate fees of PwC for services which are normally performed by the external auditor in connection with the auditing of the annual financial statements, e.g. advice on issues of accounting and reporting, which were not classified as audit services, and support with the interpretation of new accounting and reporting standards. Audit-related fees in 2011 included HUF 21 million (2010: HUF 40 million) incurred relating to the investigations (Note 1.2).

Other non audit related fees in the above table are fees of PwC primarily related to services like participation by Magyar Telekom employees in conferences and training sessions organized by PwC.

## 26 Other operating income

	For the year ended December 31,	
	2010	2011
	(in HUF millions)	
Gain on the sale of PPE, Intangible assets and assets held for sale	327	1,940
Income received for the relocation and reconstruction of our own network	1,233	1,166
Penalty interest collected	853	964
Government grants received/receivable for the compensation of expenses	-	811
Other operating income	1,035	1,511
	<b>3,448</b>	<b>6,392</b>

## 27 Interest income

	For the year ended December 31,	
	2010	2011
	(in HUF millions)	
Finance lease interest income	1,334	1,150
Other interest income	3,604	2,483
	<b>4,938</b>	<b>3,633</b>

**28 Interest expense**

	For the year ended December 31,	
	2010	2011
	(in HUF millions)	
Interest expense to DT	18,397	17,492
Other interest expense	4,660	3,476
Finance lease interest expense	529	922
Accretion / interest on provisions	704	1,578
less: borrowing costs capitalized	(506)	(284)
	<b>23,784</b>	<b>23,184</b>

Accretion / interest on provisions include HUF 1,119 million of prejudgment interest related to the disgorgement of profits as approved in the Final judgment filed by the SEC against the Company. For more details see Note 1.2.

Interest expense is shown net of interest capitalized using an average borrowing rate of 5.78% in 2011 (2010: 6.02%). When calculating the borrowing costs capitalized, other financial expenses (included in Note 29) are also considered, however, for disclosure purposes, we included the borrowing costs capitalized in the table above.

**29 Other finance expense – net**

	For the year ended December 31,	
	2010	2011
	(in HUF millions)	
Fee expense	4,236	4,174
Net foreign exchange losses / (gains)	2,855	21,095
Losses / (gains) on the subsequent measurement of financial instruments at fair value through profit and loss (derivatives) contracted with related parties	(1,410)	(11,303)
Losses / (gains) on the subsequent measurement of financial instruments at fair value through profit and loss (derivatives) contracted with third parties	998	(4,359)
Losses / (gains) on the derecognition of financial instruments at fair value through profit and loss contracted with related parties	1,996	2,581
Losses / (gains) on the derecognition of financial instruments at fair value through profit and loss contracted with third parties	592	723
Losses / (gains) on the derecognition of AFS financial instruments (Reclassifications from Other comprehensive income)	-	-
	<b>9,267</b>	<b>12,911</b>

Net foreign exchange losses include HUF 4,547 million foreign exchange loss incurred on the provisions recognized for the amounts paid to the DOJ and the SEC. For more details see Note 1.2.

### 30 Purchase of property, plant and equipment and intangible assets

	For the year ended December 31,	
	2010	2011
	(in HUF millions)	
Investments in property, plant and equipment (Note 12)	72,489	62,609
Investments in intangible assets (Note 13)	19,273	21,187
Total investments in PPE and intangible assets	91,762	83,796
Recognition / (Derecognition) of investment tax credit (Note 9.4)	(3)	-
Change in payables relating to capital expenditures	(4,459)	(3,722)
<b>Cash payments for purchases of PPE and intangible assets</b>	<b>87,300</b>	<b>80,074</b>

The Group had no significant non cash transactions in any of the reported years.

### 31 Purchase of subsidiaries and business units

	For the year ended December 31,	
	2010	2011
	(in HUF millions)	
Daten-Kontor (Note 5.1.1)	-	1,073
Globe (Note 5.1.2)	-	1,000
Budakalász (Note 5.1.3)	-	239
Cable TV networks	39	212
ISH	74	110
Modultechnika (Note 5.2)	1,421	41
<b>Cash payments for purchases of subsidiaries and business units</b>	<b>1,534</b>	<b>2,675</b>

Cash payments related to the purchase of subsidiaries and business units also include amounts paid as additional contingent purchase prices disbursed in years following the year of the business combination.

## 32 Reportable segments and information about geographical areas

### 32.1 Reportable segments

Magyar Telekom introduced a new reporting structure from the beginning of 2011. The Group's new operating segments are Hungary (which includes the former CBU, the SMB customers of BBU and the Headquarters and Technology Units) and T-Systems (which includes the former BBU, without the SMB customers). The Macedonia and Montenegro segments have not changed.

The Hungary segment operates in Hungary providing mobile, fixed line telecommunications and TV distribution services (including marketing, sales and customer relations activities) to residential and small businesses telecommunications customers with several million customers mainly under the T-Mobile and T-Home brands. The Hungary segment is also responsible for the wholesale mobile and fixed line services in Hungary, and performs strategic and cross-divisional management and support functions including Procurement, Treasury, Real estate, Accounting, Tax, Legal, Internal Audit and similar shared services and other central functions of the Group's management. This segment is also responsible for the Group's points of presence in Bulgaria, Romania and Ukraine providing wholesale services to local companies and operators. In addition, the Hungary segment is responsible for the operations and development of the mobile, fixed line and cable TV network as well as IT management in Hungary.

T-Systems operates in Hungary providing mobile and fixed line telecommunications, infocommunications and system integration services (including marketing, sales and customer relations activities) mainly under the T-Systems and T-Mobile brands to key business partners (large corporate customers and public sector).

The Group also has full-scale mobile and fixed line telecommunications operations in Macedonia and Montenegro, which represent two additional operating segments of the Group.

#### 32.1.1 Information regularly provided to the MC

The following tables present the segment information by reportable segment regularly provided to the Management Committee of the Group, reconciled to the corresponding Group numbers. The information regularly provided to the MC includes several measures of profit which are considered for the purposes of assessing performance and allocating resources, including EBITDA adjusted for the impact of certain items considered as "special influence". These items vary year-over-year in nature and magnitude. Management believes that EBITDA is the segment measure that is most consistent with the measurement principles used in measuring the corresponding amounts in these financial statements.

	For the year ended December 31,	
	2010	2011
	(in HUF millions)	
<b>Revenues</b>		
Total Hungary revenues	432,054	422,794
Less: Hungary revenues from other segments	(38,873)	(35,506)
Hungary revenues from external customers	393,181	387,288
Total T-Systems revenues	117,869	122,237
Less: T-Systems revenues from other segments	(11,780)	(15,783)
T-Systems revenues from external customers	106,089	106,454
Total Macedonia revenues	77,598	71,359
Less: Macedonia revenues from other segments	(134)	(130)
Macedonia revenues from external customers	77,464	71,229
Total Montenegro revenues	32,874	32,697
Less: Montenegro revenues from other segments	(44)	(42)
Montenegro revenues from external customers	32,830	32,655
Total consolidated revenue of the segments	609,564	597,626
Measurement differences to Group revenue	15	(9)
Total revenue of the Group	609,579	597,617
<b>Segment results (EBITDA)</b>		
Hungary	144,909	128,223
T-Systems	14,756	18,444
Macedonia	40,248	37,914
Montenegro	11,370	11,453
Total EBITDA of the segments	211,283	196,034
Measurement differences to Group EBITDA	1,683	48
Total EBITDA of the Group	212,966	196,082
Depreciation and amortization of the Group	(100,872)	(132,915)
Total Operating profit of the Group	112,094	63,167
Net financial result	(28,113)	(32,462)
Share of associates' and joint ventures' profits / (losses)	(27)	12
Total Profit before income tax of the Group	83,954	30,717
Income tax expense	(6,583)	(27,538)
<b>Total Profit for the year of the Group</b>	<b>77,371</b>	<b>3,179</b>

	As at December 31,	
	2010	2011
	(in HUF millions)	
<b>Capital expenditure (Capex) on PPE and Intangible assets</b>		
Hungary	68,395	65,559
T-Systems	3,559	4,289
Macedonia	15,208	9,961
Montenegro	4,639	4,135
Total capital expenditure of the segments	91,801	83,944
Measurement differences to capital expenditure of the Group	(39)	(148)
<b>Total investments of the Group in PPE and Intangible assets</b>	<b>91,762</b>	<b>83,796</b>

Total investments of the Group in PPE and Intangible assets correspond to the "Investments" lines disclosed in Notes 12, 13 and 30.

### 32.2 Information about geographical areas

The table below shows the revenues generated from external customers in the countries where the Group operates, using the same measurement principles as for the corresponding Group numbers.

	For the year ended December 31,	
	2010	2011
	(in HUF millions)	
<b>Revenues</b>		
Hungary	495,385	489,691
Macedonia	77,464	71,229
Montenegro	32,830	32,655
Romania	2,958	3,274
Bulgaria	922	768
Ukraine	20	-
<b>Total revenue of the Group</b>	<b>609,579</b>	<b>597,617</b>

None of the Group's external customers represent a significant source of revenue.

The table below shows the Non current assets of the Group located in the countries of operations (including goodwill allocated to operating segments operating in these countries) and the reconciliation to the total Non current assets of the Group, using the same measurement principles as for the corresponding Group numbers.

	As at December 31,	
	2010	2011
	(in HUF millions)	
Non current assets		
Hungary	703,783	696,693
Macedonia	132,510	99,870
Montenegro	41,734	43,301
Bulgaria	3,165	3,361
Romania	2,281	2,059
Ukraine	13	8
Total excluding Other non current financial assets and Deferred tax assets	883,486	845,292
Other non current financial assets (Note 8.2)	24,033	31,590
Deferred tax assets (Note 9.4)	913	750
<b>Total Non current assets of the Group</b>	<b>908,432</b>	<b>877,632</b>

### 33 Leases and other commitments

#### 33.1 Finance lease – Group as lessee

Finance leases in 2010 and 2011 mainly relate to the sale and lease back of spaces in buildings accommodating telephone exchanges. In most cases the contracts are denominated in EUR, the term of the leases is 5–10 years, and the contracts include renewal options but no purchase options.

Future lease payments under finance leases related to sale and lease back transactions at December 31, 2010 and 2011 are as follows:

	At December 31, 2010			At December 31, 2011		
	Present value	Interest component	Minimum lease payment	Present value	Interest component	Minimum lease payment
	(in HUF millions)					
Within 1 year	277	344	621	354	858	1,212
1–5 years	1,064	812	1,876	1,518	2,512	4,030
After 5 years	276	62	338	596	1,916	2,512
<b>Total</b>	<b>1,617</b>	<b>1,218</b>	<b>2,835</b>	<b>2,468</b>	<b>5,286</b>	<b>7,754</b>

Finance leases other than sale and lease back in 2010 and 2011 mainly relate to vehicles and IT equipment. In most cases the contract term of the leases is 3–5 years with renewal and purchase options.

Future lease payments under finance leases other than sale and lease back transactions at December 31, 2010 and 2011 are as follows:

	At December 31, 2010			At December 31, 2011		
	Present value	Interest component	Minimum lease payment	Present value	Interest component	Minimum lease payment
	(in HUF millions)					
Within 1 year	328	131	459	226	99	325
1–5 years	593	195	788	331	123	454
After 5 years	321	59	380	288	56	344
<b>Total</b>	<b>1,242</b>	<b>385</b>	<b>1,627</b>	<b>845</b>	<b>278</b>	<b>1,123</b>

The Group has no contingent rents related to its finance leases. The Group does not sub-lease any of the assets leased in a finance lease contract.

### 33.2 Operating lease – Group as lessee

Operating lease commitments are mainly in respect of the rental of mobile cell sites, and to a lesser extent, related to buildings, network and other telecommunications facilities.

	At December 31,	
	2010	2011
	(in HUF millions)	
Within 1 year	7,711	8,017
1–5 years	20,987	19,746
After 5 years	14,171	13,057
<b>Total</b>	<b>42,869</b>	<b>40,820</b>

The lease commitments represent a high amount of individually immaterial lease agreements, the terms of which vary on a wide range, spanning from 3 to 20 years with renewal options in most cases, but no purchase options.

### 33.3 Finance lease – Group as lessor

Finance leases primarily include the private mobile Tetra network constructed for the exclusive use of the Hungarian State, and to a lesser extent equipment provided to business customers as part of our outsourcing contracts where the Group is the service provider.

Future lease receivables under finance leases at December 31, 2010 and 2011 are as follows:

	At December 31, 2010			At December 31, 2011		
	Present value	Interest component	Minimum lease receipt	Present value	Interest component	Minimum lease receipt
	(in HUF millions)					
Within 1 year	4,298	1,403	5,701	4,267	1,140	5,407
1–5 years	15,809	3,102	18,911	12,147	1,715	13,862
After 5 years	278	74	352	369	98	467
<b>Total</b>	<b>20,385</b>	<b>4,579</b>	<b>24,964</b>	<b>16,783</b>	<b>2,953</b>	<b>19,736</b>

The interest component represents the unearned finance income. The present value due within one year is included in Other current financial assets, while the present value after one year is included in Other non current financial assets. The finance income accruing to the Group over the lease term is recognized in the Profit for the year (Interest income).

The unguaranteed residual values accruing to the benefit of the Group are insignificant.

### 33.4 Operating lease – Group as lessor

The following table includes the future minimum lease payments receivable by the Group for the operating leases of towers and PBX (private business exchange) equipment where Magyar Telekom is the lessor.

	At December 31,	
	2010	2011
	(in HUF millions)	
Within 1 year	1,165	1,340
1–5 years	2,755	1,901
After 5 years	1,072	949
<b>Total</b>	<b>4,992</b>	<b>4,190</b>

### 33.5 Purchase commitments for tangible and intangible assets

The table below summarizes Magyar Telekom's contractual purchase commitments for tangible and intangible assets with the majority falling due within one year.

	As at December 31,	
	2010	2011
	(in HUF millions)	
Property, plant and equipment	5,951	4,150
Intangible assets	3,000	9,825
<b>Total</b>	<b>8,951</b>	<b>13,975</b>

In addition to the above commitments, the Company filed an auction bid in December 2011 with the Hungarian National Media and Infocommunications Authority for unused spectrum in the 900 MHz frequency band, relating to the provision of radio communications services. The spectrum can be utilized in a technology-neutral manner, allowing for the installation and operation of GSM, UMTS, LTE and/or WiMAX mobile networks.

On January 31, 2012, the Company received from the Authority the first instance, non-final decision closing the auction. Pursuant to the first instance decision, the Company won the right of use of two duplex frequency blocks of 1 MHz each (one EGSM-band duplex frequency block of 1 MHz plus one PGSM-band duplex frequency block of 1 MHz) for a period of 15 years. Pursuant to the first instance decision, Magyar Telekom is required to pay an auction price of 10.9 billion HUF + VAT for these frequency blocks.

## 34 Related party transactions

No provision was recognized for doubtful debts related to the amount of outstanding balances; and no expense was incurred during the periods presented in respect of doubtful debts due from related parties.

### 34.1 Deutsche Telekom Group and the Federal Republic of Germany

#### 34.1.1 Deutsche Telekom Group

Deutsche Telekom AG (DTAG) is the ultimate controlling owner of Magyar Telekom Plc. holding 59.21% of the issued shares. Deutsche Telekom (DT) Group has a number of fixed line, mobile and IT service provider subsidiaries worldwide, with whom Magyar Telekom Group has regular transactions.

The Company is directly owned by MagyarCom GmbH, which is a holding subsidiary of DTAG. Magyar Telekom pays dividends annually to its owners including MagyarCom GmbH.

Deutsche Telekom International Finance (DTIF) is the treasury center of DT Group, which typically provides loan financing across the DT Group including Magyar Telekom.

The table below summarizes the above related party transactions with DT Group.

	2010	2011
	(in HUF millions)	
Revenues from telecom services provided to DT Group companies	22,395	25,594
Costs of services provided by DT Group companies	(16,497)	(15,751)
Interest expense to DTIF	(18,397)	(17,492)
Dividend paid to MagyarCom GmbH	(45,690)	(30,872)
Accounts receivable from DT Group companies	6,991	8,333
Accounts payable to DT Group companies	(7,103)	(7,972)
Loans payable to DT Group companies	(304,390)	(280,031)
Fair value of swap agreements with DTAG – asset	1,004	10,484
Fair value of swap agreements with DTAG – liability	(1,982)	-

Deutsche Telekom has pledged its support for Magyar Telekom's financing needs through to June 30, 2013.

#### 34.1.2 The Federal Republic of Germany

The Federal Republic of Germany is both a direct and an indirect shareholder and holds approximately 32 percent of the share capital of DTAG. Due to the average attendance at the shareholders' meeting, the Federal Republic of Germany represents a solid majority at the shareholders' meeting of DTAG, although it only has a minority shareholding, making DTAG a dependant company of the Federal Republic. Therefore, the Federal Republic and the companies controlled by the Federal Republic or companies over which the Federal Republic can exercise a significant influence are classified as related parties of DTAG, and consequently of Magyar Telekom as well.

DTAG and Magyar Telekom did not execute as part of its normal business activities any transactions that were individually material in the 2011 financial year with companies controlled by the Federal Republic or companies over which the Federal Republic can exercise a significant influence.

#### 34.2 Associates and joint ventures

The Group has no significant associates or joint ventures and the transactions with them are also insignificant.

### 34.3 Board and supervisory board members

	For the year ended December 31,	
	2010	2011
	(in HUF millions)	
Remuneration of the members of the Board of Directors	13	14
Remuneration of the members of the Supervisory Board	48	56
Loans granted to the members of the Board of Directors	-	-
Loans granted to the members of the Supervisory Board	3	2

### 34.4 Key management

Key management has been identified as the members of the Group's Management Committee, which is the chief operating decision making body of Magyar Telekom.

The table below shows in total the compensation expenses (including social security and other payroll related taxes) incurred by the Group in relation to the key management.

	For the year ended December 31,	
	2010	2011
	(in HUF millions)	
Salaries and other short-term employee benefits	1,335	1,521
Contractual termination expense	497	-
Share based compensation (Note 24.1)	45	216
	<b>1,877</b>	<b>1,737</b>

The Group does not provide loans to its key management.

In 2001, DT's shareholders approved the introduction of the 2001 Stock Option Plan, resulting in the granting of stock options in 2001 and 2002. 50 percent of the options granted to each beneficiary may only be exercised following the end of a vesting period of two years. The remaining 50 percent of the options granted to each beneficiary may be exercised after the end of a vesting period of three years. All options are vested as of December 31, 2011. The exercise price of the 2001 option is EUR 30.00, the term of the options ran until August 12, 2011. The exercise price of the 2002 option is EUR 12.36, the term of the options runs until July 14, 2012. At the time they were granted, the options of the 2001 and 2002 tranches had no intrinsic value, but a fair value of EUR 4.87 and EUR 3.79 respectively. The Company's Chief Financial Officer (CFO), who was a senior manager of DT at the time of the stock option, is a participant of the 2002 tranche, having 6,510 share options. Magyar Telekom does not have any potential obligation deriving from the CFO's share options, and no expenses or liabilities have been recognized in the presented years as these options are not in the scope of IFRS 2 and IFRIC 11 according to the transitional rules.

## 35 Additional disclosures on financial instruments

### 35.1 Financial assets and liabilities

The tables below include the carrying amounts and fair values of the Group's financial assets and liabilities as at December 31, 2011 and 2010.

The Group classifies fair value measurements using a fair value hierarchy that reflects the significance of the inputs used in making the measurements. The fair value hierarchy has the following levels:

- (a) quoted prices (unadjusted) in active markets for identical assets or liabilities (Level 1);
- (b) inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly (Level 2); and
- (c) inputs for the asset or liability that are not based on observable market data (Level 3).

The level in the fair value hierarchy within which the fair value measurement is categorized in its entirety is determined on the basis of the lowest level input that is significant to the fair value measurement in its entirety. The significance of an input is assessed against the fair value measurement in its entirety.

There was no transfer between Level 1 and Level 2 financial instruments. Loans and receivables and most of the financial liabilities are measured at amortized cost, but fair value information is also provided for these. The fair values of these assets and liabilities were determined using level 3 type information. There are no assets or liabilities carried at fair value where the fair value was determined using level 3 type information.

#### 35.1.1 Financial assets – Carrying amounts and fair values

December 31, 2011	Carrying amount				Total	Fair value
	Loans and receivables	Held-to-maturity	Available-for-sale (Level 1)	Held for trading (Level 2)		
	(in HUF millions)					
Cash and cash equivalents	14,451	-	-	-	14,451	14,451
Bank deposits with original maturities over 3 months	54,926	-	-	-	54,926	54,926
Trade receivables	113,350	-	-	-	113,350	113,350
Trade receivables over one year	1,696	-	-	-	1,696	1,554
Employee loans	5,392	-	-	-	5,392	3,815
Derivative financial instruments contracted with related parties	-	-	-	10,484	10,484	10,484
Derivative financial instruments contracted with third parties	-	-	-	3,841	3,841	3,841
Loans to third parties	1,164	-	-	-	1,164	892
RDC receivables	620	-	-	-	620	566
Financial assets AFS	-	-	278	-	278	278
Other current	1,422	-	-	-	1,422	1,422
Other non current	270	-	-	-	270	270
<b>Total</b>	<b>193,291</b>	<b>-</b>	<b>278</b>	<b>14,325</b>	<b>207,894</b>	<b>205,849</b>

December 31, 2010	Carrying amount				Total	Fair value
	Loans and receivables	Held-to-maturity	Available-for-sale (Level 1)	Held for trading (Level 2)		
	(in HUF millions)					
Cash and cash equivalents	15,841	-	-	-	15,841	15,841
Bank deposits with original maturities over 3 months	47,798	-	-	-	47,798	47,798
Trade receivables	106,732	-	-	-	106,732	106,732
Trade receivables over one year	1,524	-	-	-	1,524	1,609
Employee loans	4,704	-	-	-	4,704	4,849
Derivative financial instruments contracted with related parties	-	-	-	1,004	1,004	1,004
Derivative financial instruments contracted with third parties	-	-	-	301	301	301
Loans to third parties	947	-	-	-	947	947
RDC receivables	715	-	-	-	715	689
Financial assets AFS	-	-	296	-	296	296
Other current	2,400	-	-	-	2,400	2,400
Other non current	519	-	-	-	519	519
<b>Total</b>	<b>181,180</b>	<b>-</b>	<b>296</b>	<b>1,305</b>	<b>182,781</b>	<b>182,985</b>

Loans and receivables are measured at amortized cost, while available-for-sale and held-for-trading assets are measured at fair value.

Cash and cash equivalents, trade receivables, loans to Deutsche Telekom Group companies and other current financial assets mainly have short times to maturity. For this reason, their carrying amounts at the end of the reporting period approximate their fair values.

Financial assets available for sale include insignificant investment in equity instruments, all measured at fair value.

Finance lease receivables meet the criteria of a financial instrument, but these are recognized and measured according to IAS 17 – Leases, therefore not included in the tables above, but in Note 33.3.

## 35.1.2 Financial liabilities – Carrying amounts and fair values

	Carrying amount		Total	Fair value
	Measured at amortized cost	Held for trading (Level 2)		
(in HUF millions)				
<b>December 31, 2011</b>				
Financial liabilities to related parties	280,031	-	280,031	286,471
Bank loans	61,089	-	61,089	61,120
Trade payables	101,119	-	101,119	101,119
Dividend payable	392	-	392	392
Nonconvertible bonds and debentures	190	-	190	172
Derivative financial instruments contracted with third parties	-	-	-	-
Other current	22,955	-	22,955	22,955
Other	496	-	496	496
<b>Total</b>	<b>466,272</b>	<b>-</b>	<b>466,272</b>	<b>472,725</b>
<b>December 31, 2010</b>				
Financial liabilities to related parties	304,390	1 982	306,372	313,075
Bank loans	50,183	-	50,183	50,553
Trade payables	88,613	-	88,613	88,613
Dividend payable	319	-	319	319
Nonconvertible bonds and debentures	191	-	191	168
Derivative financial instruments contracted with third parties	-	869	869	869
Other current	1,024	-	1,024	1,024
Other	210	-	210	210
<b>Total</b>	<b>444,930</b>	<b>2,851</b>	<b>447,781</b>	<b>454,831</b>

Derivatives are measured at fair value, while all other financial liabilities are measured at amortized cost.

Additional fair value information on the financial liabilities is provided in Notes 16 and 17.

Trade payables, dividend payable and other current financial liabilities generally have short times to maturity, therefore the carrying values approximate the fair values.

Finance lease liabilities meet the criteria of a financial instrument, but these are recognized and measured according to IAS 17 – Leases, therefore not included in the tables above, but in Note 33.1.

**35.2 Items of income, expense, gains and losses arising on financial instruments**

The tables below include income, expense, gains and losses arising on financial instruments in 2011 and 2010.

	From interest	From subsequent measurement			From derecognition	From fee expense	Total net gain / (loss)
		At fair value	Currency translation	Impairment loss			
		(in HUF millions)					
<b>2011</b>							
Available-for-sale financial assets (Level 1)	-	(21)	-	-	-	-	(21)
Financial instruments held for trading (Level 2)	-	15,683	-	-	(3,304)	-	12,379
Loans and receivables	2,473	-	1,378	(6,299)	-	(3,989)	(6,437)
Held-to-maturity investments	-	-	-	-	-	-	-
Financial liabilities measured at amortized cost	(20,493)	-	(22,235)	-	-	(141)	(42,869)
<b>Net gain/(loss) of financial instruments under the scope of IAS 39</b>	<b>(18,020)</b>	<b>15,662</b>	<b>(20,857)</b>	<b>(6,299)</b>	<b>(3,304)</b>	<b>(4,130)</b>	<b>(36,948)</b>
<b>2010</b>							
Available-for-sale financial assets (Level 1)	-	20	-	-	-	-	20
Financial instruments held for trading (Level 2)	-	412	-	-	(2,588)	-	(2,176)
Loans and receivables	3,597	-	749	(9,991)	-	(4,076)	(9,721)
Held-to-maturity investments	-	-	-	-	-	-	-
Financial liabilities measured at amortized cost	(21,772)	-	(3,364)	-	-	(160)	(25,296)
<b>Net gain/(loss) of financial instruments under the scope of IAS 39</b>	<b>(18,175)</b>	<b>432</b>	<b>(2,615)</b>	<b>(9,991)</b>	<b>(2,588)</b>	<b>(4,236)</b>	<b>(37,173)</b>

Impairment losses on Loans and receivables includes all expenses incurred or expected to be incurred in relation to the default of our customers. Before writing off or factoring, we impair the receivables to their recoverable amounts through the use of an impairment provision account, as a result of which the actual write-off or factoring of these receivables results in no derecognition gains or losses.

### 35.3 Other disclosures about financial instruments

Magyar Telekom Plc. is also exposed to risks that arise from the possible drawdown of guarantees in a nominal amount of HUF 17.7 billion as at December 31, 2011 (2010: HUF 14.1 billion). These guarantees were issued by Hungarian banks on behalf of Magyar Telekom as collateral to secure the fulfillment of the Group's certain contractual obligations. The Group has been delivering on its contractual obligations and expects to continue doing so in the future, therefore no drawdown of the guarantees has happened in 2011, and is not expected to happen in the future.

There were no financial assets or liabilities, which were reclassified into another financial instrument category.

No financial assets were transferred in such a way that part or all of the financial assets did not qualify for derecognition.

The Group does not have compound financial instruments with multiple embedded derivatives.

## 36 Contingent assets and liabilities

### 36.1 Contingent assets

A contingent asset is a possible asset that arises from past events and whose existence will be confirmed only by the occurrence of uncertain future events not within the control of the Group. These assets are not recognized in the statement of financial position. The Group has no such contingencies where the inflow of economic benefits would be probable and material.

### 36.2 Contingent liabilities

The most significant contingent liabilities of the Group are described below. No provisions have been recognized for these cases as management estimates that it is unlikely that these claims originating from past events would result in any material economic outflows from the Group, or the amount of the obligation cannot be measured with sufficient reliability.

#### 36.2.1 Macedonia

##### 36.2.1.1 Compensation for termination of a service contract by T-Mobile MK

In January 2002, T-Mobile MK signed an agreement with a subcontractor, including a 3-month trial period, for the collection of T-Mobile MK's overdue receivables. After the expiration of the 3-month trial period, T-Mobile MK terminated this contract in April 2002 due to breaches of the contractual obligations by the subcontractor. The subcontractor initiated a lawsuit in April 2003 requesting damage compensation for foregone profit and compensation for services already rendered. Management estimates it unlikely that the subcontractor would win the court case against T-Mobile MK. The potential loss from the claim is approximately HUF 5.0 billion. The first instance decision in 2010 was in favor of T-Mobile MK, but the plaintiff submitted an appeal, therefore the timing of the final resolution is uncertain.

##### 36.2.1.2 MKT's dispute on fixed-to-mobile termination fees

In 2005, MKT changed the retail prices for the traffic from fixed to mobile network. According to the interconnection agreements with the mobile operators the change in retail prices automatically decreased the interconnection fees for termination in the mobile networks. In February 2006, one of the Macedonian mobile operators, ONE, submitted to the Agency a request for dispute resolution with reference to the termination prices. The Agency rejected the requests of ONE as "ungrounded". This decision of the Agency was appealed by ONE by filing a lawsuit at the Administrative Court of Macedonia. The potential loss from the claim is approximately HUF 0.5 billion, but the management estimates it unlikely that this would result in any material cash outflows. The final decision will be made by the Administrative Court of Macedonia, the timing of which is uncertain.

### **36.2.2 Montenegro**

#### **36.2.2.1 Employee salary disputes in Montenegro**

In July 2010, the Trade Union of Crnogorski Telekom submitted a claim to increase the salaries by 15.3% for the period between September 2009 and September 2010, based on the clause on minimum wage calculation in the Collective Bargaining Agreement (CBA). Management believes that the Trade Union is not entitled to submit such claim and also disagrees to the calculation methodology. There has not been any hearing yet in this case. The potential exposure is HUF 1.8 billion.

### **36.2.3 Hungary**

#### **36.2.3.1 Guarantees**

Magyar Telekom Plc. is exposed to risks that arise from the possible drawdown of guarantees for which see more details in Note 35.3.

## **37 Event after the reporting period**

### **37.1 Deregistration**

The Company delisted its ADSs from the New York Stock Exchange effective November 12, 2010. On November 14, 2011 Magyar Telekom filed with the U.S. Securities and Exchange Commission (the SEC) a Form 15F to terminate registration of its shares and American Depositary Shares (ADSs) in the US. The deregistration became effective on February 12, 2012, 90 days after the filing of the Form 15F. The Company will maintain its American Depositary Receipt program on a Level I basis. The Company will maintain its primary listing on the Budapest Stock Exchange and will continue to make English translations of its annual reports, financial statements and investor releases.

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## Glossary

Explanation of abbreviations used throughout the report

Abbreviation	Term
2G, 3G, 4G	Second/Third/Fourth-generation mobile technology
2Play, 3Play, 4Play	Double-play, Triple-play, Quadruple-play
ADS	American Depository Shares
ADSL	Asymmetrical Digital Subscriber Line
ARPA	Average monthly Revenue per Access
ARPU	Average monthly Revenue per User
CRM	Customer Relationship Management
DLL	Digital Local Loop
DOCSIS	Data Over Cable Service Interface Specification
DSL	See at ADSL
DVB-S	Digital Video Broadcasting Satellite
ED3	EuroDOCSIS 3.0 technology
EDGE	Enhanced Data rates for GSM Evolution
EMF	ElectroMagnetic Field
FTTx	Fiber to the x
GSM	Global System for Mobile communications
HFC	Hybrid Fiber Coax
HSPA	High-Speed Packet Access
IC	Interconnection
ICNIRP	International Commission on Non-Ionizing Radiation Protection
ICT	Information and Communications Technology
IP	Internet Protocol
IPTV	Internet Protocol-based TV
IP-VPN	Internet Protocol-based Virtual Private Network
ISDN	Integrated Services Digital Network
IT	Information Technology
LTE	Long Term Evolution
MOU	Average monthly Minutes of Use per subscriber
MTR	Mobile Traffic Recording
MVNO	Mobile Virtual Network Operator
NAPA-WINE	Network-Aware P2P-TV Application over Wise Networks
NMIA	National Media and Infocommunications Authority
PC	Personal Computer
PSTN	Public Switched Telephone Network
RPC	Revenue Producing Customer
R&D	Research and Development
RIO	Reference Interconnection Offer
RUO	Reference Unbundling Offer
SAC	Subscriber Acquisition Cost

Abbreviation	Term
Sat TV	Satellite TV
SI	System Integration
SIM	Subscriber Identity Module
SMB	Small and Medium Businesses
SMS	Short Message Service
SOHO	Small Office/Home Office
UMTS	Universal Mobile Telecommunications System
VoCable	Voice over Cable television
VoIP	Voice over Internet Protocol
WCDMA	Wideband Code Division Multiple Access
WiMAX	World Interoperability for Microwave Access
WLR	Wholesale Line Rental

### Financial calendar 2012

<b>February 23, 2012</b>	Release of 2011 full year results
<b>April 16, 2012</b>	Annual General Meeting
<b>May 10, 2012 *</b>	Release of 2012 1 <sup>st</sup> quarter results
<b>August 9, 2012 *</b>	Release of 2012 1 <sup>st</sup> half results
<b>November 8, 2012 *</b>	Release of 2012 1 <sup>st</sup> nine months results

\* Planned date.

### Disclaimer

This Annual Report contains forward-looking statements. Statements that are not historical facts, including statements about our beliefs and expectations, are forward-looking statements. These statements are based on current plans, estimates and projections, and therefore you should not place undue reliance on them. Forward-looking statements speak only as of the date they are made, and we undertake no obligation to update publicly any of them in light of new information or future events.

Forward-looking statements involve inherent risks and uncertainties. We caution you that a number of important factors could cause actual results to differ materially from those contained in any forward-looking statement. Such factors are described in, among other things, our Annual Report on Form 20-F for the year ended December 31, 2010 filed with the U.S. Securities and Exchange Commission.

**Magyar Telekom**  
**Telecommunications Public limited company**

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**Magyar Telekom stock ticker symbol**

Budapest Stock Exchange (BSE): MTELEKOM HB (Bloomberg); MTEL.BU (Reuters)

**Stock registration**

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**Published by:**

© Magyar Telekom Plc.  
Marketing & Corporate Communications Directorate  
Budapest, 2012

**Creative concepts and layout design:**

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**Management photos:**

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